Stikeman Elliott

Environmental, Social & Governance Law 2022

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1 Setting the Scene – Sources and Overview

1.1 What are the main substantive ESG-related regulations?

There are a variety of ESG-related regulations applicable to federally and provincially incorporated companies; however, the focus of this chapter will be on public companies that qualify as "reporting issuers" under applicable Canadian securities and corporate laws, with references to general Canadian corporate law and specific section references to the federal Canada Business Corporations Act (the "**CBCA**").

In compliance with the CBCA, corporate directors are required to manage, or supervise the management of, the business and affairs of a company; and in doing so, directors must comply with their fiduciary duty and duty of care. The duty of care standard requires directors to act honestly and in good faith with a view to the best interests of the company. Recently, consistent with the Supreme Court of Canada's decision in *BCE Inc. v. 1976 Debentureholders* (2008 SCC 69), section 122 of the CBCA was amended to specifically provide that when acting with a view to the best interests of the corporation, directors may consider, but are not limited to, factors such as the interests of shareholders, employees, retirees and pensioners, creditors, consumers and government, as well as the environment and the long-term interests of the corporation. When exercising their duty of care and taking corporate action that will affect stakeholders, directors should treat each stakeholder group equitably and fairly and, in resolving competing interests, the directors should evaluate and assess stakeholder interests alongside the best interests of the company with the view of creating a "better" company.

As ESG incorporation relates to the consideration of environmental, social and governance considerations in respect of a business, a director's fiduciary duty, broadly speaking, could encompass a duty to manage and oversee ESG-related matters relevant to the company, especially in the application of risk management, risk mitigation and governance, which may include actively addressing certain challenges and opportunities in the context of specific environmental and social ("**E&S**") matters.

In Canada, the regulation of capital markets is a matter of provincial and territorial jurisdiction, and while each province and territory has its own securities laws, regulations and rules administered by a local securities regulator, these local securities regulators who form the Canadian Securities Administrators (the "**CSA**") have adopted national instruments and policies that apply in all Canadian jurisdictions. Collectively, these securities laws, policies, rules and instruments are referred to in this discussion as the "**Canadian securities laws**".

Substantive ESG-related requirements are prescribed by the CSA under applicable Canadian securities laws and the rules of the Toronto Stock Exchange (the "**TSX**") and, for the most part, securities laws relating to ESG-related requirements, disclosure and best practices have been harmonised through national instruments and national policies adopted by all of the Securities Commissions. Corporate governance disclosure and best practices are governed by National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "**Corporate Governance Rule**") and National Policy 58-201 *Corporate Governance Guidelines* (the "**Corporate Governance Guidelines**").

By mandating corporate governance-related disclosure, which is generally to be included in an issuer's management proxy circular, the goal of the Corporate Governance Rule is to provide greater transparency on how issuers apply various corporate governance principles. While the CSA require issuers to disclose how they deal with certain matters, they also recognise that many corporate governance matters cannot be prescribed in a "one size fits all" manner and neither the Corporate Governance Rule nor the Corporate Governance Guidelines are intended to prescribe or restrict specific governance matters. The Corporate Governance Guidelines are thus meant to reflect "best practices" that have been formulated with desirable corporate governance principles in mind. Issuers can choose to apply or follow the best practices as set out in the Corporate Governance Guidelines, in whole or in part, depending upon their own unique circumstances, or to explain how they achieve the goals of the related corporate principles.

The "best practices" set out in the Corporate Governance Guidelines include the requirement to adopt a **written code of business conduct and ethics, which applies to not only the employees but also the board of directors of the issuer**. Although the content and tone of the code are left to the issuer's discretion, the Corporate Governance Guidelines recommend that the following matters be covered by the code: conflicts of interest; protection of corporate assets; confidentiality of corporate information; fair dealing with security holders and others; compliance with laws; and reporting of illegal or unethical

behaviour. While these subject areas may be seen to form the core "ethical" components of an internal ESG framework, given the broad scope of matters covered by ESG, a number of social and governance matters have evolved to be covered expressly under applicable codes of conduct or ethics. These include human rights protection, anti-harassment and workplace well-ness, supply chain governance and community relations as well as anti-bribery and corruption, environmental protection, equity and inclusion. However, these are often, if not always, accompanied by more specific ESG-related policies, reports or disclosures.

The TSX also substantively regulates governance through various policies or restrictions. These include requirements relating to director independence, as well as restrictions against staggered boards and slate voting through the requirement for annual elections for individual directors. The TSX also requires its listed companies to adopt majority voting policies, which require voluntary resignation by directors who fail to garner a majority of "for" votes in director elections.

More recently, there has been a concerted effort at both the federal and provincial levels to strengthen and enhance climate-related disclosure. In January 2021, Ontario published its "Capital Markets Modernization Taskforce" (the "**Ontario Taskforce**") final report, in which it recommended "mandating disclosure of material ESG information, specifically climate change-related disclosure" through regulatory Ontario Securities Commission ("**OSC**") filing requirements. The Ontario Taskforce recommends a phased approach to implementation of this new requirement based on an issuer's market cap and encourages the CSA to implement a similar requirement across Canada. Similarly, the federal government budget has sought to strengthen climate-related disclosures by mandating Canada's large corporations in 2022 to adopt the Task Force on Climate-related Financial Disclosures ("**TCFD**") standards or more rigorous, acceptable standards as applicable. In 2022, Crown corporations will also be required to implement gender and diversity reporting. In efforts to provide further clarity and facilitate consistency and comparability among issuers, in October 2021, the CSA published CSA Consultation Climate-related Disclosure Update and CSA Notice and Request for Comment Proposed National Instrument 51-107 *Disclosure on Climate-related Matters* ("**NI 51-107**"), which would introduce disclosure requirements regarding climate-related matters for reporting issuers (other than investment funds). The proposal is being published for a 90-day comment period (ending January 17, 2022). The proposed disclosure would be included in an issuer's management information circular and is related to four core elements: governance; strategy; risk management; and metrics and targets.

Also noteworthy is the *Notice relating to modern slavery disclosure requirements* (the "**Notice**") published by Quebec's securities regulator, the *Autorité des marchés financiers*. The Notice seeks to provide guidance to reporting issuers on the disclosure of issues involving modern slavery, a term defined by the International Labour Organization as any work or service performed by a person involuntarily and under the threat of any penalty. Although it does not modify existing regulatory requirements, the Notice draws the attention of issuers to certain requirements that may be related to the issue of modern slavery in the disclosure of their risks, social policies and code of conduct and ethics. Furthermore, the Notice states that when carrying out their oversight duties, boards of directors, audit committees and certifying officers should examine, among other things, management's assessment of the materiality of issues related to modern slavery and satisfy themselves that the disclosure provided in the documents filed under securities regulation is consistent with that assessment.

1.2 What are the main ESG disclosure regulations?

Reporting issuers are subject to specific reporting requirements in periodic disclosure documents required to be filed under applicable Canadian securities laws. These include Financial Statements (in accordance with the International Financial Reporting Standards), Management's Discussion & Analysis ("**MD&A**", under Form 51-102 F1), Annual Information Forms ("**AIFs**", under Form 51-102 F2), and Information Circulars (under Form 51-102 F5), which include Executive Compensation (under Form 51-102 F6) and Disclosure of Corporate Governance Practices (under Forms 58-101 F1 and F2).

In addition to these periodic disclosure requirements, reporting issuers are also required to make timely disclosure of material changes (under Form 51-102 F3) and, under applicable TSX Rules, timely and accurate disclosure of material information. These general periodic and timely disclosure requirements encompass various disclosures relating to ESG issues under Canadian securities rules, and the CSA encourage reporting issuers to demonstrate ESG considerations in their applicable disclosure filings. Certain of these requirements are discussed in further detail below.

Pursuant to the Corporate Governance Rule and Form 58-101 F1 *Corporate Governance Disclosure* ("**Form 58-101 F1**"), reporting issuers are required to disclose certain prescribed information relating to board and committee duties and responsibilities as well as board independence, composition, education, and board and committee self-assessments (which requirements differ among venture companies and those listed on the TSX or other non-venture exchanges). While these requirements have remained relatively static since inception, they were substantively expanded to include prescribed disclosure with respect to the representation of women on boards of directors, in the director identification and selection process, and in executive officer positions (the "**Diversity Disclosure**").

Generally, the Diversity Disclosure follows a "comply or explain" model, which does not require issuers to adopt any particular form of policy with respect to board appointments and the appointment of senior management. Rather, the approach provides flexibility and allows issuers to determine the considerations and policies with respect to board nominations and the appointment of senior management that are appropriate to their particular circumstances.

Under these rules, an issuer is required to include disclosure as set out in Form 58-101 F1 in its management information circular any time that the issuer solicits a proxy from a security holder for the purpose of electing directors to its board of directors (or the equivalent).

Under Form 58-101 F1, each TSX-listed reporting issuer to whom the Corporate Governance Rule applies, is required to disclose the following:

- Whether the board has adopted term limits for directors or other mechanisms for board renewal, and, where adopted, a description thereof.
- Whether the issuer has adopted a written policy relating to the identification and nomination of women directors, and, where adopted, a summary of its objectives and key provisions, the measures taken to ensure that the policy has been effectively implemented, annual and cumulative progress by the issuer in achieving the goals of the policy and whether and, if so, how the board or its nominating committee measures the effectiveness of the policy.
- Whether and, if so, how the board or nominating committee considers the level of representation on the board in identifying and nominating candidates for election or re-election to the board.

- Whether and, if so, how the issuer considers the level of representation of women in executive officer positions when making executive officer appointments.
- Whether the issuer has adopted targets for women on the board and in executive officer positions, and, if adopted, disclosure of the target and the annual and cumulative progress of the issuer in achieving such target(s).
- The number and proportion (as a percentage) of directors on the issuer's board and of executive officers of the issuer and its major subsidiaries who are women.
- Where an issuer has not adopted any of the components described above (i.e., term limits, policies, targets) or does not consider the representation of women on its board or among its executive officers in identifying candidates for such positions, the issuer must disclose why it has not done so.

Under the Corporate Governance Rule and Corporate Governance Guidelines, the CSA may periodically review compliance with these requirements and may order prospective and/or corrective disclosure, but also have the authority to enforce these through other enforcement mechanisms.

While the Corporate Governance Rule focuses on gender representation, amendments to the CBCA that came into force in 2020 expand annual disclosure requirements respecting term limits, diversity policies, and statistics regarding representation of women to include Aboriginal peoples, persons with disabilities and members of visible minorities. These amendments to the CBCA are further discussed in questions 1.4 and 2.2. To assist CBCA-incorporated issuers in addressing the CBCA disclosure requirements, Innovation, Science and Economic Development Canada ("**ISED**") published guidelines intended to encourage more consistent diversity disclosure. Notably, corporations are encouraged to disclose information in tabular format, separate disclosure with respect to boards and senior management, and specifically indicate timelines for targets. CBCA issuers are also reminded that filing a proxy circular on SEDAR will not satisfy the requirement to send diversity information to Corporations Canada. Rather, CBCA issuers must also submit this information to Corporations Canada either through their Online Filing Centre or by email to IC.corporationscanada.IC@canada.ca.

Following the amendments to the CBCA, in April 2021, ISED published Canada's first annual report on the diversity of boards and senior management of federal distributing corporations, encompassing a review of 469 distributing corporations (the "**CBCA Issuers**"), namely the *Diversity of Boards of Directors and Senior Management of Federal Distributing Corporations 2020 Annual Report*. Similarly, in March 2021, the CSA also published Multilateral Staff Notice 58-312, *Report on Sixth Staff Review of Disclosure Regarding Women on Boards and in Executive Officer Positions*, which summarises the review of the disclosure of 610 TSX-listed issuers with year-ends between December 31, 2019 and March 31, 2020 (the "**TSX Issuers**"). Differences between the results of the ISED and Staff Notice 58-312 studies are noticeable as the CBCA Diversity Disclosure requirements apply to all "distributing corporations" incorporated under the CBCA, which includes venture issuers, and addresses more facets of diversity, namely women, visible minorities, Indigenous persons and persons with disabilities. The findings of ISED establish a baseline that will be used to measure progress over the years. According to Staff Notice 58-312, 79% of TSX Issuers reviewed had at least one woman on their board, while ISED found that only 50% of CBCA Issuers had at least one woman on their board, suggesting that venture issuers generally have fewer women on their boards. Further, 20% of board seats of TSX Issuers were held by women, in comparison to 17% of CBCA Issuers. In regard to executive positions, 65% of TSX Issuers and 47% of CBCA Issuers had at least one woman in an executive officer position.

With respect to specific issues related to environmental compliance, risks and opportunities, the CSA have published guidance under Staff Notice 51-333 *Environmental Reporting Guidance* to provide insight on satisfying existing continuous disclosure requirements with respect to environmental concerns.

In the context of a wide range of environmental issues, Staff Notice 51-333 focuses on the following types of disclosure:

- *Environmental Risks and Related Matters*. The five key disclosure requirements in National Instrument 51-102 that relate to environmental matters are: environmental risks; trends and uncertainties; actual and potential environmental liabilities; asset retirement obligations ("**AROs**"); and the financial and operational effects of environmental protection requirements, including the costs associated with these requirements.
  - Environmental Risks: Issuers are required to disclose risk factors relating to the issuer and its business under item 5.2 of Form 51-102 F2. These risks include litigation risks, physical risks, regulatory risks, reputational risks, and risks relating to business model.
  - Trends and Uncertainties: The MD&A should include a narrative explanation of material information not fully reflected in the financial statements relating to applicable trends and uncertainties, including those that have affected or may affect the financial statements.
  - Environmental Liabilities: Environmental liabilities can arise from past or ongoing business activities that could impact the environment or could involve potential environmental liability due to ongoing or future business activities. With a potential liability, an issuer may be able to prevent liability by changing practices or adopting new practices to reduce negative impacts on the environment.
  - AROs: Item 1.2 of Form 51-102 F2 requires disclosure about an issuer's financial condition, results of operations and cash flows including disclosure on commitments or uncertainties that are reasonably likely to affect the issuer's business. Assets are considered retired if they are sold, abandoned, recycled or otherwise disposed of. An ARO is a requirement to perform a procedure rather than a promise to pay cash; as such, legal obligations resulting from the retirement of an asset could manifest.
  - Financial and Operational Effects of Environmental Protection Requirements: An issuer should disclose financial and operational effects of environmental protection requirements under item 5.1(1)(k) of Form 51-102 F2, including on capital expenditures, earnings, and competitive position.
- *Environmental Risk Oversight and Management*. Two key sets of disclosure requirements provide insight into a reporting issuer's oversight and management of environmental risks: environmental policies implemented by the issuer; and the issuer's board mandate and committees. In relation to environmental policies, a reporting issuer should explain the purpose of its environmental policies and the risks they are designed to address and evaluate, and describe the impact that the policies may have on its operations. For an issuer's board mandate and committees, the reporting issuer should disclose the board of directors' (or any delegate committee's) responsibility for the oversight and management of environmental risks in a manner that is meaningful to investors.

- *Forward-Looking Information Requirements*. Issuers are advised that disclosing goals or targets with respect to greenhouse gas emissions or other environmental matters may be considered forward-looking information or future-oriented financial information and would be subject to the disclosure requirements generally applicable to such information, including requirements to identify material assumptions and risks.
- *Governance Structures Around Environmental Disclosure*. Staff Notice 51-333 provides that a meaningful discussion of environmental matters in an issuer's MD&A and AIF is critical in ensuring fair presentation of the issuer's financial condition. Issuers should therefore consider discussing what environmental matters are likely to impact the business and operations in the foreseeable future and the potential magnitude of anticipated environmental risks and liabilities. An issuer should also have adequate systems and procedures to provide structure around its disclosure of environmental matters, including disclosure controls. The CSA also encourage voluntary reporting and disclosure responsive to third-party frameworks as a means to provide additional information to investors outside of continuous disclosure requirements.

More recently, in 2019, the CSA published CSA Staff Notice 51-358 *Reporting of Climate Change-related Risks*. This guidance was motivated by increased investor interest in climate change-related risks, particularly among institutional investors, the CSA's view that issuers' existing disclosure with respect to climate change can be improved, and the large number of reports on climate change disclosure and other environmental governance topics over the last several years.

The Notice highlights the respective roles of management and the board (and audit committee) in strategic planning, risk oversight and the review and approval of an issuer's annual and interim regulatory filings. While intended solely as an educational or guidance tool, Staff Notice 51-358 generally suggests the following practices for an issuer's board of directors and management:

- Ensure that the board of directors and management have, or have access to, appropriate sector-specific climate change-related expertise to understand and manage climate change-related risk.
- Establish disclosure controls and procedures designed to collect and communicate climate change-related information to management to allow for the assessment of materiality and, as applicable, timely disclosure.
- Consider whether climate change-related risks and opportunities are integrated into the issuer's strategic plan.
- Assess whether the issuer's risk management systems and methodology, including business unit responsibility, appropriately identify, disclose and manage climate change-related risks.
- Review the CSA's select questions for boards and management designed to inform the assessment of climate change-related risk. These questions include:
  - *whether the board provided appropriate orientation and information to help members understand sector-specific climate change-related issues;*
  - *whether the board was comfortable with the methodology used by management to capture the nature of climate change-related risks and assess the materiality of such risks; and*
  - *whether the board considered the effectiveness of the disclosure controls and procedures in place in relation to climate change-related risks.*

With respect to materiality, Staff Notice 51-358 emphasises that climate change-related risks and their potential financial impacts are mainstream business issues. While climate change-related risks may differ from other business risks due to our evolving understanding of these risks, the potential difficulty in quantifying these risks and the potentially longer time horizon, boards and management should take appropriate steps to understand and assess the materiality of climate change-related risks to their business.

In this context, Staff Notice 51-358 highlights certain specific considerations for determining materiality in the context of climate change-related risks:

- **Timing** – Issuers should not limit their materiality assessment to short-term risks. The uncertainty and time horizon of a risk occurring may impact the assessment of whether the risk is material but not whether it needs to be considered and analysed as to materiality.
- **Measurement** – Boards and management should consider the current and future financial impacts of material climate change-related risks on the issuer's assets, liabilities, revenues, expenses and cash flows over the short, medium and long term. Where practicable, issuers should quantify and disclose the potential financial and other impact(s) of climate change-related risks, including their magnitude and timing.
- **Categorisation of Risk and Potential Impact** – The Notice provides helpful guidelines for thinking about climate change-related risk and its potential financial, operational and business impact, including:
  - the **physical risks** of climate change, including acute (i.e., event-driven) or chronic changes in resource availability and climate patterns, including their impacts on sourcing, safety, supply chains, operations and physical assets;
  - the **transitional risks** arising from a gradual change to a low-carbon environment, including reputational risks, market risks, regulatory risks, policy risks, legal risks and technology risks; and
  - **opportunities** that may become available as a result of efforts to mitigate and adapt to climate change.

1.3 What voluntary ESG disclosures, beyond those required by law or regulation, are customary?

Depending on the business and industry of the reporting issuer and its specific shareholder or investor focus, there are a number of voluntary ESG-related disclosures that issuers may provide. These are impacted or skewed to a certain extent by the prevalence of resources issuers in Canadian capital markets. As such, voluntary disclosures are often focused on the environmental impact of the issuer's operations, including stewardship and sustainability, emissions reduction, water use and management, supply chain governance and asset retirement or reclamation. However, there has also been an increasing focus on governance and social issues, including community relations, health and safety, human rights and diversity. Voluntary corporate sustainability reporting often includes disclosure relating to a company's environmental, social and economic priorities, performance and impacts, governance and implementation of how these priorities are managed by an organisation, and has a broad focus on sustainability reporting to a broader group of stakeholders as opposed to a primary focus on investors and financial analysts. A recent survey of the disclosure practices of the S&P/TSX Composite Index constituents indicates that 71% of companies released a sustainability report (or ESG report) in 2020, up from 58% in 2019. Corporate S&P/TSX 60 issuers with dedicated ESG reports also increased to 92% in 2020 from 73% in 2019 and 48% in 2018, a figure substantially higher than the 71% in 2020 and 58% in 2019 of the broader S&P/TSX Composite

Index (Millani, *Millani's Annual ESG Disclosure Study: A Canadian Perspective* (September 2021)). Although ESG reporting is not standardised, the majority of companies continue to favour the Global Reporting Initiative ("**GRI**") framework as discussed further in question 4.1 below. Also noteworthy is the trend in TSX 60 companies regarding the disclosure of climate-related goals. According to Hugessen, in 2021, 54 companies disclosed such goal with 25 declaring a carbon neutral goal and 2050 most frequently the target set.

1.4 Are there significant laws or regulations currently in the proposal process?

As noted above, the Canadian Federal Government has recently expanded disclosure on board and executive composition disclosure beyond gender. Since January 1, 2020, all distributing corporations incorporated under the CBCA are required to include additional information about the diversity of their boards and senior management in annual proxy circulars. These amendments broaden the Diversity Disclosure requirement beyond gender and have been implemented to expand disclosure requirements to designated groups under the Employment Equity Act – being women, Indigenous persons (First Nations, Inuit, and Métis), persons with disabilities, and members of visible minorities.

Further amendments have also been adopted that will require prescribed corporations to develop an approach with respect to the remuneration of the directors and members of senior management and hold an annual, non-binding vote on such approach (generally referred to as a "say-on-pay" resolution). As is typical for "say-on-pay" votes, the results of the vote are required to be disclosed but are not to be binding on the corporation. Additional amendments will require disclosure of "the recovery of incentive benefits or other benefits", more commonly referred to as clawbacks, on an annual basis. Note that the coming into force of these amendments is tied to the implementation of corresponding regulations. Accordingly, in early 2021, Corporations Canada launched public consultations on proposed regulations under the CBCA related to such recent amendments.

In addition, due to the lack of standardised framework for ESG disclosure, the Ontario Taskforce suggests public issuers provide enhanced disclosure of material ESG information, including forward-looking information. Such disclosure may set the foundation for greater access to global capital markets and promote an equal playing field for issuers. The Ontario Taskforce has also proposed that TSX-listed companies adopt written policies that "expressly addresses the identification of candidates who self-identify as women, black, indigenous and people of colour ("**BIPOC**"), persons with disabilities or LGBTQ+ during the nomination process" and public issuers set aggregate targets of 50% for women and 30% for BIPOC, persons with disabilities, and LGBTQ+, with implementation to be completed within five and seven years, respectively. It remains to be seen whether the Ontario Taskforce's recommendations will be adopted.

The 2021 federal budget also proposes a public consultation on measures that would adapt and apply the CBCA diversity requirements to federally regulated financial institutions. The goal is to promote greater ethnic, racial, gender and Indigenous diversity among senior ranks of the financial sector and ensure that more Canadians have access to such opportunities.

As noted above, there is also a CSA proposal under NI 51-107, which would introduce disclosure requirements regarding climate-related matters.

1.5 What significant private sector initiatives relating to ESG are there?

ESG integration into private sector investing decisions continues to evolve. While responsible investing ("**RI**") as a component of risk mitigation is not new, there is a growing transition to focus on RI as an integral component of the value generation analysis. This correlates to growing pressure from the private sector for better standardisation and benchmarking of both disclosures and performance. As a result, the support for development of evaluation standards, rating indexes, and research organisations dedicated to evaluating ESG strategies, performance, responsibilities and risks, such as the Carbon Disclosure Project ("**CDP**"), the Dow Jones Sustainability Index, the ISS ESG, the MSCI ESG Index, and Sustainalytics, are beginning to develop. This also correlates to proxy advisory firms, including Institutional Shareholder Services ("**ISS**") and Glass Lewis ("**GL**"), as well as shareholder groups such as the Canadian Coalition for Good Governance placing a heightened emphasis on ESG factors for the upcoming proxy seasons. Further, the Securities Commissions, through the proposal under NI 51-107, are recommending the implementation of the TCFD Framework or that the proposed instrument is based on the TCFD Framework.

Recently, the CEOs of eight leading pension plan investment managers called for increased transparency from issuers regarding ESG matters and asked issuers to disclose ESG data in a standardised way, pointing to the Sustainability Accounting Standards Board ("**SASB**") standards and the TCFD Framework; along with the 2021 TSM Climate Change Protocol, which aims to support mining companies in managing climate-related risks and opportunities, such as associated mitigation and adaptation strategies, reporting and target-setting. Further, the "360º Governance: Where are the Directors in a World in Crisis?" report, published in February 2021, provides 13 guidelines for modifying corporate governance procedures in order to improve the financial and ESG performance of companies. These guidelines relate to the following categories: corporate purpose; board's duty, definition of stakeholders; Indigenous peoples; reporting on stakeholder impact; stakeholder committee; stakeholder conflicts; compensation policies; board refreshment; board diversity, organisational diversity; climate change; and corporate activism.

2 Principal Sources of ESG Pressure

2.1 What are the views and perspectives of investors and asset managers toward ESG, and how do they exert influence in support of those views?

ESG is growing rapidly, with assets in Canada being managed using responsible investment strategies increasing from CA$2.1 trillion at the end of 2017 to CA$3.2 trillion as of December 31, 2019. Assets affected to responsible investment accounted for 61.8% of total Canadian assets under management in 2019, up from 50.6% in 2017 (Responsible Investment Association, *2020 Canadian Responsible Investment Trends Report* (November 2020)). Relatedly, a recent survey indicates that almost 90% of Canadian institutional investors use ESG factors as part of their investment approach and decision-making.

Asset managers in many sectors are focused on the ESG performance, rating and/or evaluation of issuers, with many having specific requirements with respect to expectations or ratings, particularly with respect to environmental stewardship and management, and thus require reports or disclosure

responsive to these concerns in order to make investment decisions. However, there are a range of approaches taken to apply their principles to investing decisions. These range from screen or exclusion by restricting investments in certain sectors (such as tobacco or weapons manufacturing), to full ESG integration into investment analysis. Full ESG integration is growing with the gradual increase in recognition of the correlation between ESG and value generation. Asset managers also exert influence through direct and indirect engagement, including through implementation of proxy voting policies and policy-based voting. In this respect, Canadian institutional investors have generally reviewed their voting and engagement policies to increase the focus on ESG risks.

The Canada Pension Plan Investment Board and PSP Investments are among some of the global leaders participating in the ESG Data Convergence Project with the aim towards advancing an initial standardised set of ESG metrics and mechanism for comparative reporting. Initiated by the California Public Employees' Retirement System and global investment firm Carlyle, the collaboration efforts from the ESG Data Convergence Project are intended to consolidate and streamline the private equity industry's approach to collecting and reporting ESG data to create a critical mass of material, performance-based, comparable ESG data from portfolio companies. A primary goal of the project is to provide opportunities for deeper analysis and correlative studies between ESG factors and financial outcomes, with the goal to ultimately result in more meaningful benchmarking and to highlight the more critical ESG issues that have potential for greater impact. The ESG Data Convergence Project will examine the following initial six metrics: Scopes 1 and 2 greenhouse gas emissions; renewable energy; board diversity; work-related injuries; net new hires; and employee engagement.

Further, more than 20 financial organisations in Quebec have signed the Statement by the Quebec Financial Centre for a Sustainable Finance with an aim to solidify Quebec's leadership in sustainable finance and the financial institutions' commitments to sustainable finance and ESG principles. In responding to the climate emergency and pledging a commitment to the statement, the signories have agreed to undertake, pursue or accelerate initiatives within their organisations as well as within their business networks, which include the development of Quebec-based experts in sustainable finance and investment, the expansion of sustainable finance products and services, the advancement of sustainable finance best practices and the enhancement of ESG integration into operations.

2.2 What are the views of other stakeholders toward ESG, and how do they exert influence in support of those views?

Stakeholder views on responsible investment and ESG remain strong, with a growing focus on diversity and inclusion. In a 2020 survey conducted by the Responsible Investment Association, 72% of respondents were interested in responsible investment, with an overwhelming majority concerned about diversity in corporate leadership, particularly with inclusive workspaces free of discrimination.

The lack of BIPOC representation in Canadian corporate leadership has shifted the narrower focus on the issue of gender parity to a more expansive lens of diversity. As previously mentioned, on January 1, 2020, amendments to the CBCA required reporting on specified diverse groups for all distributing corporations under the CBCA. With this level of transparency, a 2021 study, conducted by Stikeman Elliott LLP, showed that amongst S&P/TSX 60 CBCA issuers, only 6.21% of board members and 6.11% of executive officers identified as visible minorities, 0.59% of board members and 0% of executive officers identified as Indigenous persons (First Nations, Inuit, and Métis), and 0.59% of board members and 0.14% of executive officers identified as a person with a disability.

Issues on the environment and climate change also remain important to stakeholders with influence in support of these views exerted through E&S proposals. In 2021, out of the 24 E&S proposals made, nine were environment-related shareholder proposals and three related to diversity matters. This represents an increase from the 2020 figures of 18 E&S proposals, seven of which related to environment matters and another seven of which related to diversity issues. However, it should be noted that overall, the total number of shareholder proposals declined to its lowest since 2013, primarily because many proposals were withdrawn due to companies successfully negotiating away a majority of proposals. Of particular interest is the continued focus of shareholder proposals regarding the carbon-rich assets of banks. A proposal filed by SumOfUs at Royal Bank of Canada ("**RBC**") received over 30% support of votes cast, and requested RBC adopt company-wide, quantitative, time-bound targets and annual reporting on the progress (Institutional Shareholder Services, Katerin Caseles, Rishima Kathuria, Shehrbano Khan *et al.*, *Canada 2021 Proxy Season Review*, pp 11–12).

Still, amongst the most notable developments is the commitment by two Canadian companies (CN Rail and CP Rail) to adopt a non-binding "Say on Climate" vote. This development is of interest given that "Say on Climate" was one of the dominant issues of the 2021 proxy season globally.

2.3 What are the principal regulators with respect to ESG issues, and what issues are being pressed by those regulators?

The principal regulators of ESG issues are the CSA, the TSX, and the Canadian Federal Government through amendments to the CBCA. These regulators are focused on proper governance and stewardship, board and executive gender diversity with a shift towards diversity more generally, and E&S issues, including environmental and climate change-related risks, risk management and disclosure. In late September 2021, the CSA hosted a virtual roundtable discussion concerning ESG-related issues in asset management, noting the importance of enhancing ESG-related fund disclosure so that investors are informed about the ESG-related aspects of a fund, and can make informed investment decisions. In particular, the discussion highlighted that CSA staff are in the process of developing guidance on ESG-related investment fund disclosure, which would clarify the CSA's current disclosure requirements applied to ESG funds and would cover a number of areas including fund names, investment objectives and strategies, proxy voting and shareholder engagement, risk disclosure, sales communications and ESG-related changes to existing funds. The aim of this guidance is to enhance the ESG-related aspect of disclosure documents and ensure that sales communications are not untrue, misleading or inconsistent.

2.4 Have there been material enforcement actions with respect to ESG issues?

Reporting issuers are subject to specific requirements relating to disclosure of material information as discussed above, including timely disclosure of material changes. In addition to exposure to sanctions and regulatory enforcement for failing to comply

with these disclosure obligations, issuers also risk secondary market liability for actions relating to misrepresentations and failure to make timely disclosure. With respect to ESG matters, particular areas of risk include inadequate assessment and/or disclosure of the impact of ESG factors on operations, particularly in respect of environmental and climate change-related liabilities, including changes to applicable regulations.

2.5 What are the principal ESG-related litigation risks, and has there been material litigation with respect to ESG issues, other than enforcement actions?

As voluntary ESG metrics proliferate the financial market along with regulatory requirements, there is increasing pressure for companies to ensure the adopting of and conformity with ESG standards. Corporate accountability for ESG reporting appears to be on the rise as claims for company ESG policy misstatement and performance litigation has increased, with the prevailing theme being challenges on the truthfulness of ESG statements in conflict with corporate activity and claims directly contesting the conformity of company activities and performance to generally accepted standards and frameworks.

A recent decision of the Ontario Court of Appeal in *Barrick Gold Corporation* (*Drywall Acoustic Lathing and Insulation, Local 675 Pension Fund v. Barrick Gold Corporation*, 2021 ONCA 104) illustrates this risk. In *Barrick Gold*, plaintiffs filed a class action against the corporation with respect to disclosure regarding an important gold mining project that was terminated after four years. Amongst others, plaintiffs argued that the corporation had failed to disclose material facts relating to serious environmental non-compliance regarding the project. While both the motion judge and the Court of Appeal found that plaintiffs had failed to establish environmental misrepresentations by omission, these allegations have led to careful judicial consideration of the context in which the disclosures were made.

In Canada, there appears to be a growing focus on climate change-related litigation involving tort claims against corporations with pressure exerted by the Crown, municipalities, First Nations, private citizens and environmental non-governmental organisations.

With the Supreme Court of Canada's decision in *Nevsun Resources Ltd v. Araya* in early 2020, social factors within ESG also present litigation risk for corporations. In *Nevsun*, Eritrean plaintiffs alleged that the Canadian mining company violated customary international law by allowing human rights abuses in the partly owned Bisha mine (*Nevsun Resources Ltd v. Araya*, 2020 SCC 5). The majority decision to allow the plaintiffs to bring their claim in Canada represents a progression in Canadian judicial thinking on the responsibilities and legal accountability of corporations operating abroad where human rights abuses may occur. ESG disclosure and compliance with ESG metrics is gaining importance as corporate liability is expanding.

A comparable and equally important risk to a company for failure to comply with internal ESG policies is the reputational damage in the marketplace from misinformation or underperformance on ESG metrics.

2.6 What are current key issues of concern for the proponents of ESG?

In the absence of standardised ESG methodology or frameworks, the implementation and evaluation of ESG strategies and ESG strategy outcomes can be challenging for companies and their various stakeholders. Furthermore, the lack of standardised ESG methodology also makes it challenging to provide comparisons across organisations and markets. As such, the lack of standardisation will continue to be a key issue for proponents of ESG with a push to adoption of standardised methodologies or frameworks. In recognition of this issue, in October 2021, the CSA formally supported the establishment of the International Sustainability Standards Board ("**ISSB**") in Canada and offered to host the ISSB headquarters in Canada.

There is a growing trend among investors to focus on ESG analysis rather than ESG investing, the former incorporating ESG-based criteria as a fundamental part of investment analysis utilising a measurable and consistent approach that is fully integrated into the investment process, as opposed to use of ambiguous criteria resulting in only perceived rather than actual value. ESG integration is defined as "the explicit and systematic inclusion of ESG factors in investment analysis and investment decisions", and the expectation over the long term is that "ESG investing" will be so intricately intertwined and integrated into the investment analysis that ESG investing will be the norm as opposed to the exception (CFA Institute, *ESG Integration in Canada* (2020)).

In terms of key areas of focus, there has been a growing focus on social issues including diversity, equal opportunity and inclusion as well as employee health and well-being. Proponents of ESG are pressing for incentive-based compensation structures that reward executives for incorporating and achieving ESG metrics with a focus on health and safety measures. In addition, climate change, emissions reduction and water scarcity continue to remain key environmental issues.

Cybersecurity risk, including data security, is another top-ranked ESG concern for institutional investors as it engages companies' governance and social risks. As the cyberattacks that roiled large corporations in 2019 and 2021 have shown, malicious cyber activity can inflict serious financial, operational and reputational harm on firms. The global COVID-19 pandemic is adding another layer of cybersecurity risk with the continued reliance on a remote-working environment that will likely continue to prevail to a large extent in the long term. The new work-from-home reality is creating new potential avenues for unauthorised access to company data and information technology systems on the part of hackers and cyber criminals.

3 Integration of ESG into Business Operations and Planning

3.1 Who has principal responsibility for addressing ESG issues? What is the role of the management body in setting and changing the strategy of the corporate entity with respect to these issues?

Generally, ESG strategy is directed by senior management, with relevant responsibilities divided among applicable business units or functions that are accountable and report to the board. Increasingly, there is integration across particular E&S factors given the growing trends of companies to provide consolidated external reports and disclosures, coupled with a shift towards a top-down approach as boards and board committees continue to expand on their direct oversight of E&S-related performance.

As we see investors push for greater ESG disclosure, proxy advisor firms have also made changes to their guidelines, which will influence how management, boards and board committees make decisions. Starting in 2021, GL began noting as a concern when S&P/TSX 60 issuers did not provide clear disclosure regarding the board-level oversight of environmental and/or social issues. GL will generally recommend voting against the chair of the governance committee of an S&P/TSX 60 issuer

who fails to provide explicit disclosure concerning the board's role in overseeing E&S matters for shareholder meetings held after January 1, 2022 (Glass Lewis, *2021 Proxy Paper Guidelines, An Overview of the Glass Lewis Approach to Proxy Advice* (2021)). In regard to E&S issues, ISS has adopted a global approach and will generally vote on a case-by-case basis, primarily examining whether implementation of the proposal is likely to enhance or protect shareholder value. Effective for meetings of shareholders being held on or after February 1, 2021, ISS considers, among other things, the existence of significant controversies, penalties, fines, or litigation associated with the company's environmental or social practices in vote recommendations (Institutional Shareholder Services, *Canada, Proxy Voting Guidelines for TSX-Listed Companies Benchmark Policy Recommendations* (November 2020); Institutional Shareholder Services, *Canada, Proxy Voting Guidelines for Venture-Listed Companies Benchmark Policy Recommendations* (November 2020)).

3.2 What governance mechanisms are in place to supervise management of ESG issues? What is the role of the board and board committees?

Board and board committee oversight of ESG strategies is important to ensure that the relevant ESG policies and practices are being incorporated and evaluated to align with the company's broader corporate strategy, while mitigating risk and capitalising on opportunities. Oversight may be achieved with the already established governance committee, while certain organisations elect to form specific ESG-focused committees, including those with mandates focused on matters such as risk management, safety and sustainability, human resources, etc. Notably, Stikeman Elliott's internal 2021 study found that 27 of the S&P/TSX 60 issuers have "specialised" committees related to corporate social responsibility and health, safety and environment. From the board's perspective, holistic ESG integration starts with setting the corporate culture, and then integrating key matters through risk management, corporate strategy, evaluation and compensation and disclosure. Implementation of a robust enterprise risk management framework is often the key component, with governance and accountability and ultimate oversight by senior management and the board.

3.3 What compensation or remuneration approaches are used to align incentives with respect to ESG?

The most common approach to compensation and remuneration is the integration of ESG-related targets and metrics into incentive-based compensation, with 63% of the TSX 60 constituents implementing at least one ESG metric into their incentive plan, with an average weight of 20%. Notably, energy and materials companies are leaders in implementing environmental metrics into incentive plans. However, these metrics typically relate to compliance and environmental risk management rather than greenhouse gas emissions and climate strategy (Hugessen Consulting, *2021 Proxy Season Overview Highlights from the TSX 60* (2021)). While these are more prevalently included under qualitative assessment components, there is an increasing trend towards assignment of quantitative weightings; however, the challenges with this approach include selecting components with a direct correlation to desired outcomes (i.e., business strategy, risk mitigation, etc.), ability for a meaningful individual impact, accuracy and measurement, external comparability, consistency and independent verification.

Common ESG metrics include occupational health and safety practices and outcomes, environment and sustainability goals, and diversity and inclusion factors in workforce composition and governance, with targets for health and safety and fatality rates being the most common social factors. Approaches with respect to integration also continue to evolve and include increased weighting, application of ESG modifiers and incorporation into long-term incentives. It is recognised that pairing executive compensation and remuneration incentives with long-term strategic plans including ESG strategies may contribute to the positive delivery of sustained shareholder value creation. However, it is critical for boards to discuss and monitor the selection, design and verification of comprehensive metrics, goals and related achievements associated with executive compensation consistently, and because ESG reporting and evaluation metrics are not standardised, boards should consider engaging independent third-party ESG experts to assist with the verification of ESG data and predetermined metrics to inform board members on company and executive performance. Boards should also consider which ESG factors are most relevant to their business and which factors will materially impact financial and operational performance and create long-term sustainable value. Further consideration should be given to an organisation's stakeholder base, as different stakeholders have called for the use of certain reporting frameworks.

3.4 What are some common examples of how companies have integrated ESG into their day-to-day operations?

Companies use a variety of mechanisms to integrate ESG into their day-to-day operations. These include specific ESG-related policies and requirements, including the incorporation of ESG-related targets and goals into procurement activities, thoughtful recruiting and hiring practices, stakeholder and Indigenous relations, benchmarking and disclosure, as well as integration into and reporting against achievement of business objectives.

4 Finance

4.1 To what extent do providers of debt and equity finance rely on internally or externally developed ESG ratings?

Providers of debt and equity finance rely heavily on externally developed ESG frameworks, standards, and ratings. There are numerous ESG frameworks, such as the UN Sustainable Development Goals, the UN Global Compact, the OECD Guidelines for Multinational Enterprises, Principles for Responsible Investment, and guidelines set out in national Responsible Investment industry associations. While there is a diverse array of external ESG ratings, the three most commonly used standards and frameworks in Canada include the TCFD, GRI, and SASB. All three frameworks may be used by providers of debt and equity finance in combination. The TCFD has greater focus on climate-related financial disclosure, while SASB focuses on investor needs and topics of financial materiality. GRI adds standards on social and governance topics to report on sustainability impacts in a consistent manner.

In 2015, the TCFD developed a framework of 11 recommendations to assist public companies and other organisations to effectively disclose climate-related risks and opportunities leveraging existing reporting processes. The recommendations are based on four areas: governance; strategy; risk management; and metrics and targets. In 2017, the TCFD released climate-related financial disclosure recommendations designed to help companies provide better information to support informed capital allocation.

SASB, established in 2011, developed a set of 77 ESG industry-specific standards applicable around the world. These standards focus on financially material issues reasonably likely to impact the financial condition or operating performance of a company.

GRI first developed standards in 1997 for organisations to report on sustainability impacts in a consistent manner, with a focus on ensuring that organisations are transparent and accountable. GRI sets out universal standards, and topic standards consisting of economic, environmental, or social.

In September 2020, GRI and SASB, together with CDP, the Climate Disclosure Standards Board, and the International Integrated Reporting Council (now merged with SASB), announced a shared vision for a comprehensive corporate reporting system, outlining the ways in which the existing sustainability standards and frameworks can complement generally accepted financial accounting principles. In December 2020, the group published a prototype climate-related financial disclosure standard (SASB, *SASB Standards & Other ESG Frameworks* (2021)).

4.2 Do green bonds or social bonds play a significant role in the market?

Actions to address climate change and greenhouse gas emissions continue to play a critical role in supporting the green bonds market. Investors remain interested in green project initiatives, which include, *inter alia*, renewable energy products, clean technology, and green bond principle-based infrastructure. Domestic investors are the dominant consumers of Canadian-issued green bonds that dedicate funds to specific green projects, which typically are renewable energy projects, clean technology initiatives or low-carbon buildings and developments; however, as green bond funds continue to diversify, investments relating to green transportation and water conservation are gaining popularity.

Canadian-issued green bonds remain a modest presence in the international green bond issuance market in comparison to green bond products emerging from the U.S., Europe, and China (Investment Industry Association of Canada, *Opportunities in the Canadian Green Bond Market v.4.0* (February 2020), https://iiac.ca/wp-content/uploads/Opportunities-in-the-Canadian-Green-Bond-Market-v4.0-Feb-2020.pdf; Reuters, *Canadian green bond market riding high after record quarter* (July 2021)). However, consistent with global trends, ESG bonds are quickly gaining popularity in Canada as companies seek to increase their "green" or sustainability credentials through a focus on renewable energy, pollution reduction, or climate change. For example, sustainable debt issuance in Canada is projected to surpass US$1 trillion this year, which represents a 30% increase from all of 2020 (*Financial Post*, Stefanie Marotta, *The ESG Focus Has Exploded: Sustainability-Linked Bonds Bringing New Issuers to The Table* (July 2021)).

The issuance of Canadian green bonds has been traditionally led by public sector issuers (Responsible Investment Association, *Green Bonds – Fact Sheet for Investors* (2019), https://www.riacanada.ca/content/uploads/2019/02/Green-Bonds-Fact-Sheet.pdf), including ISED and subnational issuers in Ontario and Quebec; however, continued interest in green bond principle-based investments has attracted the attention of a broader spectrum of issuers, including certain Canadian corporations and pension funds.

There are various categories of green bonds. The first, and most commonly used in Canada, are bonds with green use of proceeds. These bonds are like general obligation bonds except that all the funds are directed towards green initiatives and projects. The second are project development bonds. The proceeds from this second type of green bond fund specific purpose entities that own either a single project or many green projects. The third type of green bond are securitisation bonds. These bonds are collateralised by a pool of loans issued to fund numerous green projects.

Sustainability-linked bonds, while relatively new in the ESG investing scene, are becoming increasingly popular because unlike traditional green and social bonds, they do not impose restrictions on how the proceeds can be used. A few notable examples are Telus and Enbridge. Telus was the first Canadian company to issue sustainability-linked bonds, raising CA$750 million in bonds that pay a low interest rate if the company reduces its greenhouse gas emissions. Calgary-based Enbridge was the first North American pipeline company to offer sustainability-linked bonds, whose US$1 billion sale included goals in reducing carbon emissions and bolstering workforce inclusion.

4.3 Do sustainability-linked bonds play a significant role in the market?

The size of the sustainable investment market is still small relative to the larger retail fund market in Canada; however, the sustainable investment market is a growing area as evidenced by the number of new sustainable fund launches over the last few years.

In regard to regulatory action, the OSC approved amendments to the TSX Rule Book to reflect trading of sustainable bonds on the TSX, expanding the types of securities that are able to be traded on the TSX to include sustainable bonds. Sustainable bonds became available for trading on the TSX as of March 1, 2021 (TSX, *TMX Equities Announces Sustainable Bonds Production Launch Details* (n.d.)).

The main goal of the sustainable bond initiative is to increase accessibility and transparency of securities that are already available to Canadian investors.

4.4 What are the major factors impacting the use of these types of financial instruments?

A major factor impacting the use of sustainable bonds, including green and social bonds, is the lack of regulatory verification and standardisation for these types of financial instruments as discussed further in question 4.5. A consequence of a voluntary system for verification is that many bonds arguably lack transparency on which sustainable projects or technologies will be financed. The need for consistency and transparency is heightened in the context of labelling green bonds as "greenwashing" or a reduction in standards, which could shake investor confidence in these valuable financial instruments.

4.5 What is the assurance and verification process for green bonds? To what extent are these processes regulated?

The International Capital Market Association ("**ICMA**") Green Bond Principles are the leading framework and guideline resource for green bond supply in Canada. The ICMA Green Bond Principles are voluntary process guidelines that recommend principles of transparency, disclosure and integrity in the development of green bonds and are intended for broad use by the market, including issuers, various stakeholders, investors, and underwriters.

Canadian green bond programmes can be further bolstered by independent reviews from organisations such as Sustainalytics and the Center for International Climate and Environmental

Research – Oslo ("**CICERO**"). The International Organization for Standardization ("**ISO**") recently published parts of its international green bond standard (the ISO 14030 series) that may also enhance investor appetite for green bonds. In particular, ISO 14030-4:2021 now establishes requirements for verification bodies that review claims of conformity to the ISO 14030 series (ISO, *ISO 14030-4:2021 Environmental performance evaluation – Green debt instruments – Part 4: Verification programme requirements* (September 2021)).

The introduction of sustainable or green bonds into the market is relatively new, but their popularity is growing precipitously. Currently, there are no Canadian regulations established to provide verification of green bonds – only voluntary guidelines. The voluntary approach to green bond verification has resulted so far in a disjointed domestic and global market, creating ambiguity for what constitutes a green bond, and may potentially be hindering the growth of these types of financial instruments.

5 Impact of COVID-19

5.1 Has COVID-19 had a significant impact on ESG practices?

COVID-19 has triggered a global health crisis that has disrupted social and corporate networks, constrained local and global communities, and negatively impacted financial and economic markets. For certain companies and industries, COVID-19 has had a significant short-term impact on ESG practices where capital preservation caused by business disruption or uncertainty has been a priority. For most businesses, however, the impact of COVID-19 has underscored the focus on human capital and health and safety matters, as well as compensation governance, digital data, and communications management.

Indeed, many companies facing COVID-related issues were expected to shelve their ESG initiatives and displace their sustainability goals to shift their focus on emergency response plans and recovery strategies; however, a survey conducted by EY revealed the opposite. It was reported that 85% of companies are now more focused on integrating ESG and sustainability goals into their recovery strategies, compared to pre-pandemic periods (EY, Sean Harapko, *How COVID-19 Impacted Supply Chains and What Comes Next* (February 2021)). The severe disruption brought on by the global pandemic highlighted vulnerabilities and underlying problems within companies. Companies were, in turn, propelled to examine and challenge historical policies and practices with the aim of optimising and altering operational, logistic, and labour and employment strategies to become more resilient, collaborative, and connected with customers, suppliers, investors and stakeholders. Generally, these companies were able to rise to the challenge in responding to a multitude of variables, including investor demands for increased ESG performance reporting, increased customer expectations for sustainability, increased regulation from other countries, and employee desire for company engagement in ESG and sustainability initiatives.

With respect to investors, the global impact of COVID-19 has also magnified the importance of incorporating ESG factors into investment decisions in order to support and safeguard long-term investment strategies. Similarly, a survey conducted by ISS ESG of 65 leading global asset managers indicated that social issues are attracting more attention now than before COVID-19 and that governance remains a critical ESG factor in investment analysis. In accordance with the emphasis on social issues, asset managers are expecting to place more emphasis on workplace safety, employee treatment, and diversity and inclusion.

6 Trends

6.1 What are the material trends related to ESG?

As discussed above, the COVID-19 pandemic has accelerated the trend of greater ESG integration by highlighting the role of business in wider societal issues. In particular, ongoing regulatory changes, social pressures and shifting expectations for private enterprise have heightened and will continue to heighten demand for businesses to take responsibility for externalities affecting the environment and society. In fact, a recent survey of institutional investors, consultants and investment professionals conducted by RBC Global Asset Management revealed that the top ESG concerns for investors are corruption, climate change risk and shareholder rights.

Further, there is growing recognition amongst business and investment professionals that ESG issues can have a material impact on company value and management of these risks can preserve and enhance economic value for companies and their shareholders (Harvard Law School Forum on Corporate Governance, Kosmas Papadopoulos *et al.*, *ESG Drivers and the COVID-19 Catalyst* (December 2020)).

In addition to changes resulting from the COVID-19 pandemic, the Canadian corporate environment will likely continue to see an increased focus on diversity and inclusion, including increased pressure on companies to adopt meaningful targets or goals with respect to representation of women on boards and in senior positions, as well as an expansion to address representation of BIPOC communities.

Sustainability and responsible environmental practices will also continue to be in focus, with a transition towards third-party standardisation and frameworks, including verification and benchmarking. With respect to ESG factors generally, investors will likely also continue to push for better disclosure and explanation on how they integrate ESG metrics into key business strategies, and measurement and disclosure of their effects.

By way of example, issuers are increasingly highlighting their focus on relations with Indigenous communities. Millani found that 40% of the S&P/TSX Composite Index constituents with an ESG report provided disclosure on their management and approach of Indigenous relations. There has also been increased attention being paid by corporate issuers to water consumption and wastewater management – in 2020, 60% of ESG reports provided disclosure related to water use, compared to 45% in 2019. Biodiversity is another key risk for companies, with 38% of issuers with ESG reports discussing biodiversity (Millani, *Millani's Annual ESG Disclosure Study: A Canadian Perspective* (September 2021)).

6.2 What will be the longer-term impact of COVID-19 on ESG?

The COVID-19 pandemic has accelerated societal and economic change in an unprecedented way, and its long-term impacts remain uncharted. The forecasted recession and "long ascent" of global economic recovery following COVID-19 will require financial markets to display commitment and decisive action (ISS ESG, *Volatile Transitions Navigating ESG in 2021, Annual Global Outlook* (2021)). As a result of the disruption caused by the COVID-19 pandemic, investors, policymakers and key decision-makers will likely prioritise the evaluation of risk management and mitigation.

ISS ESG also highlights the growing importance of climate change and increasing awareness of biodiversity. Additionally,

the survey suggested that the pandemic has raised investor consideration around labour relations, supply chains and diversity (Investment Executive, Langton, J., *Canadian institutional investors have high hopes for ESG portfolios* (2020), https://www.investmentexecutive.com/news/research-and-markets/canadian-institutional-investors-have-high-hopes-for-esg-portfolios/?utm_source=newsletter#038;utm_medium=n; ISS ESG, *Volatile Transitions Navigating ESG in 2021, Annual Global Outlook* (2021); ISS ESG, *Volatile Transitions Navigating ESG in 2021, Americas* (2021)).

While the term "ESG" is broadly accepted in responsible investment markets, the range of issues that responsible investors are called upon to consider daily continues to expand.

Although all ESG factors remain integrated, COVID-19 appears to have shifted a greater emphasis on the social considerations of ESG over the governance and environmental aspects. Asset owners have displayed an increased focus on stewardship activities that hold companies accountable for ESG risks – especially in those sectors weakened by COVID-19. Corporate priorities have been refocused to enhance employee health and safety, to assess factors relating to employee productivity, engagement, and retention, and to consider revising work environment policies and incorporating flexible working arrangements. As a result, many employers will likely review long-term strategies to support modified work environments, enhancement of employee physical and mental health and wellness, employee workplace engagement, training or re-training, work systems, and flexible work arrangements to avoid productivity losses and to address longer-term changes in employee preferences and employment considerations.

The COVID-19 pandemic has also further strained economic disparity in societies, with the exposure of societal inequalities and workforce risks. This strain will likely increase the focus of ESG efforts on community engagement and impact, with a view to more directly facilitating positive community and societal outcomes, including diversity and inclusion, pay equity and equal opportunity.

With respect to governance, the COVID-19 pandemic may have highlighted gaps in director and senior management responses in relation to crisis management and change management, and may encourage a broader view of board and management composition requirements. These areas may include cybersecurity and digital governance, as well as human resource management and employee engagement.

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