Stikeman Elliott

Environmental, Social & Governance Law 2024 Canada

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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 environmental, social and governance ("**ESG**")-related regulations applicable to federally and provincially incorporated companies; however, the focus of this chapter is 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**"). This chapter does not address any trade or consumer protection laws that may regulate ESG matters.

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. 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 the 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 a view to 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, encompasses a duty to manage and oversee material ESG-related matters relevant to the company, particularly with respect to 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 requires 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 not only to 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 business ethics, human rights protection, anti-harassment and workplace wellness, supply chain governance, cybersecurity 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.

A recent set of corporate governance-related amendments have also steadily increased prescriptive governance regulation under the CBCA, including in respect of majority voting for directors, enhanced record-keeping, detailed disclosure relating to board diversity, and a more shareholder-friendly framework for submission of shareholder proposals. Under the recently adopted majority voting standards, nominees for board positions must receive at least 50% of the votes cast in support of their election in order to be elected. A similar policy has been imposed by the Toronto Stock Exchange ("**TSX**") for many years, although unlike the CBCA, the TSX policy affords discretion to boards to permit a director who fails majority vote to continue to serve in exceptional circumstances. Shareholders of CBCA companies may submit proposals, and CBCA issuers are required to disclose in their management proxy circular, closer to the date of the corporation's annual meeting of shareholders – the final date by which a shareholder proposal must be submitted for the following annual meeting of shareholders.

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. As noted above, 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, although they have been supplanted, to an extent, given recent changes in corporate law that have a similar effect.

There is a continuous, 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 recommended a phased approach to implementation of this new requirement based on an issuer's market cap and encouraged the CSA to implement a similar requirement across Canada. In efforts to provide further clarity and facilitate consistency and comparability among issuers, in October 2021, the CSA published the 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**"), a series of securities regulations meant to introduce disclosure requirements regarding climate-related matters for reporting issuers (other than investment funds). Governance-related proposed climate disclosure would be included in a reporting issuer's management information circular, and proposed climate disclosure related to strategy, risk management, risk metrics, and targets would be included in the issuer's annual information form ("**AIF**").

Shortly after the CSA proposal of NI 51–107 in October 2021, the International Sustainability Standards Board (the "**ISSB**") formed a sustainability standard-setting body associated with the International Financial Reporting Standards (the "**IFRS**") Foundation. As a result, the CSA largely undertook to reconsider their approach in light of the ISSB developments. These are discussed further in question 1.2 below.

One of the most noteworthy developments in ESG-related regulations has been the enactment of the *Fighting Against Forced Labour and Child Labour in Supply Chains Act,* which comes into force on January 1, 2024. The new Act applies to prescribed Canadian "entities" that produce, sell, or distribute goods in Canada, import foreign goods into Canada or control entities that do, requiring them to produce annual public reports about their corporate structure and supply chains that detail the company's actions towards eliminating forced labour and child labour. Specifically, Canadian entities cover a corporation or a trust, partnership or other unincorporated organisation that is either: (1) listed on a Canadian stock exchange; or (2) has a place of business in Canada, does business or has assets in Canada and that meets at least two of the three following size requirements based on consolidated financial statements:

- has at least $20 million in assets;
- generated at least $40 million in revenue; or
- employs an average of at least 250 employees.

The legislation also amends the *Customs Tariff* to prohibit the importation of goods produced by either forced or child labour. The annual report must be filed with the Minister of Public Safety and Emergency Preparedness (the "Minister") and published on the entity's website before May 31 of each year. Persons and entities that fail to comply with certain provisions of the Act, including a failure to file and publish their report, are guilty of an offence punishable on summary conviction and liable to a fine of not more than $250,000. Further, the Act extends liability to an entity's directors, officers, agents and mandataries to the extent that they directed, authorised, assented to, acquiesced in or participated in the commission of an offence.

The basic approach taken by Canada follows that of the UK, California, and Australia, by requiring entities to focus their disclosure on the steps they are taking to ensure that forced labour and child labour are not present in their supply chains. This "reporting" approach is less demanding than the "diligence" approach underlying the French and German legislation, which requires entities to actively investigate their suppliers and to report on the results of those investigations. However, unlike some other jurisdictions, Canada also requires that a report addressing a list of specified topics be filed with the government for publication on a searchable government website.

1.2 What are the main ESG disclosure regulations?

Reporting issuers are subject to specific reporting requirements in periodic disclosure documents, which are 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. Some 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 (the requirements of which 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 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.

To assist CBCA-incorporated issuers in addressing the CBCA disclosure requirements, Innovation, Science and Economic Development Canada ("**ISED**") have 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 reminded that they must also submit this information directly to Corporations Canada in the prescribed manner. In February 2022, Corporations Canada released further enhanced diversity guidelines to improve clarity and consistency of disclosure by federally incorporated corporations. Based on lessons learned from previous years of disclosure, the following insights were provided to help streamline the process:

- Clearly indicate the date of the diversity disclosure.
- Disclose and detail your written policy.
- Disclose and explain diversity considerations when nominating board candidates and appointing senior management.
- Disclose diversity targets.
- Disclose diversity number and percentage for each of the designated members.
- Disclose the term limits for directors.

In 2022, ISED published Canada's third annual report on the diversity of boards and senior management of federal distributing corporations, encompassing a review of 536 distributing corporations (the "**CBCA Issuers**"), namely the *Diversity of Boards of Directors and Senior Management of Federal Distributing Corporations 2022 Annual Report*. Similarly, in October 2023, the CSA also published Multilateral Staff Notice 58–316, *Review of Disclosure Regarding Women on Boards and in Executive Officer Positions (Year 9 Report)*, which summarises the review of the disclosure of 602 TSX-listed issuers with year-ends between December 31, 2022 and March 31, 2023 (the "**TSX Issuers**"). According to Staff Notice 58–316, 89% of TSX Issuers reviewed had at least one woman on their board, 27% of board seats were held by women, 71% had at least one woman in an executive officer position and 43% had adopted target for representation of women in on their board.

The CSA have also 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 *Continuous Disclosure Obligations* 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 Management Discussion and Analysis ("**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: These can arise from past or ongoing business activities that could impact the environment or 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 regarding 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 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 which 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 the 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 past 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.

With respect to specific issues related to environmental compliance, risks and opportunities, the Canadian Sustainability Standards Board ("**CSSB**") recently indicated that it will work with the ISSB to support the uptake of the new sustainability disclosure standards (the "**ISSB Standards**") released in June 2023. The ISSB released its first two sustainability disclosure standards (the "**ISSB Standards**"), which are designed to ensure that entities provide sustainability-related information alongside financial statements in the same reporting package and for the same reporting period. IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium, and long term. This includes the approach, governance processes, controls, and procedures an entity uses to monitor and manage sustainability-related risks and opportunities, the processes an entity uses to identify, assess, prioritise and monitor sustainability-related risks and opportunities and an entity's performance in relation to sustainability-related risks and opportunities. IFRS S2 requires disclosure of climate-related risks and opportunities that could reasonably be expected to affect an entity's prospects. Climate-related risks include both physical risks (i.e., risks that arise from weather-related events such as storms, floods or droughts) and transition risks (i.e., policy, legal, technological, market or reputational risks that arise from efforts to transition to a lower-carbon economy). While Canadian entities are not currently required to comply with the ISSB Standards, there has been broad support in Canada and globally for the development and adoption of consistent and comparable sustainability disclosure requirements. In July 2023, the CSA announced that they welcome the publication of the ISSB Standards and commend the ISSB for developing a global framework for investor-focused disclosure that is responsive to market demand for more consistent and comparable disclosures.

However, timing and scope of implementation will continue to be considered by the CSSB for Canada (Canadian Securities Administrators statement on proposed climate-related disclosure requirements, July 5, 2023).

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 resource 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 survey of the disclosure practices of the S&P/TSX Composite Index constituents indicates that 80% of companies released a sustainability report (or ESG report) in 2021, while corporate S&P/TSX 60 issuers with dedicated ESG reports remained at 92% in 2021 (Millani, *Millani's 6th Annual ESG Disclosure Study: A Canadian Perspective,* September 2022).

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. No further action was taken by Corporations Canada following those consultations.

Consistent with the Ontario Taskforce's recommendation 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 those within the LGBTQ+ community during the nomination process", the CSA has recently proposed amendments to expand the current requirement to focus on diversity beyond gender. This includes disclosure on aspects of diversity beyond the representation of women, with the intention to elicit meaningful insight about how non-venture issuers identify and evaluate new candidates for nomination to the board, how they address board renewal, and how diversity is incorporated into those considerations. It is also intended to provide investors with decision-useful information that enables them to better understand how diversity ties into an issuer's strategic decisions and encourages issuers to better articulate their corporate governance practices related to board nominations,

board renewal and diversity. Notably however, members of the CSA have published alternative proposals. One group favours a more flexible approach that allows issuers to determine which "identified groups" are relevant to their operations, accompanied by narrative disclosure on diversity objectives and mechanisms. The other group, led by the Ontario Securities Commission, advocates for disclosure in respect of prescribed "designated groups" and more prescriptive and standardised disclosure imposed on all issuers (Notice and Request for Comment on amendments to Form 58–101F1 Corporate Governance Disclosure of National Instrument 58–101 *Disclosure of Corporate Governance Practices* and proposed changes to National Policy 58–201 *Corporate Governance Guidelines* pertaining to director nomination process, board renewal and diversity, April 2023).

As noted above, the CSA and the CSSB also continue to consider how and when the recently released ISSB Standards will be implemented in Canada.

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 Global Reporting Initiative ("**GRI**"), the Dow Jones Sustainability Index, the ISS ESG, the MSCI ESG Index, and Sustainalytics began to develop**.** This also correlated 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. The publication of the two inaugural standards published by ISSB regarding sustainability and climate-related disclosure is a notable development in this respect for issuers as the standards are meant to provide a global reporting framework that seeks to meet investors' and market participants' expectations.

In 2020, 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 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. The recent publication of the ISSB Standards is considered by Canadian institutional investors to be a significant positive step consistent with these sentiments (Millani, *Semi-Annual ESG Sentiment Study of Canadian Institutional Investors*, August 23, 2023). 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 (or in opposition) of those views?

Asset managers across several 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 regarding environmental stewardship and management, and thus require reports or disclosure responsive to these concerns in order to inform their investment decisions. However, there are a range of approaches taken to apply their principles to investing decisions, which may include the implementation of screens or exclusions through the restriction of investments in certain sectors (such as tobacco or weapons manufacturing), to full ESG integration into investment analysis. As the correlation between ESG and value-generation becomes increasingly recognised, the implementation of full ESG integration becomes more widely accepted. In this respect, a recent survey indicates that 88% of Canadian institutional investors have identified ESG integration into the investment process as the method they prefer for investing sustainably (Schroders, *Sustainability North America Institutional Investor Study, 2022*). Interestingly, the ESG pushback in the U.S. has not translated materially into changes in Canadian institutional investors' investment approach, with almost 90% of 40 asset owners and managers representing over CA $5.8 trillion in assets under management surveyed by Millani staying the course (Millani, *Semi-Annual ESG Sentiment Study of Canadian Institutional Investors*, August 23, 2023). Asset managers also exert influence through direct and indirect engagement, including through the implementation of proxy voting policies and policy-based voting; and as a result, 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 Public Sector Pension ("**PSP**") Investments are among some of the global leaders participating in the ESG Data Convergence Initiative with the aim of advancing an initial standardised set of ESG metrics and a mechanism for comparative reporting. Initiated by the California Public Employees' Retirement System and the global investment firm Carlyle, the collaboration efforts of the ESG Data Convergence Initiative 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 initiative is to provide opportunities for deeper analysis and correlative studies between ESG factors and financial outcomes, in the hopes of ultimately resulting in more meaningful benchmarking and highlighting the more critical ESG issues with the potential for greater impact. The ESG Data Convergence Initiative examines the following initial six metrics: Scopes 1 and 2 greenhouse gas emissions; renewable energy; board diversity; work-related accidents; net new hires; and employee engagement.

Further, in October 2021, more than 20 financial organisations in Quebec signed the Statement by the Quebec Financial Centre for a Sustainable Finance which aimed 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 signatories 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 (or in opposition) of those views?

Stakeholder views on responsible investment and ESG remain strong, with a growing focus on biodiversity and greenwashing. In a 2022 survey conducted by the Responsible Investment Association (the "**RIA**"), 64% of respondents were interested in responsible investment, although indicating a decline in interest since 2021 when 73% indicated an interest. Of that percentage, the topic of biodiversity loss resonated most with respondents. The majority of respondents were concerned about biodiversity loss, with 74% of respondents saying they were either very or somewhat concerned. 68% of respondents also indicated that it was important or somewhat important for companies in their portfolios to be committed to preventing the loss of biodiversity in the way they conduct their business, with 32% believing that companies will be worse off in the future if they do not manage these risks. As a result of this growing awareness surrounding the importance of decreasing and reversing biodiversity loss, there is the potential for companies to face stricter regulations, changes to consumer preferences, and potential damage to their reputation or brand, if they fail to manage the risks of biodiversity loss, all of which could impact their bottom line (Responsible Investment Association, *2022 RIA Investor Opinion Survey – Canadian Investor Perspectives on Responsible Investing, Biodiversity & Greenwashing,* 2022).

Investors' concerns about biodiversity loss are also accompanied by widespread concerns about greenwashing which presents challenges for individual investors, their advisors and fund manufacturers. Greenwashing was defined as false information that is distributed by an organisation to make it look more environmentally responsible than it actually is. 75% of the surveyed institutional investors ranked "mistrust/concerns about greenwashing" as the top perceived deterrent to the growth of RI, with 78% agreeing that there needs to be increased regulation and scrutiny in the investment industry to combat greenwashing.

In 2023, a management-supported proposal at Cenovus Energy, requiring that the company publish a report regarding its lobbying and public policy advocacy alignment *vis-à-vis* its net zero goal, received 99% support. It is also notable that proposals made at the meetings of two Canadian banks requesting third-party racial audits garnered significant support with 38% and 42% of votes supporting them (John Vizikas, 2023 Canada Proxy Season Recap, ISS Governance, August 25, 2023). Also worth mentioning are the shareholder proposals on climate plans submitted at the meeting of the six largest Canadian banks in 2023 with support ranging from 16% to 21%, a similar figure as in 2022, further discussed in question 2.7 below.

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

Leaving aside the Competition Bureau, which has the power to review, investigate and enforce environmental claims, the principal regulators of ESG issues are the CSA, the TSX, and the Canadian Federal Government through amendments to the CBCA. The Office of the Superintendent of Financial Institutions ("**OSFI**") also acts as regulator for federally regulated financial institutions ("**FRFIs**"). 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 February 2022, the CSA published *Staff Notice 81-334 ESG-Related Investment Fund Disclosure* (the "**Staff Notice**"), which seeks to clarify and explain how existing regulatory requirements apply to ESG-related fund disclosure, without creating any new obligations. Specifically, the Staff Notice provides guidance on how existing disclosure regulations apply to ESG-related funds, including in respect of the following:

- **Investment objectives and fund names**. According to the Staff Notice, to prevent greenwashing, the fund's name and description of its investment objectives should "accurately reflect the extent to which the fund is focused on ESG".
- **Fund types**. The CSA note that while not required, a fund may want to, where relevant, identify itself as a fund that focuses on ESG in addition to its primary fund type (i.e., an ESG Canadian equity fund, ESG Global equity fund, etc.).
- **Disclosure of investment strategies**. The requirement that a fund's prospectus disclose its investment objectives and processes applies to ESG-related objectives and strategies. As such, a fund is required to provide adequate disclosure about the ESG-related aspects of its investment strategies and selection process.
- **Proxy voting and shareholder engagement**. Where a fund uses proxy voting as an ESG investment strategy, it must include a summary of the ESG aspects of the proxy voting policies and procedures. While funds are not required to disclose their shareholder engagement policies, the Staff Notice encourages funds to provide transparency with regard to the scope and nature of shareholder engagement as an ESG strategy.
- **Risk disclosure**. Funds should consider whether there are material risks associated with its ESG strategies and disclose where applicable. Such ESG-related risks may include concentration risk and the risk of underperformance due to the fund's ESG focus or reliance on third-party ESG ratings.
- **Suitability**. According to the CSA, a fund's suitability statement should "accurately reflect the extent of the fund's focus on ESG" and, where applicable, the specific aspects of ESG on which the fund focuses. Where appropriate, the suitability statement may state that the fund is suitable for ESG-focused investors, provided such statement accurately reflects the ESG aspects of that fund.
- **Continuous disclosure**. A fund's annual and interim management reports of fund performance must, among other things, disclose how the fund's portfolio composition, and changes to composition, relate to the fund's ESG-related investment strategies and objectives. Further, as funds with ESG-related objectives will also aim for ESG-related outcomes, the Staff Notice encourages funds to disclose performance indicators towards achieving these outcomes.
- **Sales communications**. CSA Staff consider sales communications which fail to accurately reflect the extent to which a fund is focused on ESG, as well as the particular ESG aspect(s) the fund focuses on, to be misleading. According to the Staff Notice, examples of misleading disclosure may include suggesting that a fund is focused on ESG when it is not, misrepresenting the extent and nature of the fund's use of ESG strategies, and making inaccurate claims about the fund's ESG performance or results. Further, guidance is provided related to accurately providing fund-level ESG ratings, scores or rankings.

- **ESG-related terminology**. Funds using ESG-related terms that are not commonly understood should clearly explain the terms in plain language.

Since the publication of the Staff Notice, there has been a significant increase in the number of investment fund managers ("**IFMs**") that include disclosure about environmental, social and governance ("**ESG**") factors and strategies in the prospectuses of their funds. However, for many of these funds, the consideration of ESG factors plays only a limited role in the fund's investment process with some only considering ESG factors as one of the many inputs in their risk management process. The CSA intend to continue monitoring disclosure documents and marketing materials and consider "future policy initiatives" as appropriate.

Another notable development is the publication by the OSFI of the Guideline B-15: *Climate Risk Management* in March 2023, which sets out OSFI's expectations for the management of climate-related risks. The Guideline is OSFI's first prudential framework that is climate sensitive and recognises the impact of climate change on managing risk in Canada's financial system. Specifically, the guideline states the OSFI's governance, accountability structure and risk management expectations for climate-related risks. It also reinforces its climate risk management expectations by providing guidance regarding climate-related financial disclosure expectations. In particular, OSFI use climate – related financial disclosures to meet its mandate of protecting depositors, creditors, and policyholders, and contributing to public confidence in the Canadian financial system, by ensuring relevant information is publicly available to enable understanding of FRFIs' financial condition and the risks to which they are exposed.

Additionally, in the most recent Federal Budget, the government released their plan to move towards the mandatory reporting of climate-related financial risks in 2024, in accordance with the TCFD framework. The OSFI will consult federally regulated financial institutions and require them to publish climate disclosures that are aligned with the TCFD framework beginning in 2024.

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 and any potential enforcement actions from the Competition Bureau, which will not be covered herein, 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. As part of the preparation of Staff Notice 81–334 discussed above, the CSA conducted a review of 32 funds managed by 23 fund managers. The review identified a number of issues regarding the disclosure of investment strategy, proxy voting strategy and changes to portfolio composition. Those findings led the CSA to conclude that clarification was needed on how existing disclosure requirements apply to ESG-related funds. Recently, a complaint was filed by a group of investors with the Alberta Securities Commission requesting that the regulator investigate into alleged misleading statements made by an issuer in a recent sustainability-linked bond ("**SLB**"), and to issue guidance as to how issuers should to structure their SLB targets. The complaint reflects the concern of market participants that SLBs can be structured with targets that are unambitious so as to allow issuers to reach them and benefit from lower borrowing costs.

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 within the financial market along with regulatory requirements, there is increasing pressure for companies to ensure the adoption 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 as to 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.

In November 2021, Greenpeace Canada filed a complaint with the Competition Bureau, Canada's competition regulator, alleging that Shell violated the federal Competition Act by making false or misleading representations with their Drive Carbon Neutral products. Greenpeace Canada has argued that Shell's "carbon neutral" claim is not substantiated, and disputed the validity of its carbon offsets. Greenpeace Canada also submitted a complaint to the Competition Bureau of Canada in March 2023 alleging that the Pathways Alliance's "Let's clear the air" advertising campaign makes false and/or misleading representations to the public. Specifically they argue that: (1) the Pathways Alliance net-zero plan fails to incorporate the life-cycle of their product and does not account for more than 80% of their emissions, meaning that their own calculations do not result in them achieving net zero; (2) despite claiming they are making strides towards net zero, they are expanding their fossil fuel production; (3) technology to face their carbon capture and sequestration project are speculative; and (4) their representations give the impression that Pathways is a climate leader, but individually and through industry affiliation, Pathways members have advocated, advertised, and/or spoken against climate action in Canada. While the *Shell* case is still before the Competition Bureau as of October 2023, the Pathways Alliance's case has set off an official inquiry as of May 2023.

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 the risk of litigation. 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, Indigenous Peoples, private citizens and environmental non-governmental organisations. In the *Thomas and Saik'uz v. Rio Tinto Alcan Inc.* decision released in January 2022, the British Columbia Supreme Court confirmed that third-party proponents can be held liable for torts affecting a First Nations' established

or claimed Aboriginal rights and title if these entities exceed the bounds of its regulated authority. Saik'uz First Nation and Stellat'en First Nation claimed in nuisance and for breach of riparian rights against Rio Tinto for the diversion of water from the Nechako watershed, which depleted Nechako white sturgeon, sockeye and chinook salmon fish stocks. They claimed that their Aboriginal right to fish for food and for use for social and ceremonial purposes was impaired. Rio Tinto successfully argued that such statutory authorisation was constitutionally valid and permitted them to commit the nuisance, and that they were not responsible for British Columbia ("**BC**") authorising the construction and operation of the Dam despite knowing it would affect fish population in the Nechako watershed.

As seen in 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.

Additionally, as discussed above, OSFI has adopted Guideline B-15: *Climate Risk Management* in March 2023, which sets out its expectations for the management of climate-related risks. Further, OSFI will consult federally regulated financial institutions and require them to publish climate disclosures that are aligned with the TCFD framework beginning in 2024. These developments will place federally regulated banks and insurers at an increased risk of litigation relating to misrepresentation of claims, deceptive trade practices and securities fraud.

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

The lack of standardisation continues to be a key issue for proponents of ESG with a push towards the adoption of standardised methodologies or frameworks. However, the publication of ISSB's two inaugural standards in June 2023 will likely change the landscape for Canadian issuers. Although the ISSB standards are not binding in Canada, the support their publication received from the CSA suggest that they will make their way into the legal regime over the coming years.

There is also 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 the 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 become the norm rather than an exception to it (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. A recent survey of prominent asset owners and managers reveals that biodiversity is cited as the second most important ESG topic by investors, followed by human capital and human rights (including Indigenous rights and reconciliation), ahead of EDI (Millani, *Semi-Annual ESG Sentiment Study of Canadian Institutional Investors*, August 23, 2023). Proponents of ESG are also continuing to press for incentive-based compensation structures that reward executives for incorporating and achieving ESG metrics with a focus on health and safety measures. Large-cap issuers are increasingly paying heed to these demands, with about 75% of TSX60 companies having formally incorporated ESG metrics in compensation plans or disclosed their intention to do so in 2023 (Hugessen Consulting, *ESG in Compensation: Learnings from the 2023 Proxy Season,* September 2023). 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 have roiled large corporations in recent years have shown, malicious cyber activity can inflict serious financial, operational and reputational harm on firms. The continuing impact of the global COVID-19 pandemic is adding another layer of cybersecurity risk with the continued reliance on a remote-working environment, which will likely prevail to a large extent in the long-term. The hybrid work structure, which still includes some form of work from home, continues to create new potential avenues for unauthorised access to company data and information technology systems by hackers and cyber criminals. In the U.S., the Securities and Exchange Commission has recently adopted new rules requiring the disclosure of cybersecurity risk management, strategy, governance, and material incidents. Effective September 5, 2023, the Rules apply to U.S. domestic companies and foreign private issuers ("**FPIs**"). FPIs, including those eligible for the U.S.-Canada Multijurisdictional Disclosure System ("**MJDS**"), must furnish, on Form 6-K, information on material cybersecurity incidents that they disclose in a foreign jurisdiction to any stock exchange or securityholder. The Rules also require enhanced disclosure of a company's cybersecurity risk management and governance in annual reports on Form 20-F. Canadian issuers eligible to use MJDS are permitted to use Canadian disclosure standards and documents to satisfy the SEC's registration and disclosure requirements. Against this backdrop, it is likely that the application of the new SEC rules will provide guidance to Canadian issuers regarding their cybersecurity disclosure.

2.7 Have ESG issues attracted shareholder activism, and from whom?

The dominance of environmental and social shareholder proposals in 2021 and 2022 has continued into 2023, with 47 proposals already submitted to a vote at Canadian companies between January to June compared to 67 proposals submitted in total in 2022. While climate-related activism is trending to become a key issue for reporting issuers, the results of shareholder initiatives throughout the 2023 proxy season thus far, has unfortunately yielded little success. Despite Canada trending towards a relatively elevated number of shareholder proposals compared to previous years, only one shareholder proposal garnered majority support so far this year. This shareholder proposal, requesting that the company produce a report on climate lobbying, was also supported by management, making its approval a virtual certainty. Other shareholder proposals concerning climate-related matters saw moderate support

levels in Canada this year, ranging anywhere between 4%–29% support. Further, shareholder proposals requesting the adoption of say-on-climate votes saw a decline in support, from 22% in 2022 to 19% in 2023. These climate-related trends suggest that momentum behind the adoption of say-on-climate votes appears to be stalling. Further, regarding broader ESG matters, Canada's first so-called anti-ESG shareholder proposals only received around 1% of shareholder support. On the social side, the strongest support for a shareholder proposal was seen at two financial service companies, RBC and BMO, requesting they publish third-party racial equity audits. The proposal garnered 42% support at RBC and 38% at BMO.

3 Integration of ESG into Strategy, 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 growth in the trend towards companies providing 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. There is, however, no "one-size-fits-all" approach for allocating ESG oversight responsibilities among the board and its committees and the delegation of responsibilities may change over time. Board oversight of ESG issues can reside with the full board, an existing board committee (i.e. audit committee), or a newly formed, dedicated ESG committee. It can also be shared by the full board and one or more committees or by multiple committees covering ESG issues that fall within their charter mandates and/or policies. Companies may also use a combination of these approaches. Moreover, as many companies move to adopt a more holistic approach to integrating ESG metrics into their corporate frameworks, it is more common to see the addition of Chief Sustainability Officers to the executive teams as the need for collaborative oversight across business units increases. Ultimately, it depends on the size, industry and culture of the organisation.

As we see investors push for greater ESG disclosure, proxy advisor firms have also made changes to their guidelines that influence how management, boards and board committees make decisions. Current as of 2023, Glass Lewis has indicated that if there is evidence suggesting that environmental and/or social issues have been improperly manged or mitigated, it may recommend that shareholders vote against the members of the board who are responsible for oversight of environmental and/or social In addition, current as of 2023, for companies in the S&P/TSX Composite Index, Glass Lewis will recommend voting against the governance committee chair unless the company has provided explicit disclosure outlining the board's role in overseeing environmental and social ("**E&S**") issues. Glass Lewis' policy related to climate risk also requires that companies, particularly those whose financial position may be impacted by greenhouse gas emissions, disclose how they are mitigating and overseeing climate risk. Glass Lewis may recommend voting against board members responsible for overseeing climate-related matters in the case of failure to provide explicit disclosure relating to climate-related issues as recommended by the Task Force on Climate-related Financial Disclosures and/or concerning the board's role in overseeing E&S matters (Glass Lewis 2023 Policy Guidelines).

Regarding 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 held on or after February 1, 2023, ISS considers in its vote recommendations, among other things, the existence of significant controversies, fines, penalties, or litigation associated with the company's practices relating to issue(s) relating to environmental or social practices raised in a company's proposal. Effective for meetings held on or after February 1, 2023, with respect to companies which are significant GHG emitters, through their operations or value chain, ISS will generally recommend voting against, or withhold from the incumbent chair of the responsible committee, in cases where it determines that the company is not taking the minimum steps needed to understand, assess, and mitigate risks related to climate change to the company and the larger economy. With respect to management or shareholder-sponsored say on climate proposal, ISS takes a case-by-case approach taking into account factors such as the completeness and rigor of the plan. Effective for meetings on or after February 1, 2024 and subject to certain exceptions, for companies in the S&P/TSX Composite Index, ISS will generally vote against, or withhold from the chair of the nominating committee, or chair of the committee designated with the responsibility of a nominating committee, or the chair of the board of directors, if no nominating committee has been identified or no chair of such committee has been identified, where the board has no apparent racially or ethnically diverse members (Institutional Shareholder Services, *Canada, Proxy Voting Guidelines for TSX-Listed Companies Benchmark Policy Recommendations* (December 2022); Institutional Shareholder Services, *Canada, Proxy Voting Guidelines for Venture-Listed Companies Benchmark Policy Recommendations* (December 2022)).

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

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. As mentioned previously, oversight may be achieved through an already existing board 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. Stikeman Elliott's internal 2023 study found that 23 of the S&P/TSX 62 issuers have "specialised" committees related to corporate social responsibility and health, safety and environment. As stakeholders delve deeper and demand more transparency into the oversight and management of ESG issues, boards and senior management are better positioned to articulate the rationale behind how ESG is incorporated into their reporting frameworks, how ESG is integrated in the development of corporate policy and evaluation of performance metrics, and how ESG reporting metrics influence the evolution of a company's corporate strategy.

Generally, a board and board committees are responsible for setting and developing a company's overall ESG strategies whereas senior management is responsible for overseeing the

implementation and reporting of the company's ESG strategy. 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 about 76% of the TSX 60 constituents implementing at least one ESG metric into their incentive plan, with an average weight of 20% which is consistent with the past few years. Notably, industrials and energy and materials companies are leaders in implementing environmental metrics into incentive plans. One of key themes present among TSX60 companies of all industries has been a focus on incorporating EDI, as well as environmental- and climate-related metrics within their incentive programmes (Hugessen Consulting, *ESG in Compensation: Learnings from the 2023 Proxy Season*, September 2023). While these are more commonly 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 human capital and employee engagement. A significant number of Canadian companies listed on the S&P/TSX Composite link ESG performance to executive compensation in some manner. In general, the two main ESG themes identified in compensation plans across sectors are: (1) climate change; and (2) diversity, equity and inclusion. Notably, Canadian banks have emerged as global leaders in creating ESG-linked incentive structures for executives, and were highlighted by *Sustainalytics* in 2021 as being among the 9% of companies in the FTSE All World Index to tie executive incentives to ESG (Responsible Investment Association, *ESG in Executive Pay: A Look at the Big Canadian Banks*, May 2022).

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 different 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, implementing higher reporting standards for suppliers to increase visibility and supply chain traceability, thoughtful recruiting and hiring practices, increasing health and safety reporting practices and incorporating employee feedback to enhance safer work environments, stakeholder and Indigenous relations, benchmarking and disclosure, financing, and integration into and reporting against achievement of business objectives. A more recent development in this area is the impact on portfolio composition and "integration into compensation incentives".

3.5 How have boards and management adapted to address the need to oversee and manage ESG issues?

As ESG topics expand and mature, and investors and proxy voting advisory firms continue to demand that companies incorporate and advance ESG strategies across industries and disciplines, boards and management need to stay current on the evolution of ESG topics to meaningfully respond to its stakeholders. The broad application of ESG can seemingly be challenging to manage, but it is widely recognised that there is no uniform solution on how a company should integrate ESG into its operations and framework. However, boards and management that spend time on identifying and prioritising key ESG issues that relate to and impact their primary operations are better positioned to collect data and report on meaningful advancements of their ESG strategies.

Sophisticated stakeholders will not be satisfied with mere declarations of ESG strategies and targets, and will probe boards and management for data and demonstrable results towards these strategies and targets. Therefore, boards and management that are charged with ESG oversight are increasing the frequency and scope of data collection with the aim of demonstrating the depth and transparency of their ESG reporting, in order to integrate appropriate ESG strategies and targets into their company standards and to guide their business objectives and activities. Boards continue to rely on existing committees to address ESG challenges (Spencer Stuart, *2022 Canada Spencer Stuart Board Index*).

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. Those frameworks are, however, different depending on the financing instrument. For example, 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. Securitisation bonds are the third type of green bond. These bonds are collateralised by a pool of loans issued to fund numerous green projects. Green bonds are typically issued and monitored following specific frameworks that align with the Green Bond Principles, introduced by the International Capital Market Association ("**ICMA**"). A green bond framework is a document created by the issuer that clearly articulates the company's proposed use of proceeds for the bond. This disclosure enables investors to better assess the green eligibility of the projects and make more informed investment decisions (International Capital Market Association, *Green Bond Principles, Voluntary Process Guidelines for Issuing Green Bonds*, June 2021). It is usually recommended that issuers obtain a second-party opinion on their green bond framework from an external review provider to confirm its alignment with the four components of the Green Bond Principles (Sustainalytics, a Morningstar Company, *Second-Party Opinion Plans*, 2023). Though these principles are voluntary, they promote transparency, clarity and integrity around sustainable finance projects and how the environmental objectives will be achieved. Issuers who intend to launch a green bond are required to build a green bond framework, which should align to the following four components as specified under the Green Bond Principles (Chartered Professional Accountants Canada, *How to Ensure Finance Drives a Sustainable Economy*, 2023).

- **Use of proceeds:** proceeds of a green bond need to be used to finance or re-finance green projects. These projects should contribute to environmental objectives such as climate change mitigation, natural resource conservation, and pollution prevention and control.
- **Process for project evaluation and selection:** green bond issuers should clearly communicate the environmental sustainability of the projects to their investors. This includes the environmental objectives of the project, the process by which an issuer determines the green eligibility of the project and the process to manage any potential material, environmental or associated social risks. A high level of transparency into the issuer's overall objectives, strategy and policy is also encouraged.
- **Management of proceeds:** proceeds (funds) must be managed properly in a sub-account, a sub-portfolio, or the issuer must demonstrate that there is a formal internal process to manage those funds. This process should be linked and aligned to the lending or investment operations for green projects.
- **Reporting:** issuers are required to report on the allocation of proceeds to eligible green projects. This is usually communicated in an annual report where the issuer can specify the list of green projects, provide a brief description of the projects, and stipulate the respective allocations. The issuer may also report on the expected impact of its green bonds.

When there is an intentional mix of environmental and social benefits, the bond is referred to as a sustainability bond, for which the ICMA provides a separate set of guidelines, namely Sustainability Bond Guidelines (International Capital Market Association, *Sustainability Bond Guidelines*, June 2021).

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. Instead, sustainability-linked bonds are linked to the performance of certain key performance indicators in achieving pre-defined sustainability performance targets, and depending on whether this is achieved, certain characteristics of the bonds may vary (e.g., coupon ratchet). 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.

The Sustainability-Linked Bond Principles ("**SLBP**") are voluntary process guidelines which recommend structuring features, disclosure and reporting for sustainability-linked bonds. They are intended for use by market participants and are designed to drive the provision of information needed to increase capital allocation to such financial products. The SLBP are applicable to all types of issuers and any type of financial capital market instruments. The SLBP are collaborative and consultative in nature based on the contributions of members and observers of the Green Bond Principles ("**GBP**") and the Social Bond Principles ("**SBP**") (referred to as "**the Principles**"), and of the wider community of stakeholders. The SLBP recommend a clear process and transparent commitments for issuers, which investors, banks, underwriters, placement agents and others may use to understand the financial and/or structural characteristics of any given SLB. The SLBP have five core components:

1. Selection of Key Performance Indicators ("**KPIs**").
2. Calibration of Sustainability Performance Targets ("**SPTs**").
3. Bond characteristics.
4. Reporting.
5. Verification.

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 are typically 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) (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. The global green bond market is continuing its growth with more than half of a trillion dollars in issuance for the first six months of 2023, up by almost 20% compared to the same period in 2022 (Bloomberg, Green bonds boom in first half of 2023, July 27, 2023).

The issuance of Canadian green bonds has traditionally been led by public sector issuers (Responsible Investment Association, *Green Bonds – Fact Sheet for Investors,* February 2019), including ISED and subnational issuers in Ontario and Quebec. In this respect, the recent Government of Canada *Green Bond Framework* is a notable development (Government of Canada,

Green Bond Framework, March 2022). The Framework aligns with the Government's climate and environmental priorities and identifies those expenditures that are eligible for allocation to a green bond. Its core components deal with use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. Both the framework and the allocations of proceeds are subject to independent external review. Against this backdrop, the Government of Canada issued its inaugural CA$5 billion green bond in March 2023. In addition to the public sector, 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.

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.

With 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 as to 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. Given investors' expectations and sophistication, issuers are pressured to enhance transparency and provide more robust contractual commitments.

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

As discussed above, the 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. According to the ICMA framework, the four principles applicable to Green Bonds, which are also applicable to Social and Sustainability bonds, include the use of proceeds, process for project evaluation and selection, management of proceeds, and reporting.

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), which 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).

Currently, no Canadian regulations have been 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 as to what constitutes a green bond, and may potentially be hindering the growth of these types of financial instrument.

5 Trends

5.1 What are the material trends related to ESG?

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. Part of this is a continued focus on biodiversity. Private-sector initiatives have focused on best practices around biodiversity, such as the Cross-sector Biodiversity Initiative, which is a partnership between the Equator Principles, a financial sector industry association, the International Council on Mining and Metals ("**ICMM**"), a mining industry association, and Ipieca, a global oil and gas industry association. In Canada, there is an ongoing dialogue between mining companies and institutional investors, namely through the Mining Association of Canada, regarding biodiversity and conservation, with the goal of aligning companies' disclosure with investors' expectations in this area (Millani, *Biodiversity, Finance et Mining: Understanding the link*, September 2023).

Furthermore, ESG-related matters are increasing in prominence within the due diligence phase of mergers and acquisitions ("**M&A**") transactions. Specifically, buyers in M&A transactions are considering more ESG-focused representations and warranties. In these cases, the representing party, usually the target, makes a statement related to ESG matters, which typically takes the form of clauses to be included alongside labour and employment representations in M&A agreements. In addition, representations made by target companies to comply with specific codes or principles are also increasing in popularity. Examples of this type of representation include precious metals miners adhering to the Responsible Gold Mining Principles developed by the World Gold Council and carbon-intensive companies being required to abide by the TCFD framework. A similar increase in focus is also impacting public M&A transaction considerations.

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 the 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 as to how they integrate ESG metrics into key business strategies, and measurement and disclosure of their effects.

In light of the developments discussed above, ESG considerations are now part of the governance and strategic landscape of Canadian publicly-listed companies. Thus, issuers are getting ready to meet the formal reporting requirements on the horizon. Issuers' preparation pays heed to the fact that ESG considerations involve all of their stakeholders, and can raise litigation as well as reputational risks that must be taken into account.

Going forward, a number of trends are appearing on the horizon. The first is the fact that carbon neutrality as a goal is evolving in favour of being "climate positive", which requires companies to create an environmental benefit by removing carbon dioxide from the atmosphere. A second trend speaks to the current state of the labour market which leads many companies to increase their focus on employee satisfaction, productivity, and retention. Another trend concerns supply chain management. In the aftermath of the COVID-19 pandemic, global supply chains have been under stress across all sorts of commodities and goods. The rising cost of energy and materials, in addition to the geopolitical instability, including the ongoing wars in Ukraine, has further impeded the supply chains. These difficulties have forced many large companies to re-evaluate their strategy for engaging suppliers and the general layout of their supply chains in order to be more resilient. Lastly, investors', consumers' and citizens' scrutiny of companies' actions *vis-à-vis* their reporting has significantly increased, raising the stakes for companies that engage in greenwashing.

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