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ESG update: Appetite for enhanced climate and diversity disclosure gaining steam in Canadian capital markets

June 22, 2023 | Ian Polisuk, Simon Igelman, Jennifer Jeong

Introduction

Earlier this year, Miller Thomson published an article that examined notable environmental, social and governance ("**ESG**") disclosure requirements mandated by securities regulators and encouraged by proxy advisory firms.[1] Subsequently, there have been significant developments pertaining to board diversity and environmental risk disclosure requirements applicable to public companies. Due to the absence of standardized ESG reporting requirements, it is imperative for directors to stay informed about emerging trends in ESG-related matters. This article reviews recent developments in securities regulations applicable to board diversity requirements and environmental risk disclosure and explores the evolving emphasis placed by investors and stakeholders on ESG factors.

ESG themes in 2023 securities regulations: continued focus in climate and diversity

National Instrument 58-101 – Disclosure of Corporate Governance Practices ("**NI 58-101**") establishes regulations for public companies focused on enhancing corporate governance transparency, but it does not explicitly outline ESG requirements. In order to complement NI 58-101, regulators have provided guidance on ESG practices that are relevant to its implementation. Generally, regulators have prioritized board diversity and the disclosure of climate change-related information. However, recent suggestions provided by regulators indicate a burgeoning interest in adopting more comprehensive disclosure requirements.

(a) The Ontario Securities Commission's ("OSC") approach to diversity disclosure

On April 13, 2023, the Canadian Securities Administrators ("**CSA**") released proposed amendments to Form 58-101F1 (the "**Proposed Amendments**"),[2] which build upon the "comply or explain" disclosure requirements[3] introduced in 2014. The 2014 updates to Form 58-101F1 mandate non-venture issuers to disclose whether the issuer has adopted a written policy regarding the identification and nomination of female directors, including details of the issuer's objectives and practices, to ensure its policies are effectively implemented. Non-venture issuers include reporting issuers listed on the Toronto Stock Exchange, Cboe Canada (formerly, the NEO Exchange), a United States stock exchange (including the New York Stock Exchange and the Nasdaq) and certain market places outside of Canada and the United States.[4] The 2014 updates also require disclosure on whether issuers have adopted targets, such as a number or percentage, or a range of numbers or percentages concerning the representation of females on the issuer's board and executive officer positions.[5] If the issuer has not adopted such policies or targets, they must provide reasons for their absence. Furthermore, issuers regulated under the *Canada Business Corporations Act* ("**CBCA**") are required to adhere to the "comply or explain" disclosure model in reference to their board and senior management composition for designated groups, including Aboriginal peoples, persons with disabilities, members of visible minorities and women.[6]

The CSA is currently seeking public comments on the Proposed Amendments, which offer two potential options for diversity disclosure applicable to non-venture issuers, designated "Form A" and "Form B". Form A grants issuers the flexibility to tailor their diversity practices and policies, allowing customization according to their needs. It does not impose the requirement to report data on specific diversity groups other than gender-related information.[7] The second approach, Form B, prescribes disclosure regarding the representation of designated groups on boards and in executive officer positions, including females, Indigenous peoples, racialized persons, persons with disabilities, and LGBTQ2SI+ persons. This reflects the approach outlined in the CBCA, with the addition of a mandated category for LGBTQ2SI+ persons. Specifically, it requires the issuer to disclose its written strategy to achieve or maintain diversity on the board, including any policies pertaining to board diversity amongst the designated groups.[8] This aims to provide investors with comparable statistical data among issuers by proposing designated categorizations of historically under-represented groups.

The OSC has openly expressed support for the approach taken in Form B. This stance is in line with the OSC's endorsement of more extensive diversity disclosure requirements, as stated in its 2023-2024 Statement of Priorities ("**SOP**").[9] The OSC expressed its commitment to incorporating Indigenous perspectives into securities regulations and ensuring a distinct Indigenous category separated from a "catch-all" diversity category.[10] Adopting the Form B approach of the Proposed Amendments would advance the aforementioned goals.

The comment period for the Proposed Amendments is set to expire on July 12, 2023.

(b) Expanding beyond climate-related disclosure

On October 18, 2021, the CSA provided an update to its 2019 Staff Notice 51-358[11] introducing the Proposed National Instrument 51-107 – Disclosure of Climate Related Matters ("**Proposed NI 51-107**"), aiming to establish consistent and comparable standards for Issuers' climate disclosures.[12] It refers to the Task Force on Climate-Related Financial Disclosure ("**TCFD**") Recommendations, which provide guidelines as to how issuers should disclose climate-related factors across four core themes: governance, strategy, metrics and targets, and risk management.[13] The TCFD Recommendations include suggestions for disclosing climate-related risks and opportunities, efforts to reduce greenhouse gas emissions, and processes and policies used to identify risks. Canadian companies and regulators have long relied on these recommendations for guidance on environmental disclosure.

On October 12, 2022 the CSA announced its active consideration of the anticipated International Sustainability Standards Board's ("**ISSB**") climate-related disclosure standards and the US Securities and Exchange Commission's ("**SEC**") proposals to require climate-related information in US SEC-regulated companies' registration statements and annual reports.[14] The ISSB was formed by the International Financial Reporting Standards ("**IFRS**") to standardize sustainability disclosure standards. The ISSB deliberations indicate plans to incorporate the TCFD Recommendations into guidelines on environmental disclosure beyond climate-related issues.[15] Once finalized, the ISSB guideline is expected to shape global metrics and mandates for ESG disclosures. While the SEC and ISSB guidelines are not binding on Canadian companies, the CSA's attention to these incoming standards suggest they should not be ignored. The CSA has stated that "while the CSA, SEC and ISSB proposals are all largely based on TCFD recommendations, some substantive differences exist," which the CSA will continue to monitor.[16]

In addition to the CSA's focus on climate-related disclosure, the Office of the Superintendent of Financial Institutions ("**OSFI**") published Guideline B-15: Climate Risk Management on March 7, 2023.[17] This guideline encourages OSFI-regulated financial institutions to be mindful of updates like the ISSB guidelines providing broader expectations for climate disclosure. Furthermore, the OSC's 2023-2024 SOP solicited stakeholder comments in response to the previous year's Statement of Priorities. The stakeholder comments emphasized the importance of continuing with climate-related disclosures, while keeping note of international developments and standards. Therefore, it is possible that the ISSB's anticipated guidelines may be met with support from the OSC.

Asset Management Company ("AMC") guidelines

Besides the efforts of regulators and advisors to promote ESG-related disclosure, the 2023 voting guidelines of BlackRock Inc. ("**BlackRock**") and The Vanguard Group ("**Vanguard**") further illustrate rising investor interest in ESG factors.

(a) Diversity-related guidelines

BlackRock and Vanguard have expressed their support for demographic and professional diversity on a company's board, as they believe that such diversity enhances the board's capacity to effectively meet the needs of shareholders. BlackRock's guidelines explicitly advocate for gender, racial, and ethnic diversity in the composition of a company's board. For example, BlackRock has advised that boards of companies, especially those in the S&P/TSX Composite Index, should aspire to set goals of achieving at least 30% diversity in their memberships and expresses that diversity in thought leads to better long-term economic outcomes. Specifically, BlackRock considers that having at least two women directors and a director who identifies as a member of an underrepresented group are positive indicators.[18] BlackRock also embraces the "comply or explain" approach to diversity disclosure regarding a company's board composition. If the issuer fails to disclose their approach to diversity in their board composition or fails to provide compelling reasons for their absence, both Vanguard and BlackRock suggest their funds may vote against members of the nominating or governance committee of the issuer. Additionally, Vanguard emphasizes diversity by encouraging representation from a range of racial or ethnic groups, including Indigenous peoples, on corporate boards. It is important to note that Vanguard distinguishes the categorization of Indigenous peoples from other racial or ethnic groups.[19]

(b) Environment-related guidelines

Climate change-related disclosure continues to be significant to investors. BlackRock and Vanguard encourage disclosing business practices and environment-related risk or opportunity assessments, with emphasis on climate-related risks, as important considerations in voting decisions. BlackRock and Vanguard also support reports aligned with TCFD frameworks and industry-specific metrics defined by the Sustainability Accounting Standards Board ("**SASB**"), which is now a part of the ISSB. BlackRock continues to allow flexibility in company strategies in approaching climate-related risks, but advises that failure to provide sufficient sustainability-related disclosures may result in "express concerns through [their] engagement and voting".[20] Vanguard-advised funds favour boards that can effectively oversee material climate risks and disclose their oversight practices.[21]

Conclusion

Alongside the AMC guidelines, investors have become increasingly vocal about their emphasis on ESG Factors. Norway's Government Pension Fund Global (the "**Oil Fund**"), the world's largest sovereign wealth fund, filed its own shareholder proposals on climate change, which included demands to four United States companies to set targets ensuring a net-zero carbon emission by 2050.[22] The Oil Fund has also supported climate activist shareholder proposals against ExxonMobil and Chevron to introduce Scope 3 targets in reducing greenhouse gas emissions, claiming these US companies are not “ambitious enough.”[23] However, there are claims of hypocrisy given the Oil Fund’s failure to take similar actions against European oil and gas companies from which they derive significant revenue.

As ESG policies continue to evolve, they have become a focal point for broader ideological battles. Companies such as Chick-fil-A, Bud Light and Target have faced public criticism for their diversity, equity and inclusivity (“**DEI**”) initiatives among the general public. While recent anti-ESG trends are becoming apparent in the US investment community, which have been exacerbated during the current period of economic stagnation,[24] few anti-ESG proposals have truly gained traction in the investor community.[25] Such opposition in the US has primarily targeted policies aimed at increasing DEI on boards and the workplace.[26] Despite some scrutiny, it is apparent that investors and other market participants are willing to actively participate in the development and enforcement of ESG-related disclosure and policy guidelines, and anti-ESG trends may dissipate in the medium to long term.

Evidenced by the broadening scope of ESG-related requirements by regulators and the adoption of ESG-related benchmarks and metrics by AMCs, ESG continues to be of importance in investment decision-making. As regulatory guidelines and investor expectations continue to value the long-term impact of sustainable practices, there will be continued evolution and pressure on companies to enhance their ESG transparency and performance.

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[1] Jonathan Tong & Mark Sandor, “Public company directors and ESG disclosure requirements” (2 March 2023), online (blog) MT Biosphere < https://www.millerthomson.com/en/publications/communiques-and-updates/mt-biosphere/march-2-2023-4/public-company-directors-esg-disclosure-requirements/ >

[2] OSC, *Proposed Amendments to Form 58-101F1 Corporate Governance Disclosure of NI 58-101 Disclosure of Corporate Governance Practices and Proposed Changes to NP 58-201 Corporate Governance Guidelines*, 46 OSCB 3125 (13 April 2023). [Proposed Amendments]

[3] OSC, *Amendment Instrument for NI 58-101 Disclosure of Corporate Governance Practices* (December 2014). [2014 Amendment Instrument for NI 58-101]

[4] OSC, *National Instrument 51-102 – Continuous Disclosure Obligations*.

[5] 2014 Amendment Instrument for NI 58-101, *supra* at 37 OSCB 11035.

[6] C Gaz II, *Regulations Amending the Canada Business Corporations Regulations, 2001*: SOR/2019-258 (10 July 2019).

[7] Proposed Amendments, *supra* at 46 OSCB 3128.

[8] Proposed Amendments, *supra* at 46 OSCB 3134.

[9] OSC, *2023-2024 OSC Statement of Priorities* (18 April 2023). [OSC 2023-2024 SOP]

[10] OSC 2023-2024 SOP *supra.*

[11] OSC, *CSA Staff Notice 51-358 Reporting of Climate Change-related Risks*, 42 OSCB 6617 (1 August 2019).

[12] OSC, *51-107 – Consultation Climate-related Disclosure Update and CSA Notice and Request for Comment Proposed National Instrument 51-107 Disclosure of Climate Related Matters* (18 October 2021).

[13] TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures* (15 June 2017).

[14] CSA, News Release, *Canadian securities regulators consider impact of international development on proposed climate-related disclosure rule* (12 October 2022). [CSA considerations on climate-related disclosure]

[15]IFRS, *Exposure Draft: Sustainability Disclosure Standard [Draft] IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* (March 2022).

[16] CSA considerations on climate-related disclosure, *supra.*

[17] OSFI, News Release *OSFI issues new guideline on Climate Risk Management* (7 March 2023).

[18] BlackRock Investment Stewardship, *Proxy voting guidelines for Canadian securities* (January 2023). [BlackRock Guidelines]

[19] Vanguard, News Release *Proxy Voting Policy for Canadian Portfolio Companies* (1 February 2023).

[20] BlackRock Guidelines, *supra* at 18.

[21] Vanguard, News Release, *Vanguard Investment Stewardship Policy Insights: Vanguards Approach to Climate Risk Governance* (February 2023).

[22] Richard Milne, “Norway’s oil fund to step up ESG proposals to US companies”, *Financial Times* (16 May 2023), online: <https://www.ft.com/content/62e3c629-44cf-43f7-9682-a056f9b5c634>

[23] Richard Milne, “Norway’s oil fund sides with climate activists against ExxonMobil and Chevron”, *Financial Times* (26 May 2023) online: <https://www.ft.com/content/ad012975-0c77-4aba-b0b5-4174290dd2a7>

[24] Andrew Winston, “Why Business Leaders Must Resist the Anti0ESG Movement” (5 April 2023) online: <https://hbr.org/2023/04/why-business-leaders-must-resist-the-anti-esg-movement>

[25] Heidi Welsh, “Anti-ESG Shareholder Proposals in 2023”, *Harvard Law School Forum on Corporate Governance* (1 June 2023) online: <Anti-ESG Shareholder Proposals in 2023 (harvard.edu)>

[26] *Ibid.*

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