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360° Governance: Where are the Directors in a World in Crisis?

By Peter Dey and Sarah Kaplan

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Prologue

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In 1994, the Toronto Stock Exchange (TSX) accepted a new set of guidelines for board governance as developed in the report "Where Were the Directors?". Triggered by the mixed response by the Canadian corporate sector to the stresses of the 1990–1991 recession, the development of the guidelines (also known as the "Dey Report") was meant to urge boards of directors to align with "growing expectations concerning the manner in which boards of directors are constituted, and the relationships between the board and shareholders."

Two-and-a-half decades later, in the face of climate change, rising economic inequality, systemic racism and the COVID-19 pandemic, it is time for a new set of guidelines. To develop these new guidelines, we joined together to examine from a practical and scholarly standpoint what good governance in the 21st century should be. Peter Dey brings to this project his experience as a lawyer, regulator, investment banker and board member, as well as his background in developing the 1994 guidelines. Sarah Kaplan is author of *The 360° Corporation: From Stakeholder Trade-offs to Transformation* and brings her decade of experience as a management consultant as well as her current work as a business school professor to enrich the discussion with insights from scholarly research and management practice. Through several months of collaboration as well as broad consultations, we have come to a point of view reflected in this document.

While the 1994 guidelines—which concern best practices around board independence and oversight—continue to be relevant, they served the governance needs of the 1990s. We ask now, "Where are the directors in a world in crisis?" The guidelines we have developed in response to this question are based on the principle that companies must account for the interests of all stakeholders that surround them (hence, 360° Governance).

The challenges facing a corporate director in the early 1990s were very different from the challenges facing directors today. The guidelines generated at that time in the "Where Were the Directors?" report dealt with basic issues of governance: the role of the board, how to constitute a board, committees of a board, the independence of directors. The title of the report said everything. Of the then-principal players in corporate governance—the shareholders, the board of directors and management—the board was the least involved in the governance of Canadian corporations. This weakness was apparent in a number of corporate failures following the 1990–1991 recession. There was also a recognition of the need to upgrade Canadian corporate governance systems to accommodate trends in globalization, international trade and technological change. This came at a time when other jurisdictions were modernizing their standards of governance (for example, in the 1992 Cadbury Report in the UK[1] and the 1994 King Report in South Africa[2]). Canadian standards of governance needed reform for Canada to continue to be competitive.

The 1994 report recommended that all Toronto Stock Exchange–listed companies disclose whether the company's governance system complied with the guidelines. If the company didn't comply, it was required to provide an explanation—the so-called "comply or explain" approach. The immediate response of many publicly traded companies to the guidelines and the disclosure requirement was to tick the boxes. But very quickly the market began attributing more value to well-governed companies. The result was that companies began investing serious resources in upgrading their governance systems. The composition of the boards of Canadian companies reflected the most significant change: boards increased their independence from management. The quality of a company's governance system became a gating issue for investors and for other stakeholders.

Since the issue of the 1994 report, there have been a number of significant reforms of governance standards through both the legal process and the market. Perhaps the most important occurred as a result of two Supreme Court of Canada decisions: the *Peoples Department Stores* and the *BCE 1976 Debenture Holders* cases. The Court affirmed that boards of directors have a duty to act with a view to the best long-term interests of the corporation, and by corollary, do not have a duty to act only in the best interests of any particular stakeholder group (read: shareholders). These decisions underlined the legal shift from shareholder primacy to stakeholder primacy.

The case law has now been enshrined in legislation through amendments to the Canada Business Corporations Act which provide that when acting with a view to the best interests of the corporation, directors and officers may consider, but are not limited to considering, the interests of creditors, consumers, governments, employees and pensioners, the environment and the long-term interests of the corporation. At the same time, the *BCE* decision gave little guidance as to how companies should implement this approach. Indeed, a large body of empirical literature has analyzed changes after the *BCE* decision—e.g., changes to takeover premiums or new litigation patterns—and found no effect.[3] Because of the uncertainty about what these cases mean in practice, the ghosts of "shareholder primacy" and the US *Revlon* case (in which the Delaware Supreme Court held that directors had the singular responsibility of maximizing immediate shareholder value[4]) still haunt Canadian corporate board rooms.[5]

The guidelines proposed in this document on "360° Governance" are aimed at giving clarity about how boards can effectively consider the interests of all stakeholders and the rights of Indigenous Peoples in their decision making. They reflect the current environment and a similar sense that, as in 1994, Canada must upgrade its governance standards or risk being left behind. The guidelines also reflect our understanding, from research and consultations, of the issues that boards are facing in the 21st century and the best practices for addressing them. Our exercise is very similar to the exercise which produced the Dey Report: identify current issues of governance; study how boards of directors respond to these issues; identify the best practices in responding; and organize the best practices into a series of guidelines available for boards to use.

We are grateful for the support of the Michael Lee-Chin Family Institute for Corporate Citizenship, which sponsored this project, facilitating Peter Dey's appointment as an Executive-in-Residence at the University of Toronto's Rotman School of Management and appointing Sarah Kaplan an academic Fellow of the Institute. To develop these guidelines, we reviewed the scholarly research in law, management, governance, economics, political science and other relevant domains and consulted a wide variety of academics, governance experts and stakeholders. We are indebted to the 54 members of our Advisory Board, our PhD research assistants, and other commenters whose input helped shape this document; however, the views expressed in this report are ours alone and should not be attributed to any of the review board members. Following the guidelines below, we include a commentary that provides support for and adds nuance to each of the recommendations.

The guidelines do not mandate any actions by the board. They follow the same "comply or explain" approach to implementation as was used in the Dey Report. However, we believe that boards of directors of all companies need to address and respond to the issues raised by the guidelines. We also anticipate that legislative or regulatory bodies may also seek to enact regulations or laws requiring compliance. It is our hope that these guidelines will serve as both a useful resource and an inspiration to corporate Canada and help lead Canada into a prosperous 21st century.

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Peter Dey is Chairman of Paradigm Capital, an independent investment dealer, and member of the Board of Directors of Gran Tierra Energy. He has held numerous corporate directorships, was Managing Director and Chairman of Morgan Stanley Canada (1994-2001), and a partner at Osler, Hoskin & Harcourt from 1972-1983; 1985-1994; and 2001-2005. From 1993-1995, he chaired the Toronto Stock Exchange Committee on corporate governance which established guidelines for the governance of Canadian corporations in the report "Where Were The Directors?" (also known as the "Dey Report"). He has also served as Chairman of the Ontario Securities Commission and was Canada's representative to the Organization for Economic Co-operation and Development Task Force that developed the OECD Principles of Corporate Governance released in May of 1999. He is an Executive-in-Residence at the University of Toronto's Rotman School of Management. Although Peter Dey is Chairman of Paradigm Capital, he participated in the preparation of this Report independently of Paradigm Capital and the views expressed in this report are solely the views of Peter Dey and Sarah Kaplan and should not be attributed in any way to Paradigm Capital.

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Background: The need for new governance standards

The year 2020 is forcing a reckoning about the role of the corporation in society, and along with it, the responsibilities of boards of directors to the corporation's myriad stakeholders. It is increasingly clear that corporations depend on a wide variety of stakeholders to function effectively. Customers, the planet, workers, communities and others offer the resources and markets required to grow businesses.[6] And, while corporations contribute jobs, innovation and economic growth to our country, corporate operations have also contributed to creating or exacerbating social problems: climate change, income inequality, gender inequality, the opioid crisis, etc.

Too often, these social costs have been treated as "externalities," outside the scope of action for companies. At a time when a company's primary responsibility has been to produce short-term returns to its shareholders, they have been dismissed as simply the cost of doing business. Yet, for an accumulating set of reasons, stakeholder concerns are now corporate concerns. While many companies are already on the path to addressing these issues, there is more to do.

Even before the COVID-19 pandemic, society was placing greater social expectations on corporations. The critique of the corporation accelerated during the 2008–2009 financial crisis, in which social inequities became increasingly vivid. The Occupy movement made possible a broader social conversation about the role of the corporation in society. Workers (especially Millennial and Gen Z, and likely COVID's new Gen C) only want to work for companies that don't do harm; consumers steer away from products from companies with bad reputations; "clicktivists" can create reputational harm through social media, etc. It is no longer enough for companies to say they are "law and regulation abiding."

The COVID-19 pandemic—and resulting health and economic crisis—has only exacerbated schisms in society. But it has also given us an opportunity to build back better. Rather than getting back to "normal," we need to envision an economy that works for everyone.

Our proposals are made recognizing the contributions corporations make to our communities by creating employment and producing economic growth and innovation. But they are also made recognizing that corporations cannot pursue growth strategies without understanding the impact of these strategies on their stakeholders. Our proposals are also made because we believe they make good business sense. Indeed, understanding stakeholder impacts can contribute to the long-term sustainability of the corporation's business, help avoid catastrophic risk and lead to transformative growth opportunities. Our proposals are intended to assist boards in addressing these challenges and creating these opportunities.

Why corporate action is central to addressing social ills

We have the chance to realign the relationships between corporations and their stakeholders in ways that benefit society and companies themselves. The corporation, as a commercial vehicle, is being carefully scrutinized. In the law, it is considered to be a person, a member of the community, and thus must conduct its business as a responsible member of that community. Thus, we must expect companies to be responsible to a broad array of stakeholders. As former Unilever CEO Paul Polman has said, a company "cannot be a bystander in the system that gives [it] life in the first place." [7]

At the same time, we share the concern that increasing the scope of corporate action to address stakeholders and social concerns puts in private hands decisions about social good that should ideally be enacted by democratically elected governments.[8] These concerns have been raised most recently by Robert Reich in his book *The System: Who Rigged it, How We Fix It*—where he describes stakeholder capitalism as "faux democracy"—and Joel Bakan in *The New Corporation: How "Good" Corporations are Bad for Democracy*—in which he argues that social responsibility is a power grab by corporations to avoid regulation.

With these appropriate caveats, we also agree with legal scholars and economists who suggest that globalization has decreased the ability of states to control multinational corporations and the impacts they impose.[9] The complexity of the issues facing society—inequality, climate change, global pandemics—means that government regulation cannot be the only tool for addressing society's needs. That is, governmental regulation is important, but corporations must also take on roles that deal with the impacts of their operations on stakeholders. Indeed, given the scope of social challenges as well as the needs of specific stakeholders in specific places, corporations may have the best capabilities to innovate "local" solutions to global problems.

Though society is rapidly moving past Milton Friedman's famous arguments that it is not in the corporate domain to address social causes, it is useful to examine the underlying rationale to show that stakeholder interests can no longer be considered separate from good management and good governance. First, Friedman argued that "[t]he stockholders or the customers or the employees could separately spend their own money on the particular action if they wished to do so."[10] But economists have pointed out that individuals do not have access to scalable projects that would offset the negative impacts of corporate action.[11] Indeed, the corporation as a legal construct was created precisely because it allowed the aggregation of capital by limiting liability in order to pursue projects and investments that were beyond the scope of any individual. Second, Friedman stated that companies should operate within the "rules of the game" (set by governments). But it is increasingly clear that many companies exceed the boundaries of individual governments and that the complex challenges facing society today cannot be entirely managed only through legislation and regulation. Further, Canadian companies may operate in countries where laws and regulations assuring the protection of stakeholders are not robust or are poorly enforced. Thus, we cannot place responsibility for social impacts on governments or individuals alone.

Why stakeholders are a central concern for boards of directors

The relative salience of different stakeholders will vary from company to company depending on the nature of the company's operations. From a legal standpoint, Section 122 (1.1) of the CBCA specifically lists shareholders, employees, retirees and pensioners, creditors, consumers, government and the environment.[12] From a practical standpoint, firms should be concerned about any and all stakeholders that are associated with enterprise risks or opportunities. In this sense, a stakeholder is any actor or group that is associated with the creation (or destruction) of value by the firm.[13] Many of these concerns are embedded in what is known now as environmental, social and governance (ESG) criteria as well as in discussions of corporate social responsibility (CSR). We should mention that the practice of CSR has tended to become something severed from the business itself, cordoned off from senior executives and directors, relegated to marketing or public relations teams or to a corporate philanthropy office. "CSR" thus becomes something that people do on the "side of their desks." Our guidelines are meant to reinforce the fact that corporate philanthropy will not be enough. The stakeholder issues we highlight are often existential for companies and central to firm strategy and governance.

Note that while we use the language of "stakeholder" throughout this document to represent the communities impacted by a company's operations, we recognize that Indigenous Peoples are not simply one set among many stakeholder groups. Many Indigenous people reject the designation of "stakeholder," which implies that their interests might be balanced with other interests, rather than affirming their inherent rights. In our guidelines, we call out the special status of Indigenous Peoples in Canada and the obligations of corporations to conform to the requirements of Truth and Reconciliation as well as the UN Declaration on the Rights of Indigenous Peoples.

For myriad reasons, addressing impacts on stakeholders must be central to corporate governance because stakeholders create enterprise risks as well as strategic opportunities for innovation, growth and transformation. External forces such as new ratings systems, media coverage and stakeholder activists are raising the costs of not engaging in governance reform and the opportunities of good governance.[14] On the risk side, if stakeholders are neglected, they will seek to create costs for companies through such actions as social media campaigns, protests, boycotts, lawsuits and similar public displays of their displeasure. On the innovation side, engaging with stakeholders can offer insights into underserved markets or new market opportunities. There is an informational and educational value, which might benefit financial performance, that comes from considering stakeholders. Thus, stakeholder engagement is now an essential element of corporate board competencies.

The goal of this report is to achieve balance in the manner in which boards perceive stakeholders. Historically, the shareholder has occupied a large share of the board's attention. The guidelines are meant to elevate the status of other stakeholders in the board's mind rather than reflect a bias against shareholders.

Regulation and legislation. Given the severity of the many crises on our hands, such as inequality and climate change, governments at all levels are increasingly changing the rules of the game for Canadian companies. As some recent examples, the OSC instituted "comply or explain" regulations for women on boards and executive leadership in 2015 and this has been followed by federal legislation covering women and other underrepresented groups. In December 2020, the federal government announced additional carbon taxes. Proposed changes from the Government of Canada's Expert Panel on Sustainable Finance and the Ontario Capital Markets Modernization Taskforce include corporate reporting that conforms to the TCFD (Task Force on Climate-related Financial Disclosures) guidelines.[15]

Because many Canadian companies have international operations, they may also be subject to laws in other countries such as the UK's Pay Transparency regulation. And, even if laws and regulations are not in place at the moment, they may soon be. The UNPRI (Principles for Responsible Investing) calls this the "Inevitable Policy Response": in their assessment, it is not a question of whether there will be greater government intervention on crucial issues for society, but when.[16] Thus, boards of directors must anticipate and respond to increasing legal and regulatory constraints on strategic decisions.

War for talent. The new generations of workers in blue-, pink- and white-collar jobs are more interested in working for companies they can believe in. And even though Millennials and Gen Z (who by 2029 will make up 72% of the workforce) are leading the pack in terms of a desire for their employers to contribute to social or ethical causes, Gen X and Boomers are not far behind.[17] And, according to a LinkedIn survey, the vast majority of respondents indicate they would consider taking a pay cut to work at an organization whose purpose and values align with their own.[18] Human resource consulting firms report that firms with higher ESG scores, lower carbon emissions and a greater proportion of women on their boards of directors also have higher employee satisfaction and are more attractive to young talent.[19] In short, ESG has become a competitive advantage in the war for talent.[20]

Customer demand. Customers are also demanding that their suppliers respond to societal challenges. In the B2C (business-to-consumer) space, studies have shown that 64% of consumers—Millennials and younger generations in particular—tend to buy products that have social benefits and are more trusting of and loyal to brands that are seen as socially responsible.[21] Nearly half of consumers will walk away from a brand that does not align with their values.[22] As an example, in response to consumer awareness that food production accounts for nearly one-quarter of all greenhouse gasses, the World Resources Institute has created the Cool Food Pledge, which helps the food industry track its climate impact. The City of Toronto is the only Canadian signatory to date, but major US food chains such as Panera Bread and Chipotle Mexican Grill are already labeling their meals accordingly in order to attract customers.[23] Increasingly, companies must use the same strategies to attract consumers as they use to attract employees. This is just as true in the B2B (business-to-business) space, where major buyers such as Walmart want suppliers to reduce emissions, adhere to worker health and safety standards, eliminate waste and cut toxins in their manufacturing processes.[24]

Operational disruptions. Climate change creates risks that can have a material impact on financial performance.[25] More and more companies are reporting material effects on earnings from weather-related damage to physical plant. Supply-chain disruptions due to climate events have grown rapidly. Litigation related to corporate climate change impact has increased exponentially. The transition to net-zero emissions also creates risks and opportunities. Car companies and gas stations must deal with the fact that electric vehicles will come to dominate private transportation in the next two decades. Oil companies need to develop strategies that deal with the transition away from fossil fuels. Manufacturers, retailers and other businesses will need to transform their operations to reduce emissions. And, if net-zero targets for emissions are not achieved, all companies will have to transform their operations to deal with the massive disruptions to operations that will come from catastrophic climate change impacts, including the effects of more extreme weather events. Climate needs to be at the centre of any board's deliberations.[26]

Improved performance. Attention to ESG issues is associated with superior financial performance; companies that adopt formal sustainability policies and those with higher ESG ratings that tie specifically to material impacts have better financial returns than their peers. In addition, firms with better board governance—those that have established processes for stakeholder engagement, disclose ESG metrics and tie executive compensation to these metrics—outperform their counterparts over the long term in terms of stock price, lower cost of capital and returns.[27] Corporate social responsibility is particularly beneficial for firm financial performance and stakeholder impacts when it is built on the firm's core competencies rather than simply being charitable actions.[28] Yet research has also shown that investing in "non-material" ESG—that is, corporate social responsibility activities that cannot be directly tied to a material impact—does not harm a company's financial performance. This means that, even if financial materiality cannot (yet) be assigned to a specific stakeholder impact, working to mitigate any negative impacts of corporate operations does not harm a company's financial performance relative to peers that do not do so.[29] So,"materiality" does not have to be the gating factor in attending to stakeholder issues. And whether or not materiality is part of the equation, research shows that firms that have a greater stakeholder orientation also tend to exhibit greater innovation productivity.[30]

Investor values. More and more, investors are showing interest in a firm's stakeholder impacts, both because they are seen to be material and also because these impacts align with their values. Shareholders have more complex interests than just short-term stock price appreciation. More than 30% of investments is held in some ESG vehicle or another, a proportion that is estimated to grow to 50% by 2025. Major institutional investors such as BlackRock are claiming that they want companies to pursue purpose, and others, such as the Norwegian sovereign wealth fund and many faith-based groups, are divesting of fossil fuels. And 75% of all investors say that they use ESG criteria for at least one quarter of their portfolios.[31] Research shows that corporations are forced to make meaningful and not just symbolic changes when they are targeted by social and environmental activist investors.[32]

Investor stewardship is a hot topic these days.[33] Major institutional investors, including those with passive index funds, are experiencing growing pressures to be perceived as good stewards, to invest more in stewardship and to tie stewardship more closely to their portfolio management.[34] Other jurisdictions such as the UK have adopted stewardship codes in their financial market regulations.[35] At the same time, there is another set of investors focused only on short-term gains, for example some activist investors actually look for companies that make social responsibility investments as takeover targets because they define those investments as "waste" that can be stripped out for short-term performance boosts. The activist pressure from both sides can feel like a "pincer attack" to many companies in the current moment.[36] However, we estimate that these latter types of investors will become increasingly scarce as the understanding of the material effects of stakeholder impacts grows. Indeed, the presence of long-term investors in the average company's shareholder base has doubled in the past two decades.[37]

These changes are barreling towards Canadian companies like a run-away freight train. Every board will need to get ahead of these complex and evolving dynamics. Truly frontier boards of directors are already engaged in dealing with these challenges.

Canada is lagging

The 1994 Dey Report was developed because of the need for Canada to remain competitive in global markets as other major jurisdictions were implementing reforms that mirrored best practices in governance. We are at a similar turning point today. Reforms are speeding ahead in countries around the world and Canada is not leading the way. At the same time, the *BCE* decision means that Canada has much of the legal infrastructure for reform already in place.[38]

Reforms are moving apace in the UK, Europe and other jurisdictions such as South Africa, where the latest version of the King Report (King IV in 2016) on corporate governance covers much of the same territory as the guidelines we are presenting here. As Canada lags, it will make our companies uncompetitive in their ability to attract global capital, as demonstrated by the recent move by the Norwegian sovereign wealth fund to exit oil sands holdings in Alberta, a possible herald of further global divestments.[39]

In the United States, with the win for President Joseph Biden, we can anticipate closer regulation of corporate behavior south of the border. Even in advance of the election, the US Business Roundtable issued a statement in August 2019 repudiating shareholder primacy and promising to create value for all stakeholders. Yet corporate Canada is mainly absent in making similar commitments.[40] While the deep integration of US and Canadian societies, in particular in the corporate sector, means that the US corporate response to social issues will continue to influence governance reform in Canada, we need a "made-in-Canada" solution.

Stakeholder management is a necessary board competency in the 21st century

We conclude—from our consultations, a review of existing governance guidance and a reading of the academic research—that stakeholder management is a necessary board competency in the 21st century. With the pace of change in expectations of corporations accelerating and stakeholder impacts becoming increasingly salient to company operations, if there ever were a time to have a high-performing board, it is now.[41] Effective boards will need to be expert in recognizing ways that their companies' interests could have adverse impacts on stakeholders and seek to resolve these tensions in creative and generative ways.

Importantly, we wish to highlight that stakeholder pressures are not just "burdens" that create compromises with profits but rather also opportunities for innovation and transformation.[42] Research shows that social responsibility leads to more resilient organizations that can withstand the shocks and crises that are becoming increasingly frequent.[43]

Our 13 Guidelines form the basis of modern board competencies. Guideline 1 starts by establishing a corporate purpose that addresses all stakeholders, followed by Guideline 2, which emphasizes the board's duty to exercise its powers in the long-term best interests of the corporation, which by necessity considers the interests of the corporation's stakeholders. Guideline 3 defines stakeholders as any party that contributes to the operation of the corporation's business or could be impacted by those operations. Guideline 4 highlights the special attention needed for engaging with and gaining consent from Indigenous Peoples. Guidelines 5 and 6 suggest the creation of a separate Stakeholder Committee that would build the board's expertise on, monitor reporting about and offer guidance on stakeholder issues. We also recognize that stakeholder interests may come into conflict, and Guideline 7 advises boards to develop processes by which all stakeholders can be fairly treated as these competing interests are resolved. Guideline 8 directs boards to assure that management compensation is aligned with the corporate purpose and the metrics established. To guarantee that boards gain the competencies and diverse perspectives needed to address these 21st century challenges, Guideline 9 pushes boards to have rigorous processes of board refreshment, including term limits, and revised skills matrices for assessing current board members or recruiting new ones. With specific reference to diversity, and recognizing recent regulatory and legislative mandates in this domain, Guidelines 10 and 11 suggest that boards develop targets for the board and for the organization to achieve greater representation of women, visible minorities, Indigenous Peoples, people with disabilities and other underrepresented groups. Guideline 12 highlights climate change as a specific risk and opportunity that must be addressed with great urgency due to the existential crisis it poses. And, finally, because of the increased expectations of companies to take political stands on various stakeholder issues, Guideline 13 provides for board oversight and deliberation for these choices.

Our guidelines are meant to help boards get up to speed on what will be required of them. They reflect best practices which we believe will become mainstream in coming years. They are designed to be flexible enough to accommodate the different needs of different companies as well as the inevitable changes in regulations, standards and society. The goal is to avoid a box-checking exercise and instead focus on the capabilities that boards need to develop. The guidelines are not intended to over-bureaucratize corporate activities in ways that might feel oppressive to smaller companies but instead help all companies develop these skills so that they are prepared for coming regulations, increased expectations of investors and material impacts of stakeholder issues.

There are no surprises in the guidelines. They enshrine best practice. Leading companies are already doing some or all of the things we recommend. The guidelines incorporate guidance already offered by other prominent organizations in Canada and around the world, such as the UNPRI (Principles for Responsible Investing), the Canadian Coalition for Good Governance, the Taskforce on Climate-related Financial Disclosure (TCFD), the Reconciliation & Responsible Investment Initiative, the Institute for Corporate Directors, the Canadian Gender and Good Governance Alliance, the World Economic Forum's 4Ps (principles of governance, planet, people, prosperity), the Ontario Capital Markets Modernization Taskforce, the United Nations "Protect, Respect and Remedy" Framework, the OECD Guidelines for Multinational Enterprises and many others. At the same time, fully implementing the guidelines will require major shifts in Canadian corporate governance.[44]

Our guidelines are meant to give much more precision to addressing stakeholder impacts. At the same time, we echo the court in the *BCE* decision that "there is no such thing as a perfect arrangement." [45] Good governance is a journey, not a destination, and each board of directors needs to look towards its next step on that journey. The purpose of our efforts is to offer best practice guidelines that all boards of directors should want to pursue because, in doing so, they will be equipped to guide their companies through the challenges of this century.

The 360° Governance Guidelines

1. Corporate Purpose

Every board should identify, disclose and regularly review the purpose of the business of the corporation. Put simply, why does the corporation exist? There are two aspects to purpose. The first is that the corporation was brought into existence and exists to meet human wants or needs by producing a product or service to be used by customers of the corporation. It is through fulfillment of this purpose that value is created. The second is that these efforts to produce value may impact the corporation's stakeholders positively or negatively. The corporation exists because its stakeholders support the business of the corporation by contributing to the operation of the corporation's business, by consuming the corporation's products or services and by granting the corporation a social license to operate its business. The support of stakeholders can only be expected if the corporation understands and addresses the impact of its efforts on them. Without knowing why the corporation exists, it is difficult for a board of directors to judge effectively the best interests of the corporation. The statement of purpose should be a living document rooted in the fundamental value proposition of the corporation. It should be specific enough to enable accountability and be revisited with some regularity so as to assure it still provides that most useful and most powerful guiding light for the board and the company's management.

2. Board's Duty

Every board should understand that, in exercising its powers and discharging its duties, it must act with a view to the best interests of the corporation. Every board should be able to identify and articulate the best interests of the corporation in every decision the board makes and should be able to align these interests with the corporation's purpose. When acting with a view to the best interests of the corporation, the duty of loyalty will of necessity demand that boards consider the interests of the stakeholders of the corporation. This includes considering the long-term sustainability of the corporation's business.

3. Definition of Stakeholders

To understand the best interests of the corporation, the board should have knowledge of the stakeholders of the corporation. Each corporation will have its own unique group of stakeholders. Stakeholder groups may include people and organizations interested in or representing the following: climate and greenhouse gasses, communities in which the corporation operates, governments, customers, current and former employees and their representatives, pollution and environmental damage, supply-chain parties, holders of the corporation's debt, shareholders and any other party or group connected to the corporation that contributes to the operation of the corporation's business or could be impacted by the corporation's operations.

4. Indigenous Peoples:

The corporation should establish and implement a mechanism for fostering its relationship with Indigenous peoples which recognizes the unique historical circumstances under which the relationship is created. Ideally, such a mechanism would be jointly developed to apply to the specific Indigenous Peoples affected by any prospective project. Cognizant of the fact that Indigenous peoples are not mere stakeholders with interests but peoples with constitutional rights that are recognized and affirmed by section 35 of the Constitution Act, 1982, and recognizing that the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) is applicable to the laws of Canada (and is already in BC law), boards must assure that these rights are recognized in any activities that may affect or impact the rights of Indigenous Peoples. Specifically, UNDRIP implementation in Canada may require that corporations obtain the "free, prior and informed consent" from the impacted Indigenous Peoples. Corporations should report activities with and without free prior and informed consent to shareholders as a matter of risk disclosure.

5. Reporting on Stakeholder Impact

In order for the board and stakeholders to understand the corporation's management of its stakeholders, the corporation should integrate reporting on stakeholder impact in its annual report. The report should reflect the status of and changes in the corporation's relationship with its stakeholders. To enable benchmarking and accountability and to track progress over time, boards may want to adopt an existing social accounting standard in their integrated reporting. Noting that there are currently several efforts ongoing to align existing standards, boards may also want to include reporting on issues that extend beyond these standard measures.

6. Stakeholder Committee

The board should identify those stakeholders that have a material impact on or could be impacted by the corporation's business over the long term (as described in Guidelines 3 and 4) and should review the reporting and disclosure about each stakeholder group (as described in Guideline 5). The board should assess the impact on the corporation's stakeholders of all initiatives requiring board approval. The board should also have mechanisms for engaging directly with key groups of stakeholders. For many boards, these functions will best be carried out by a Stakeholder Committee which would function in a manner similar to the audit committee in its responsibility for overseeing the veracity of the reporting on stakeholder impact but would also have larger strategic responsibilities for responding to stakeholder interests. Smaller firms or firms with a surfeit of other committees, for whom creating a new committee might be onerous, might incorporate these responsibilities in another committee or in a lead director role.

7. Stakeholder Conflicts

In making a decision, the board should be able to conclude that the corporation's stakeholders have been fairly treated and that none of the stakeholders' interests have been unfairly disregarded. To reach this conclusion, the board may have to resolve competing interests amongst stakeholders, which should involve a process that fairly considers the interests of all of the stakeholders involved.

8. Compensation Policies

The board should ensure that management compensation is aligned with achieving the purpose and long-term sustainability of the corporation. This can be accomplished by adopting metrics and targets (as identified in Guideline 5) in compensation plans that are aligned with the purpose of the corporation. The plans should provide that the achievement of these targets makes up a meaningful component of management's bonus and other forms of compensation.

9. Board Refreshment

Every board should have a process which ensures board renewal, board diversity and the right mix of skills across the skills matrix. Recognizing that a director can cease to be independent after serving as a director for a sustained period of time, the process will likely include term limits, age limits or both. This process should be complemented by regular performance assessments of all directors. In addition, the skills matrix used to assess current and desired board member competencies should be updated to include knowledge about key stakeholder issues as identified in Guidelines 3 and 4.

10. Board Diversity

Boards should be designed to include the appropriate mix of backgrounds and lived experiences. The demographics of the board should represent the communities in which the corporation operates. Specifically, as suggested by regulations governing most Canadian stock exchanges, boards should announce targets for representation of women on the board and track progress towards achieving these targets. Consistent with recent federal legislation (Bill C-25), companies should also report on the representation of other underrepresented groups, at a minimum the other protected groups under the Human Rights Code: Indigenous Peoples, persons with disabilities and members of visible minorities.

11. Organizational Diversity

Every corporation should have and disclose its policy relating to diversity in its leadership and overall work force. This includes gender diversity as well as diversity along all dimensions protected by the Human Rights Code. The policy should provide specific targets and timelines for achieving them. Management should regularly report to the Board on its progress in meeting its targets, and this information should also be disclosed in the company's annual report.

12. Climate Change

Every corporation should have and should disclose its policy for addressing climate change and climate-related risks and opportunities. Consistent with TCFD (Task Force on Climate-related Financial Disclosures) recommendations, boards should disclose their oversight of climate-related issues including the processes by which board committees consider climate-related issues when reviewing strategic choices and how the board monitors and oversees progress against goals and targets for addressing climate-related issues.

13. Corporate Activism

Corporations may from time to time be pressured to state their position on an issue with social or political implications. The corporation may also decide, of its own volition, to make such a statement. The CEO should lead the process to decide whether to make a statement and what the content should be. Before making that decision, the CEO should consult the board to obtain the board's input and approval on whether, when and how to take a stand. The disclosure of the position of the corporation should be prepared in the same manner and with the same degree of care as any other release by the corporation. Because the nature of the issue may attract substantial attention from investors and other stakeholders, the board should ensure that the corporation has in place a process which will enable the CEO and the board, if necessary, to respond to public inquiries.

Legal status and scope of application of the 360° Governance Guidelines

Legal status of these guidelines

Though these guidelines are a set of voluntary principles and best practices, they reflect recent trends in practice, legislation and regulation. If, over time, these guidelines are superseded by government action, then of course the law prevails.[46] That being said, it is likely that many of these guidelines will be adopted in a "comply or explain" regulatory or legislative framework in Canada or in other countries where Canadian companies operate. As these practices are adopted, it is likely that they will become the standard for courts in assessing whether business judgment has been exercised with a view to the best interests of the corporation. In the absence of these governance structures and practices, it will be increasingly difficult for directors to defend their actions as exhibiting good business judgment if they are relying on a dated system of governance that does not address the issues raised by these guidelines. Courts will look for standards against which corporate action can be measured, and we anticipate that the practices implied by these guidelines and similar practices will find their way into jurisprudence.

Similarly, nothing in these guidelines should be seen as precluding action on the part of governments and regulators. Our hope and expectation is that any intervention by governments and regulators will simply be an exercise in confirming existing best practices. Corporate efforts to adopt these best practices should not prevent efforts by governments and regulators to set the rules of the game. However, at the same time, mandatory "comply or else" laws or regulations may not be helpful in achieving the desired ends because of the wide variety of businesses in the Canadian economic landscape. This will be especially the case if the board of directors focuses on compliance rather than the application of the best governance practice for the specific issue at hand. On the other hand, the risks of creating too-stringent standards must be balanced with the risk that on issues that require urgent corporate action, "comply or explain" may not be effective in driving change. A case in point is the OSC comply or explain regulation on women on boards and executive leadership, which has over 5 years only marginally increased representation.

In addition, a patchwork of laws and regulations that vary between jurisdictions (as, for example, is the case with current regulations and laws on diverse representation on boards, which differ between the provinces and the federal government) may create unhelpful burdens on businesses that are subject to them. Thus, we encourage harmonization of laws and regulations where possible.

Scope of application of these guidelines

These guidelines were drafted to apply to all organisations, regardless of their legal form, and not just large, publicly traded companies. While each company should find a way to make these guidelines as meaningful as possible in its own context, we are of the view that following these guidelines will increasingly become necessary for the long-term sustainability of the corporation. We are hopeful that these guidelines will not be construed as a burden but instead as an aid to companies facing the challenges and opportunities of the 21st century. For companies not already following these practices, the guidelines should sensitize them to where the world is moving.

Smaller companies (publicly traded or not) may be concerned that they simply do not have the resources to take on more governance responsibilities. In addition, one might be worried that additional governance requirements might dampen innovation and entrepreneurship. Small and medium enterprises (SMEs) employ more than 90% of private sector workers and are the engines of economic growth and job creation, and burdensome regulations are often seen as hindering their entrepreneurialism. Yet, as the Canadian Coalition on Good Governance has indicated in their own E&S Guidebook, "There is no such thing as too early or too small for a company and its board to begin cultivating a long-term value driven culture, with a clear view of how E&S [environmental and social] factors may impact strategy and risk." Even small companies should worry about the "far greater cost of learning the hard way that E&S management should have been prioritized." [47]

Entrepreneurs need to enroll a variety of stakeholders in order to gain the resources required to innovate and grow.[48] Furthermore, as small companies grow, there is a risk that their governance structures and processes will not evolve with societal expectations of them. As we highlighted in the introduction to the guidelines, attention to stakeholders can also be an important source of innovation, growth and competitive advantage. Good governance can help SMEs gain credibility, enhance their reputation, attract talent, gain access to capital on better terms, appeal to customers, prevent fraud or other unethical behavior and withstand market shocks.[49] Thoughtful managers will see 360° Governance as an opportunity rather than a burden. However, because each company is on its own journey towards better governance, responding to the guidelines is voluntary, thereby enabling each company to achieve better governance in a manner best suited to its own context.

While most governance guidelines have focused on publicly traded companies, private companies will also benefit from greater attention to evolving governance best practices. A privately held company will realize the same benefits as a publicly traded corporation if it deals with its stakeholders in the manner proposed in the guidelines. Increasingly, owners of private companies such as pension funds are requiring "public company"-type governance practices, and if a private company does go public, it must already have in place the expected governance practices. Major pension funds and other institutional investors, which hold many private companies and sit on their boards, will be an important vector for upgrading governance standards.

1. Corporate purpose

Every board should identify, disclose and regularly review the purpose of the business of the corporation. Put simply, why does the corporation exist? There are two aspects to purpose. The first is that the corporation was brought into existence and exists to meet human wants or needs by producing a product or service to be used by customers of the corporation. It is through fulfillment of this purpose that value is created. The second is that these efforts to produce value may impact the corporation's stakeholders positively or negatively. The corporation exists because its stakeholders support the business of the corporation by contributing to the operation of the corporation's business, by consuming the corporation's products or services and by granting the corporation a social license to operate its business. The support of stakeholders can only be expected if the corporation understands and addresses the impact of its efforts on them. Without knowing why the corporation exists, it is difficult for a board of directors to judge effectively the best interests of the corporation. The statement of purpose should be a living document rooted in the fundamental value proposition of the corporation. It should be specific enough to enable accountability and be revisited with some regularity so as to assure it still provides that most useful and most powerful guiding light for the board and the company's management.

A statement of corporate purpose is an important orienting device for both the board and management. It should not be considered separate from how a company creates value but integral to it. Thus, "purpose" should not be seen as something a company does in addition to the pursuit of profits but instead, as Larry Fink of BlackRock has said in his letter to CEOs, as the "animating force for achieving [profits]." [50] There is a risk of course that a statement of corporate purpose will simply be "virtue signaling" in a marketing or investor relations exercise.[51] But to use it in this way is to undermine its potential to articulate a company's holistic goals. Corporate purpose should be a statement that guides the understanding of what is in the best long-term interests of the corporation. The definition of a corporation's purpose should recognize the stakeholders who make the existence of the corporation possible. The statement of purpose should define which goals the corporation will prioritize, including how these goals will be measured and address the potential for conflicts between competing objectives. It is critical that the board of directors leads the process for defining corporate purpose and keeping it current. In doing so, boards will be in a better position to exercise business judgment and to defend their decision making.

Canada is lagging in a global movement towards formal statements of purpose. The Pacte Law in France requires companies to measure impacts on "social and environmental issues" so that the company's management considers these issues carefully and contemplates the possibility that the corporate purpose (*raison d'être*) would be enshrined in corporate bylaws.[52] In the UK, the Purposeful Company Taskforce has also pushed companies to be explicit about their purpose, which would include understanding how "the entire investment chain has a role in enabling a longer-term perspective to be taken with key stakeholders treated fairly in decision making." [53] The UK Corporate Governance Code affirms that a board's role is to "promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society" and that, to do so, the board "should establish the company's purpose, values and strategy." [54] In the United States, more than 200 CEOs of the Business Roundtable issued a Statement on the Purpose of the Corporation, which requires companies to "create value for all stakeholders." Though this is a general set of principles and has not yet risen to the level of board governance in most companies, it may create an impetus for firms to develop specific statements of purpose for their own companies.[55]

The statement of purpose should recognize the impact that a company's operations may create at any stage of its operations, from creation of products and services, to their use, to their disposal after use. Companies can use the statement of purpose to develop a transformational strategy for addressing the negative impact the corporation's operations create. For example, Philip Morris (PMI), a manufacturer of cigarettes, which we now understand to be a leading cause of death, adopted a statement of purpose in 2017 that focuses on delivering a "smoke-free" future, targeting the end of cigarette sales in most countries in the next 10–15 years.[56] Indra Nooyi's transformation of PepsiCo from junk-food giant to a company focused on healthy alternatives and reducing sugar and fat from its products can be understood in the same light. We now understand junk food to be a leading cause of obesity and diabetes, undermining the health of people around the world, and Nooyi started

1. Corporate purpose, cont.

PepsiCo's transformation to address the health impacts of its products.[57] As society increasingly understands the negative impacts of company operations—the use of conflict minerals in the manufacture of iPhones, the use of Amazon's facial recognition technology by the police, the impact of oil and gas companies on the climate crisis, Rio Tinto's destruction of Indigenous religious artifacts, and so on—corporations will face increasing pressure to establish business purposes that address these negative impacts and transform their businesses. Boards will increasingly be held accountable for actions measured against that corporate purpose.

A statement of purpose can be a double-edged sword if done incorrectly. Academic researchers and practitioners raised several potential concerns. First, a risk of making a formal statement of purpose is that it could somehow constrain innovation, strategic change or new directions the corporation might take. Indeed, historically, it used to be much more common for Canadian founders to set up a purpose in the documents of incorporation stating the objective of the corporation, but these statements were abandoned as a practice because many corporations found themselves restricted by these initial purposes. Second, the development of a statement of purpose may risk creating a document that can be used simply to defend actions by the board rather than one that enables value creation for all stakeholders. Third, economists are particularly concerned that a vague statement of purpose may be used by management to increase their discretion and resist board oversight. That is, management could use a vague statement to justify a broad range of actions. None of these are the intent of the statement of purpose recommended in this guideline. Instead, we envision a living document rooted in the value proposition of the corporation, one that is specific enough to enable accountability and can be revisited with some regularity so as to ensure it still provides the most useful guide for the board and the company's management.

Some have suggested that the Benefit Corporation (B Corporation) organizational form would be a solution to the challenges we pose in these guidelines. Indeed, B Corporations are required to issue a statement of purpose known as a "Benefit Statement." This statement should cover how the company will reconcile any conflicts between efforts to make a profit and efforts to improve society. Unfortunately, research shows that even these statements have historically often been too vague and aspirational to provide a mechanism for accountability.[58] B Corporations emerged in the United States as an alternative to traditional public corporations to enable explicit efforts to address benefits to society. This model has now been adopted in British Columbia, though, given the *BCE* Supreme Court decision, which established that boards must act in the best interest of the corporation and in doing so can take into account the interests of a broad range of stakeholders, companies in Canada do not need an alternative legal form in order to engage in efforts targeted at a public benefit to create value for all stakeholders.[59] Indeed, the CBCA and provincial versions of this Act require that directors pursue their corporation's purpose, which clarifies what is in the best interests of the corporation. The only additional feature of the B Corporation to note here is that it requires firms to disclose a "benefit report" each year that includes the directors' assessment against a third-party standard of whether the firm has promoted the public benefits it outlined in its benefit statement. As we suggest in Guideline 5, this disclosure is now a standard of good governance for any type of firm and does not require the B Corporation designation in order to issue these reports.

2. Board's duty
Every board should understand that, in exercising its powers and discharging its duties, it must act with a view to the best interests of the corporation. Every board should be able to identify and articulate the best interests of the corporation in every decision the board makes and should be able to align these interests with the corporation's purpose. When acting with a view to the best interests of the corporation, the duty of loyalty will of necessity demand that boards consider the interests of the stakeholders of the corporation. This includes considering the long-term sustainability of the corporation's business.

Boards of directors have two overarching duties: the duty of loyalty (to act in the best interests of the corporation) and the duty of care (to use due diligence in exercising business judgment). Nothing has changed about these obligations. However, we suggest that what counts as the best interests of the corporation and what counts as exercising good business judgment is changing in courts of law and in the courts of public opinion. Practicing lawyers, legal scholars and governance experts are all raising the warning flag to boards of directors that they will come under increased scrutiny by investors and other stakeholders on all issues related to environmental, social and governance issues (ESG).[60] Knowledge about diverse stakeholders and the impact of corporate operations on them is fast becoming an essential competency of any board of directors.[61] The duty of loyalty will be increasingly interpreted to require boards to address issues such as climate change that affect the long term sustainability of the corporation. Leading Canadian companies are putting increased emphasis on director skills in environmental, social and other stakeholder issues.[62]

These increased expectations demand a new set of skills for directors, which should be the subject of director education as well as included in the skills matrix used to identify new and assess current directors, which will be discussed in more detail below in Guideline 9 on board refreshment. Neglect of the development and maintenance of these board-level skills may be seen by the courts as a neglect of the duties of the board of directors in failing to respond to today's challenges.

These increased expectations will also be mirrored in the evolution of laws, regulations and judicial decisions. Without considering the interests of all of the corporation's stakeholders, the board risks exposing itself to an action for oppression, which will be discussed in more detail below in Guideline 7 on resolving conflicts between stakeholders.

3. Definition of stakeholders
To understand the best interests of the corporation, the board should have knowledge of the stakeholders of the corporation. Each corporation will have its own unique group of stakeholders. Stakeholder groups may include people and organizations interested in or representing the following: climate and greenhouse gasses, communities in which the corporation operates, governments, customers, current and former employees and their representatives, pollution and environmental damage, supply-chain parties, holders of the corporation's debt, shareholders and any other party or group connected to the corporation that contributes to the operation of the corporation's business or could be impacted by the corporation's operations.

The relative salience of different stakeholders will vary from company to company depending on the nature of the company's operations. Within academia, there is a vigorous debate about who should count as a stakeholder—ranging from a very narrow focus on the shareholder or other providers of capital to a much broader focus on any entity a company impacts.[63] From a legal standpoint, Section 122 (1.1) of the CBCA specifically lists shareholders, employees, retirees and pensioners, creditors, consumers, government and the environment.[64] However, from a practical standpoint, firms should be concerned about any and all stakeholders that have an impact on or are impacted by the corporation.

One way to identify stakeholders is to assess impacts across the lifecycle of a company's products or services. Some products or services are made using processes that may have negative impacts (e.g., raw materials that make our phones are sometimes produced with conflict minerals or child labour). Some products can be used for detrimental purposes (e.g., face recognition for police surveillance). Some products or services can have negative impacts at the end of their lifecycle (e.g., packaging that ends up in landfills). Thus, a stakeholder can be most usefully thought of as an actor or group that is associated with the creation (or destruction) of value by the firm at any stage of the lifecycle.[65]

Historically, many of these kinds of impacts have been counted as "externalities" that do not enter into the equation of firm value. Researchers have analyzed the Dupont settlement over toxic emissions related to the manufacture of Teflon to highlight the challenge. The analysis showed that it was cheaper for Dupont to pollute, and rational to do so at the time, because the short-term costs of pollution were borne by others and the long-term costs due to damages paid and reputational harm were discounted at the time of the decision by the probability of being detected and the likelihood of enforcement.[66] Increasingly, these short-term calculations will no longer be tenable as such "externalities" are becoming internalized by corporations.

Further altering the calculus for corporations, pressures from employees, customers, governments, social movements and investors are increasingly demanding that these costs and risks be included in business decisions by the firm. Firms will no longer be able to make trade-offs between short-term returns and long-term damages. Thus, the board must make sure the voices of stakeholders are represented in board deliberations (through processes and structures identified in these guidelines).

Corporations have been shown to play an important role globally in both protecting and exacerbating human rights–related issues in communities where they operate or obtain resources.[67] In recognition of this fact, UN Secretary-General Kofi Anan appointed John Ruggie (then Professor at Columbia University) as Special Representative of the Secretary-General to come up with a set of guidelines for human rights in transnational corporate operations. One of the core aspects of the "Ruggie Report" is to include the human rights–related impacts of a proposed project in due diligence, similar to environmental impact assessments.

3. Definition of stakeholders, cont.

This approach is becoming more mainstream. The recommendations, which are summarized in the footnote, provide a template for identifying, avoiding or remediating impacts on stakeholders.[68]

International bodies have issued other similar guidelines related to stakeholder impacts, such as on workers or the environment, which may be of use for boards in seeking to understand their own company's stakeholders. For example, the OECD's Guidelines for Multinational Enterprises instruct firms to "[e]ngage in or support, where appropriate, private or multi-stakeholder initiatives and social dialogue on responsible supply chain management while ensuring that these initiatives take due account of their social and economic effects on developing countries and of existing internationally recognised standards."[69] The International Labour Organization has highlighted how the 1998 ILO Declaration on Fundamental Principles and Rights at Work and the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (the "MNE Declaration," most recently revised in 2017) connect to corporate social responsibility.[70] Hundreds of global companies have committed to science-based targets that are aligned with the Paris Agreement on climate change.[71]

In brief, there is no shortage of information as to which stakeholders' interests and rights should be considered by boards of directors. It will be up to each board to make their own assessment of their own company's impacts on these stakeholders and of these stakeholders' impacts on the company.

4. Indigenous Peoples

The corporation should establish and implement a mechanism for fostering its relationship with Indigenous peoples which recognizes the unique historical circumstances under which the relationship is created. Ideally, such a mechanism would be jointly developed to apply to the specific Indigenous Peoples affected by any prospective project. Cognizant of the fact that Indigenous peoples are not mere stakeholders with interests but peoples with constitutional rights that are recognized and affirmed by section 35 of the Constitution Act, 1982, and recognizing that the UN Declaration on the Rights of Indigenous Peoples (UNDRIP) is applicable to the laws of Canada (and is already in BC law), boards must assure that these rights are recognized in any activities that may affect or impact the rights of Indigenous Peoples. Specifically, UNDRIP implementation in Canada may require that corporations obtain the "free, prior and informed consent" from the impacted Indigenous Peoples. Corporations should report activities with and without free prior and informed consent to shareholders as a matter of risk disclosure.

As two settlers writing these guidelines, we want to put special emphasis on the inherent rights of Indigenous Peoples—First Nations, Inuit and Métis and Indigenous peoples in any location where the company operates around the world—and the role of corporations in respecting them. It is important that Indigenous Peoples are not treated simply as one set among many stakeholder groups.[72] Many Indigenous people reject the designation of "stakeholder," which implies that their interests might be balanced with other interests, rather than affirming their inherent rights.[73] In recognizing Indigenous rights, the principles of Truth and Reconciliation apply, and boards of directors have an important role to play in honouring these principles in their own organizations. However, before reconciliation is possible, truth is required. For centuries, corporations have benefited from the diminishment of Indigenous rights, and many have profited directly from infringements on these rights. This cannot continue to be the case in an era of reconciliation as the risks of ignoring and infringing rights becomes greater and greater. Many boards of directors want to do better but lack experience and education, struggling to know how to do the right thing.

Truth and Reconciliation's Call to Action 92 on "Business and Reconciliation" requires businesses to: "(i) Commit to meaningful consultation, building respectful relationships, and obtaining the free, prior, and informed consent of Indigenous Peoples before proceeding with economic development projects. (ii) Ensure that Aboriginal Peoples have equitable access to jobs, training, and education opportunities in the corporate sector, and that Aboriginal communities gain long-term sustainable benefits from economic development projects. (iii) Provide education for management and staff on the history of Aboriginal Peoples, including the history and legacy of residential schools, the United Nations Declaration on the Rights of Indigenous Peoples, Treaties and Aboriginal rights, indigenous law and Aboriginal-Crown relations. This will require skills-based training in intercultural competency, conflict resolution, human rights and anti-racism."[74]

This language is echoed in the UN Declaration on the Rights of Indigenous Peoples (passed by the UN General Assembly in 2007 and affirmed by Canada in 2016). On December 3, 2020, the federal leadership introduced Bill C-15 to affirm UNDRIP in Canadian law.[75] A similar law has also been passed in British Columbia.[76] While UNDRIP is aimed at what governments should do, companies will be delegated the responsibility for free, prior and informed consent and will be expected to engage in negotiations that may take time to resolve.

It is fair to say that there is controversy on all sides about Bill C-15.[77] From a business standpoint, some might be concerned that "free, prior, and informed consent" might constitute veto power over business projects. Indeed, in some cases, cancellation of a project might end up being the outcome. However, the focus on the idea of the "veto" has taken over the conversation about Indigenous rights in an unhelpful way, framing consultation as a burden rather than as a legal and moral duty.[78] As UBC Professor Shirley Lightfoot has pointed out, "There seems to be a fear somehow that if free, prior and informed consent is upheld that Indigenous

4. Indigenous Peoples cont.

Peoples will have more rights than everyone else. That is completely 180 degrees off."[79] Instead, consent is not about giving Indigenous Peoples more rights than everyone else but rather assuring equal rights.[80] It is also the case that for many projects, several different First Nations or Indigenous communities may be impacted, and their interests may not all be aligned. UNDRIP and Truth and Reconciliation principles are meant to be the minimum threshold for action by companies to find ways to compensate communities and modify plans such that the impacts of corporate actions are accounted for. Modifications to plans should be done in a spirit of consent. Consent includes the right to determine how impacts will be accounted for, not just that they will be accounted for. Consent is not fulfilled with permission alone, but also encompasses the terms and conditions of that permission. While often the focus is on economic growth and employment, the focus should not be solely on monetary compensation and should also consider the social and cultural effects of projects on communities.

The language of UNDRIP has interpreted "free, prior, and informed consent" as an objective to be strived for, something companies seek, something companies make efforts to obtain. Crucially, in the Canadian context, simply having this process in place will not be seen as sufficient. That process should lead to consent as an outcome. What the "right" thing to do will vary by context. Consultation cannot be a "feel good" box-checking exercise where companies listen to concerns but then forge ahead as planned.[81] Pam Palmater, lawyer and Chair in Indigenous Governance at Ryerson University offers a useful analogy to mutual consent that is required in other domains (sexual consent or medical consent): if you are going to go ahead no matter what is revealed in the consultations, then it is not consent.[82]

There are a growing number of examples of projects that have done this fairly successfully.[83] And, industries are working to develop engagement guides that can help companies follow through on these commitments.[84] Yet, recent history has also demonstrated that ignoring or downplaying Indigenous rights can result in significant business and reputational risk. Legal challenges will inevitably cause delay and uncertainty and can result in project cancellation. Resource lawyer Bill Gallagher has documented 300 legal victories for Indigenous Peoples in resource cases.[85] These cases also demonstrate the inadequacy of relying solely on the consultation and accommodation framework with Indian Act Bands alone when other groups such as hereditary chiefs play important roles as well.

There is increasing pressure on investors to embed the principles of reconciliation in conducting due diligence and in exercising their stewardship of companies in which they invest.[86] This movement will increase the salience of Indigenous rights in boardroom discussions. Projects proceeding without free, prior and informed consent have resulted too often in conflict on the ground, which can have a material impact on the corporation's reputation and goodwill and sometimes results in project cancellation. Industrial projects that may have the required regulatory permits and adequate consultation, but do not have the free prior informed consent of all Indigenous Peoples impacted by those projects, can still face

4. Indigenous Peoples cont.

significant risk that is often not known to shareholders until a legal case or conflict reaches the media. In addition to seeking the free, prior and informed consent of all impacted Indigenous communities, corporations should report projects without consent to shareholders as a risk disclosure issue. This will assist investors and shareholders in their due diligence and in exercising their stewardship of companies in which they invest. For example, a mine with free, prior and informed consent would be valued higher than a similar mine without it.

Finally, corporate Canada is increasingly recognizing that it can learn a great deal from Indigenous knowledge about stewarding the land and building sustainability communities. Consultation and collaboration with Indigenous communities can lead to exciting solutions to important challenges such as climate change (see Guideline 12).

5. Reporting on stakeholder impact
In order for the board and stakeholders to understand the corporation's management of its stakeholders, the corporation should integrate reporting on stakeholder impact in its annual report. The report should reflect the status of and changes in the corporation's relationship with its stakeholders. To enable benchmarking and accountability and to track progress over time, boards may want to adopt an existing social accounting standard in their integrated reporting. Noting that there are currently several efforts ongoing to align existing standards, boards may also want to include reporting on issues that extend beyond these standard measures.

Reporting is an essential component of addressing stakeholders. From the standpoint of internal and external accountability, without reporting and audits of reports, boards and management cannot make informed decisions, track progress and prove to stakeholders that the company is making good on its word. A statement of purpose risks being characterized as an exercise in "greenwashing" or "purpose-washing" if not backed up with metrics and plans. Further, reporting on stakeholders is more and more considered a standard for top-performing companies.[87] Proxy advisors such as Glass Lewis have issued guidance that they will be raising a red flag if company boards do not provide clear disclosure on board oversight of environmental and social issues.[88] In the United States, 90% of S&P 500 companies produced such reports in 2018 (up from 20% in 2011), while in Canada, only about half of S&P/TSX companies did.[89]

While there are concerns that preparing existing disclosures is already expensive and time consuming, our guideline on reporting is not simply meant to create more work for staff or consultants. Some worry that further reporting requirements will chase firms from public markets, but as pension funds and other institutional investors in private companies increasingly require their portfolio companies to adhere to the principles of good stakeholder governance, the distinction between reporting for public and private companies will be reduced. Furthermore, the ultimate purpose of reporting is not just compliance. It will be ineffective if it becomes a box-checking exercise. Instead, a good reporting process should be part of informed strategic decision making, where the processes for understanding stakeholder interests and assessing metrics of performance can highlight previously unanticipated risks or bring attention to innovative new possibilities for growth.

While many companies issue sustainability or social responsibility reports separate from their annual reports (provided in Canada in the Annual Information Form and in the US in the 10K), the latest thinking suggests that integrated reporting—in which all financial and stakeholder reporting is integrated into an understanding of company performance—is the best practice (though South Africa is the only country to mandate integrated reporting).[90] If reports are issued separately, there is a risk of sending external and internal signals that there are two purposes of the corporation, where the shareholder purpose dominates. To be consistent with the articulation of the purpose of the corporation (Guideline 1), reporting should provide an integrated view that will give investors and other stakeholders greater insight into the company business model and approach to creating value.

While every company is different, and salient stakeholder issues vary across firms, there are important advantages to using standardized reporting frameworks, though they will likely need to be complemented with firm-specific metrics as well as clear narratives about how these metrics connect to the stated purpose of the firm. Standardized reporting allows for benchmarking across firms and tracking progress over time. The current voluntary reporting frameworks allow companies to report only on areas in which they are performing well or to change the metrics over time in order to find ways to signal progress.

5. Reporting on stakeholder impact, cont.

Our guidelines come out at a time in which reporting standards are in flux. Absent strong governmental or regulatory guidelines, a market for private reporting standards emerged over the past decade. In recent months, there has been a movement to align standards and reinforce the importance of integrated reporting. There are many acronyms that take some getting used to. (1) In June 2017, the Financial Stability Board (FSB) issued guidelines from the Task Force on Climate-related Financial Disclosures (TCFD).[91] (2) In September 2020, the Carbon Disclosure Project (CDP), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Stantards Board (SASB) co-authored a "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting."[92] (3) In November 2020, SASB and the International Integrated Reporting Council (IIRC) announced that they are merging to create the Value Reporting Foundation (VRF) to maintain the Integrated Reporting Framework.[93] (4) At the same time, the International Financial Reporting Standards Foundation (IFRS) is looking to create a Sustainability Standards Board (comments on their proposal closed on December 31, 2020).[94] (5) At the time of this report's publication, companies are increasingly using the 17 UN Sustainable Development Goals (SDGs) as guidance for reporting.[95]

These standards are already being widely used, as 51% of S&P 500 companies use GRI, while 14% had reports aligned with SASB, 5% aligned with TCFD, 36% aligned with specific UN SDGs, 65% respond to CDP, and 29% utilized external assurance. Similar statistics are not available for Canada, but Canada should not be lagging developments in the US.

Recent developments suggest that companies can look forward in the near future to a simplified set of choices about which reporting framework to use. A key observation is that these different standards are all pointing in the same direction, with some differences in emphasis but few conflicts. For the moment, the Ontario government's Capital Markets Modernization Taskforce proposed in their July 2020 consultation report that companies report using SASB or TCFD or both in their Annual Information Form.[96] Ideally, regulators and legislators should make these requirements clear and consistent across all jurisdictions in Canada.

Note that none of these standards is perfect. None covers all of the stakeholders that might be important to any particular company. Nor do quantifiable metrics necessarily capture all aspects of company operations.[97] So, we should see SASB or any other reporting standard as a starting point, but each company will also want to decide what else should be reported. For example, SASB is based on issues with financial materiality that are fairly straightforward to measure. However, the broader concerns about risk and opportunities associated with stakeholders go beyond the metrics in the standards, particularly in areas where financial materiality is not plainly articulated.

6. Stakeholder committee

The board should identify those stakeholders that have a material impact on or could be impacted by the corporation's business over the long term (as described in Guidelines 3 and 4) and should review the reporting and disclosure about each stakeholder group (as described in Guideline 5). The board should assess the impact on the corporation's stakeholders of all initiatives requiring board approval. The board should also have mechanisms for engaging directly with key groups of stakeholders. For many boards, these functions will best be carried out by a Stakeholder Committee which would function in a manner similar to the audit committee in its responsibility for overseeing the veracity of the reporting on stakeholder impact but would also have larger strategic responsibilities for responding to stakeholder interests. Smaller firms or firms with a surfeit of other committees, for whom creating a new committee might be onerous, might incorporate these responsibilities in another committee or in a lead director role.

Many leading companies already have Sustainability or Social Responsibility committees. This guideline proposes for those that don't, the creation of a Stakeholder Committee to monitor stakeholder interests and the risks and opportunities associated with stakeholders. We make this proposal recognizing that every company will have its own approach to designing its governance system. Some companies will believe that they have enough committees or don't have the resources to constitute another committee, and, rather than creating a new committee, will allocate the functions of a stakeholder committee to an existing committee. Others may simply decide that management of stakeholders should be a full board responsibility. Smaller companies or companies with limited governance resources could identify a "lead director" for stakeholder issues or define a process for reviewing these considerations. Small companies should not put off dealing with stakeholder issues. These issues are important for companies of all sizes.

Many boards do not yet have competencies in effective stakeholder engagement beyond that of the shareholder, and we view the creation of a Stakeholder Committee as one important measure to assuring these competencies are developed. Research shows that boards need both individuals with expertise in stakeholder issues and a commitment to society through social engagement in order to be effective in addressing stakeholder impacts.[98]

This committee should be separate from the audit committee so that the board's responsibility for managing stakeholder relations is not allocated to the already over-worked audit committee. At the same time, we recognize that consideration of stakeholder interests will be needed by other committees of the board (e.g., compensation, as highlighted in Guideline 8) as well as in full board strategic discussions. Some have suggested that stakeholder interests can be handled in the risk committee, and this may make sense in some circumstances as neglect of stakeholder issues can certainly create important material risks for companies. On the other hand, a focus only on the risk side of the equation may miss strategic opportunities for innovation or re-orientation that might come from a discussion of stakeholder issues. Others have suggested that these responsibilities might belong to the governance committee, where social responsibility strategies may have historically resided. Again, this will only make sense if this structure allows for adequate auditing and the development of competencies around stakeholder issues.[99]

Specifically, a stakeholder committee would audit the reporting on the impact of the corporation's operations on stakeholders in integrated reports (see Guideline 5). The objective of auditing the reports will be to create trust and transparency in the impact of the corporation on its stakeholders. This committee should report regularly to the board. The work of the committee should include not just a review of management reports on key metrics but also mechanisms for direct consultations with stakeholders and a hands-on approach to learning about ESG issues.

7. Stakeholder conflicts
In making a decision, the board should be able to conclude that the corporation's stakeholders have been fairly treated and that none of the stakeholders' interests have been unfairly disregarded. To reach this conclusion, the board may have to resolve competing interests amongst stakeholders, which should involve a process that fairly considers the interests of all of the stakeholders involved.

One of the greatest challenges that directors will face is that of resolving or accommodating what will likely be conflicting interests across stakeholders, not just between shareholders and other stakeholders, but between or within other stakeholder groups themselves.[100] While such conflicts offer opportunities to innovate in ways that could create value for everyone involved, it is also true that sometimes these conflicts are irreconcilable. The statement of purpose (Guideline 1) should provide the board with guidance on how to address conflicts both across and within stakeholder groups.[101]

We also are cognizant of the reality that one group of stakeholders, the shareholders, elect the people who are responsible for resolving the conflicts amongst stakeholders. The challenge for the board is to resolve conflicts in a manner that reflects the best interests of the corporation and at the same time maintains the support of the shareholders.

The resolution of these conflicts must be done in a way in which each party can be said to have been fairly treated. There is no formula for how decisions about such trade-offs should be evaluated. The goal here is not to create more "process" that simply constructs justifications that can withstand legal scrutiny. Instead, it is to assure real debate that elicits and considers different perspectives.

As South Africa's King IV guidelines suggest, these decisions will always be context specific: "Stakeholder inclusivity involves the balancing of interests over time by way of prioritising and, in some instances, trading off interests. A decision on how to achieve this balance is made on a case-by-case basis as current circumstances and exigencies require but should always be done in the best interests of the organisation over the longer term. Balancing the needs, interests and expectations of stakeholders is a dynamic and ongoing process. The quality of stakeholder relationships indicates how effectively an organisation is able to strike this balance in making its decisions." [102] Rarely are the trade-offs simple to articulate and analyze.

Note that there will be stakeholders who are uninterested in the board's balancing exercise. For some groups who simply want to prevent a company from pursuing a project, compromise will be no less objectionable. A board may not be able to make every stakeholder "happy" in any particular decision. That being said, careful deliberations can often lead to innovative solutions that might construct "win-win" solutions.[103]

Some of our interviewees highlighted the potential for a flawed application of "stakeholder consultation," which paradoxically can reduce the degrees of freedom for action by trending towards the lowest common denominator. Done formulaically, consultation could inhibit boards from taking more venturesome and innovative action. A solution is something more fundamentally like deliberative democracy, which would give people a chance to iterate on the issues. There are trade-offs, but if boards have a more engaged discussion, they will come out with something that is not the lowest common denominator.

7. Stakeholder conflicts, cont.

The question is how to decide what "fairly treated" means. Here, we need to refer to the business judgment rule and the oppression remedy. The oppression remedy is a unique feature of Canadian corporate law in which complainants can seek remedy when their interests have been unfairly disregarded by actions of the board or the corporation. Complainants can be shareholders, creditors or any other persons who, at the discretion of the court, assert they have not been fairly treated.

To date, the oppression remedy has largely been used by minority shareholders and creditors, though the provisions in the act are broad enough for a range of stakeholders to make claims.[104] Legal scholars have argued that a broader application of the oppression remedy is needed in order to "to encourage and discipline 'long-termism' in corporate decision making," either (or both) through increased judicial activism to grant leave to more types of stakeholders seeking to make a complaint or through revision of the language of the oppression remedy in the CBCA, OBCA and elsewhere, to make explicit this broader scope.[105]

There are many methods by which boards of directors can assess and address conflicts in stakeholder interests. To address them adequately, boards need processes to bring the conflict clearly before the board and a board room environment where all directors feel comfortable expressing their views. In a well-structured board, opposing points of view will be expressed on contentious issues, giving the board a balanced perspective on the issue. Boards are not strangers to dealing with conflict, although too often boards are presented with a fait accomplit by management. To effectively deal with stakeholder interests, management presentations should describe the competing stakeholder interests in board presentations so that boards are aware of the trade-offs that may be required in reaching a decision.

The World Economic Forum recommends developing a "materiality matrix" which brings together stakeholder risks and opportunities.[106] Many boards already have an enterprise risk management system with "green, yellow, orange and red" ratings that can be expanded to address the full range of stakeholder interests.[107] Boards might also come up with other procedures that fit the particular needs of the company and the specific decision. The key point is that boards will need processes for addressing conflicts and for assuring that the interests of all stakeholders are fairly considered.

8. Compensation policies
The board should ensure that management compensation is aligned with achieving the purpose and long-term sustainability of the corporation. This can be accomplished by adopting metrics and targets (as identified in Guideline 5) in compensation plans that are aligned with the purpose of the corporation. The plans should provide that the achievement of these targets makes up a meaningful component of management's bonus and other forms of compensation.

Integrating stakeholder considerations into executive compensation is essential to the company achieving its purpose. The COVID-19 pandemic has tested the boundaries of most compensation plans and forced boards to reconsider the terms of these plans. It is timely for these plans to be reviewed in light of the development of a purpose for the corporation.

Academic research in finance and strategic management suggests that compensation schemes that include social responsibility metrics lead to an increase in firm value along with an increase in long-term orientation, while at the same time promoting an increase in social and environmental initiatives, a reduction in emissions and an increase in green innovations.[108] And, conversely, metrics such as EPS (earnings per share) that are inherently short-term focused are closely associated with a lack of long-term investment.[109]

Executive compensation should be tied to a select number of metrics that are captured in the Stakeholder Report (as described in Guideline 5), not to general achievement of "social responsibility." This discussion will force a determination of which objectives are most important to the corporation. The metrics also need to be sensitive to the executives' actions so that executives can act to meet the targets, challenging enough to incentivize outperformance, and forming a meaningful enough component of the overall pay framework to capture executives' attention and efforts.[110] The board should disclose how they will assess and reward performance against these targets.[111]

Leading companies are already doing it. Shareholders are demanding it. A study of 2019 proxy filings in the US showed that 18 S&P 1500 companies received shareholder proposals demanding a link between executive pay and ESG metrics—Apple, Inc. being prominent among them—which was a 50% increase from the year before.[112] This trend will only increase over time.

One caution to raise about executive compensation is that prior efforts to bring executive pay under control have not achieved their aims. For example, "say on pay" shareholder proposals have led to expensive processes whereby boards, to avoid litigation, hire compensation consultants who benchmark against a comparison set of firms. While this can sometimes lead to a reduction in CEO compensation,[113] in many cases the use of benchmarking can lead to a rising tide in everyone's pay packages, which is particularly problematic given the growing attention to the pay gap between executives and workers.[114] Thus, implementation of ESG metrics into compensation packages should be done in a way that avoids these kinds of unintended consequences.

While Guideline 6 recommends that each company have a Stakeholder Committee, it is also clear that stakeholder issues such as aligning compensation must be incorporated in other appropriate committees of the board: in this case, the Compensation Committee. The UNPRI (Principles for Responsible Investment) offers a set of guidelines for integrating ESG issues into executive pay that compensation committees will likely find useful.[115]

9. Board refreshment

Every board should have a process which ensures board renewal, board diversity and the right mix of skills across the skills matrix. Recognizing that a director can cease to be independent after serving as a director for a sustained period of time, the process will likely include term limits, age limits or both. This process should be complemented by regular performance assessments of all directors. In addition, the skills matrix used to assess current and desired board member competencies should be updated to include knowledge about key stakeholder issues as identified in Guidelines 3 and 4.

Board refreshment is important for several reasons. First, turning over the board assures greater independence, as some have argued that board members lose their independence after many years of service. Second, renewal also allows boards to seek out board members with skills related to emerging new risks or areas of operation and to bring new ideas and perspectives to strategic decision making. Third, renewal also enables boards to increase their representation of currently underrepresented groups such as women, visible minorities, Indigenous Peoples and people with disabilities (see the discussion of Guideline 10 below). Fourth, research shows that board refreshment—in particular, the addition of women board members and board members who are more aligned with investors' concerns about sustainability, and the removal of "stale" board members—is positively associated with better environmental performance.[116]

Board refreshment can be achieved through term limits, age limits or both, as well as rigorous board evaluations. Our guideline suggests that all three are essential. Many leading firms have already implemented these approaches. According to Osler, Hoskin & Harcourt, 24% of 100 large Canadian companies they surveyed already use age and term limits together.[117] The Capital Markets Modernization Taskforce has recommended 10 years maximum tenure in draft guidelines. Many jurisdictions around the world specify a maximum tenure of board members of on average 8–10 years and regard directors as no longer independent after that time period.[118] Board refreshment has to be carefully managed to ensure continuity without unnecessarily constraining the refreshment process.

BoardSource created a list of pros and cons for term limits and strongly advocated adopting them. The list of "pros" is long (fresh insights, better board monitoring, improved board dynamics, adaptability to changes in corporate needs) and the downsides are few, primarily related to loss of organizational memory and the need for the governance committee to spend more time on identifying, recruiting and orienting new board members.[119] Thus, to reap the benefits of the new insights, experience and knowledge that come with new board directors, refreshment must include a greater investment in onboarding and educating board members about the specific context or contexts in which the company operates. Some board members we interviewed felt they were only able to be effective after three years on the board because of the steep learning curve. Some of this can be attributed to the value of experience, but some can also be attributed to inadequate onboarding procedures, inadequate time spent coming up to speed or under-investment in director education. Boards may want to impose limits on the number of boards on which a director sits in order to assure they a have adequate time to devote to being expert in the company's issues.

It is also important to conduct regular evaluations of board members' performance. Done correctly, this can help some directors who are no longer contributing effectively to move along. However, these reviews can become pro forma and riddled by conflicts of interest as people in tight social networks find it difficult to make the tough decision to remove a board member. More than one person we

9. Board refreshment, cont.

interviewed indicated that these reviews are only effective with a strong chair of the board. Relying solely on board evaluation processes for board refreshment may not lead to the desired turnover, which speaks to the need to complement it with term limits. We are proposing that boards adopt policies for refreshment that have an edge.

The review and renewal process will be greatly helped by revisiting the board skills matrix. Our review of skills matrices of many leading companies show that they often neglect knowledge about key environmental and social issues that are proving to be material for many companies. Typical matrices focus on functional experience, geographic representation and management experience. Given the growing understanding of the risks and opportunities posed by many stakeholders, the skills matrix should be revamped and more carefully defined. For example, just because a board member has been a senior leader doesn't mean they would automatically be expert in talent management or compensation. The board's capabilities should align with the company's most material drivers. If any stakeholder issue becomes important for company strategy, investors should expect the board to have the requisite skills to address it.[120] Where there is a gap in skills, it should be a priority in director education and recruitment.

10. Board diversity
Boards should be designed to include the appropriate mix of backgrounds and lived experiences. The demographics of the board should represent the communities in which the corporation operates. Specifically, as suggested by regulations governing most Canadian stock exchanges, boards should announce targets for representation of women on the board and track progress towards achieving these targets. Consistent with recent federal legislation (Bill C-25), companies should also report on the representation of other underrepresented groups, at a minimum the other protected groups under the Human Rights Code: Indigenous Peoples, persons with disabilities and members of visible minorities.

Board diversity has already captured the attention of legislators and regulators. Many Canadian companies are subject to "comply or explain" legislation or regulation that calls for reporting on women on boards (as for the Ontario Securities Commission[121]), or also (in recent federal legislation[122]) for other protected classes in the Human Rights Code, including visible minorities, Indigenous Peoples and people with disabilities. Of note, even with comply-or-explain in place for OSC-regulated companies, only 28.8% have set targets for women on boards and only 35% of vacated or new board seats were filled by women (65% are still going to men).[123] Of 230 CBCA public companies providing disclosure, almost none disclosed having targets for designated groups other than women: one company had a target for visible minorities, one a target for Indigenous Peoples, none had targets for persons with disabilities and two had targets for a combination of designated groups other than women.[124] While these rules only ask that companies set a target or explain why they have not, the very slow progress on representation has triggered the Capital Markets Modernization Taskforce to recommend in their draft rules that all TSX-listed companies set targets and annually provide data on progress. Our guidelines are consistent with this recommendation. Without targets, it is difficult to hold organizations accountable for their failure to make progress.

Many countries, local jurisdictions or exchanges—Norway, Germany, France, Italy, the State of California, NASDAQ, and others—now have quotas in place, and evidence suggests that they have been effective in supporting greater diversity in boards with none of the costs that people had feared.[125] A large body of research documents the idea that affirmative action principles are perceived by those in privileged positions as compromising quality or meritocracy.[126] Indeed, emerging research analyzing the Ontario Securities Commission "comply or explain" regulation shows that one of the prominent "explanations" for not setting targets or not achieving adequate representation of women is that of meritocracy. These companies frequently explain in their information circulars that they do not want to compromise quality in pursuit of diversity.[127]

Yet, these excuses ring hollow in the face of research which suggests that quotas actually increase quality by adding to boards and companies highly talented minorities and women who had been previously overlooked and eliminating from consideration less qualified people who had achieved their positions because of historical advantages.[128] Research has not documented negative impacts of board diversity on performance, and often shows that more diversity on boards brings value to firms by increasing the diversity of experience and improving board monitoring.[129] As discussed in Guideline 9 above, current boards of directors may not have the full set of skills required for the demands of the 21st century. The pursuit of demographic diversity is likely to help also in the pursuit of new skill sets. Indeed, research suggests that adding women to boards of directors is associated with improved social and environmental performance.[130] Thus, to say that there are no or few qualified women, Indigenous people, visible minorities and people with disabilities is not credible.

10. Board diversity, cont.

Because attention to the representation on boards of other underrepresented groups such as visible minorities, Indigenous people, members of the LGBTQ+ community, and people with disabilities is so recent, there is less research to guide us. But, from a pure representation standpoint, according to the 2016 census, 22.3% of Canada's population are visible minorities and this is projected to grow to 1/3 of the total population by 2036.[131] One in five Canadians over the age of 15 has one or more disabilities.[132] More than 5% of people living in Canada are Indigenous, though in many local communities where Canadian companies operate (such as in timber, mining or oil extraction), the percent is much higher.[133] Yet, only 7 seats of CBCA public company boards are held by Indigenous people, 6 by persons with disabilities, and 5.5% are held by visible minorities (of the companies that disclose this information).[134] To be effective, boards should factor into their composition the communities in which their companies operate, which would suggest the need to significantly increase the number of women, Indigenous people, visible minorities and people with disabilities on every board. Specifically, if companies are serious about Indigenous rights, as discussed in Guideline 4, then assuring representation of Indigenous Peoples on the board of directors would be essential.

11. Organizational diversity
Every corporation should have and disclose its policy relating to diversity in its leadership and overall work force. This includes gender diversity as well as diversity along all dimensions protected by the Human Rights Code. The policy should provide specific targets and timelines for achieving them. Management should regularly report to the Board on its progress in meeting its targets, and this information should also be disclosed in the company's annual report.

While attention to board diversity has been a primary focus of regulators, legislators and advocacy groups, the need for attention to diversity throughout the organization is rising in importance as well. Further, while some might hope that increased diversity on boards will trickle down to representation in the rest of the organization, there is only mixed evidence that this might be the case, and even where present, it occurs at small increments.[135] Thus, it is not enough for boards to focus on their own diversity.

Boards must attend to existing regulations, such as those from the OSC and the Government of Canada that already require reporting on diversity in executive leadership as well as on boards of directors. As covered in Guideline 4, the Truth and Reconciliation Call to Action 92 (ii) also expects companies to "[e]nsure that Aboriginal peoples have equitable access to jobs, training, and education opportunities in the corporate sector, and that Aboriginal communities gain long-term sustainable benefits from economic development projects." The BlackNorth initiative has highlighted the lack of representation of Black people at all levels of organizations.[136] In the war for talent, many companies are missing out on the best teams because of systemic biases built into their recruiting, retention and promotions systems.

Further, institutional investors are paying attention to organizational diversity as a material risk factor. The #MeToo and Black Lives Matter movements increase reputational risks for firms that do not reflect the communities they operate in. As one example, Vanguard, as part of their stewardship, is now asking companies to have anti-racist policies. They are asking questions such as, "What are the risks of becoming a target of boycotts or protest? What are the risks of erosion of brand loyalty?"[137]

Pay transparency legislation, which is already in place in the UK and other jurisdictions and will soon be coming to some Canadian companies through the federal Pay Transparency Act,[138] subjects firms to extra scrutiny.[139] Many Canadian companies have already made pay transparency reports for their UK operations, and these show gaps in pay of 19-82% between women and men (before and after bonuses are taken into account, respectively). The primary driver of the wage gap is the lack of women in higher-paid, senior positions in organizations. Indeed, women and people of other underrepresented groups face many difficulties in being promoted in organizations. According to Osler, only 4.4% of TSX-listed companies have a CEO who is a woman.[140] In 2020, for the S&P/TSX 60, 6 of 799 senior executives and 4 of 686 board members were Black.[141]

Yet, despite this lack of representation, companies have resisted setting targets. If only 29% of OSC-regulated companies set targets for women on boards, even fewer—less than 10%—do so for women in executive leadership.[142] Current diversity and inclusion efforts often focus on implicit bias training, but evidence is weak that this approach alone will achieve much success and may even lead to backlash [143] As evidenced by the increasing conversation about systemic and structural discrimination, the answer will not lie in training alone, and especially not the type

11. Organizational diversity, cont.

of training that is meant to "fix" the people who are experiencing discrimination so that they can fit into existing corporate culture. The answer will come in changing the systems and structures themselves.[144] This change will be accelerated by setting targets and measuring progress on recruiting, promotion, retention, attrition and distribution of people in roles that create a path to leadership. Boards of directors can set the tone at the top to accelerate this change by setting targets for representation and demanding accountability.

12. Climate change
Every corporation should have and should disclose its policy for addressing climate change and climate-related risks and opportunities. Consistent with TCFD (Task Force on Climate-related Financial Disclosures) recommendations, boards should disclose their oversight of climate-related issues including the processes by which board committees consider climate-related issues when reviewing strategic choices and how the board monitors and oversees progress against goals and targets for addressing climate-related issues.

Climate change must be called out for intensive focus by the board because we are facing an existential crisis, and it is becoming increasingly material for all companies. Climate change is not outside the scope of action for any company in any industry. For many years, climate risk was, as then-Bank of England Governor Mark Carney described, "a tragedy of the horizon," in that most of the consequences would be faced by future generations and were beyond typical company planning time frames.[145] This is no longer the case. Companies will either need to make a major transformation to get to a lower-carbon economy or they will have to make a major transformation to deal with the disruptions caused by climate change. Flooding, storms, heat waves and fires will have massive impacts on infrastructure, physical plant, supply chains, insurance risks and other factors that affect the firm's bottom line. At the same time, companies can seize innovative business opportunities to achieve net-zero emissions, such as new forms of energy or storage, new methods of packaging or transportation and new products and services.[146]

Any board that is not actively overseeing the threats and opportunities associated with climate change will be remiss in its duty of loyalty. Legal scholars suggest that standards for due diligence in board decision making—in the case where stakeholders might bring actions in respect of climate-related risks—will likely include questions such as, "Did the directors and officers undertake to identify potential transition risks and physical risks from climate change and climate change policies? Did the directors and officers develop an ongoing process or program for monitoring and identifying new climate-related risks, and have mechanisms in place to respond rapidly to changes in the risk profile? Did directors and officers put appropriate strategies in place to manage climate-related risks?" And so on.[147]

More than in any other area, climate impacts will produce what the UNPRI calls "Inevitable Policy Responses."[148] That is, the question is not whether there will be more regulation but how soon it will come. The Paris Agreement's "ratchet mechanism," which supports additional climate pledges in 2025, means that we should anticipate more policy announcements in the next few years. In December 2020, the Government of Canada laid out a carbon tax plan that will have direct economic effects on company operations for the next decade.[149] Similarly, new clean fuel standards are coming into play.[150] And, if we are to achieve the Paris targets and avoid the anticipated disruptions caused by global warming, then more government action like this is inevitable.

Further, environmental performance is becoming a crucial source of competitive advantage in appealing to customers, funders and other important constituencies. Increasingly, companies are competing for and trumpeting their performance on things such as the Climate Disclosure Project (CDP) "A List" of firms that excel on environmental transparency and action.[151] In addition, proxy advisors are now issuing climate voting policies, as they have found that 60% of their investors feel that reporting on climate-related risks and actions to mitigate them should be required of all companies.[152]

12. Climate change, cont.

Canada is in a particularly tight bind when it comes to addressing climate change. On the one hand, we want our country to be seen as a global leader on issues crucial to the planet. On the other hand, on a per capita basis, Canada is 5th in the world on CO2 emissions, worse than all European countries and just slightly better than the US.[153] In 2020, the TSX/TSXV listed more oil and gas issuers than any other exchange, including 20% of all global public oil and gas companies—50% of issuers had oil and gas properties outside of Canada.[154] Of course, it is not just oil and gas companies that are a source of climate challenges. Every company is implicated in one way or another.

The OSC has already issued a number of Staff Notices to guide issuers about disclosing material environmental matters.[155] More recently, the Ontario Capital Markets Modernization Taskforce's July 2020 Consultation Report proposed that TSX companies adhere to TCFD (Taskforce on Climate-related Financial Disclosures) guidelines on reporting. The TCFD recommends that boards disclose their oversight of climate-related risks and opportunities including the process and frequency with which the board and its committees are informed about climate-related issues, whether and how the board considers climate issues in strategic decision making and how the board monitors progress against goals and targets to address climate-related issues.[156] In the TCFD's latest status report, it is clear that leading companies are adopting the guidelines. Of large-cap firms (those worth greater than $10 billion) globally, 42% already disclose at least some of the TCFD-aligned information. Even more interestingly, the companies doing the disclosures found that the biggest benefit was in using the information to re-examine the impact of climate change on the company's business and strategy.[157]

In short, climate change is increasingly material to company performance, either because of direct impacts, societal pressures or government regulation. Boards of directors will increasingly be expected to have deep competencies in climate change and will be guiding their companies through the needed transformations to address the climate crisis.

13. Corporate activism

Corporations may from time to time be pressured to state their position on an issue with social or political implications. The corporation may also decide, of its own volition, to make such a statement. The CEO should lead the process to decide whether to make a statement and what the content should be. Before making that decision, the CEO should consult the board to obtain the board's input and approval on whether, when and how to take a stand. The disclosure of the position of the corporation should be prepared in the same manner and with the same degree of care as any other release by the corporation. Because the nature of the issue may attract substantial attention from investors and other stakeholders, the board should ensure that the corporation has in place a process which will enable the CEO and the board, if necessary, to respond to public inquiries.

In the current political environment, corporations are more and more expected to take a public position on political or social issues in ways they might not have in the past.[158] The issue may arise because of some development external to the corporation or because of some occurrence within the corporation. Some of the possible subjects of this type of statement have been raised in this report, e.g., climate change, racial discrimination, diversity and supply chain issues. The corporation may make a public statement on a political issue because the issue impacts the corporation's purpose or impacts its stakeholders. It may be important, for example, to the corporation's work force or to consumers of the corporation's products.

In a political environment that is increasingly volatile, the pressure on corporations to speak to social issues has increased. Examples of CEO activism in the US include statements against anti-LGBTQ laws and policies, the National Rifle Association's promotion of gun policies and downplaying of gun violence, restrictive immigration policies and family separations at the US southern border, among other areas. The pressure may be different in Canada but nevertheless exists. Corporations in every sector need to be prepared to manage increasing social and political activism. Every large Canadian corporation has operations in other jurisdictions either directly or through a supply chain. Issues may arise in these other jurisdictions that challenge Canadian corporations. A vivid recent example is Shopify's January 2021 decision to remove Donald Trump's web stores from Shopify's platform after the Trump-incited insurrection at the US Capitol building.[159] The corporation may decide to remain silent or may decide to make a public statement and take further action.

There are risks on both sides: If a company takes a stand, it may offend certain constituencies, but if it doesn't take a stand, it may be subject to criticism from key stakeholders where silence will be conspicuous. Research in the US shows that 77% of consumers wanted CEOs to speak out when their company's values were threatened, while at the same time consumers would be less likely to buy from a company if they disagreed with CEO remarks and more likely to buy if they agreed.[160]

The corporation's position would normally be expressed by the CEO. Most CEOs would consult their board of directors before going public on a high-profile issue, particularly if the issue is controversial. Thus, it is important that the corporation have in place a process that the CEO can invoke to decide whether or not to issue a statement, when to take a stand, how to do it and how to address any negative consequences that may follow.[161] The board should also consider what level of discretion the CEO should be afforded in speaking out on these types of issues. The process will provide a forum in which the board can decide if such a statement would be in the best interest of the corporation.

Conclusion: The urgency of 360° Governance

The message that underlies 360° Governance is straightforward. The world we live in today makes demands on boards of directors that the governance standards of 25 years ago are not equipped to address. The message has many themes: diversity, climate, equality, environment, sustainability; themes that, if addressed by all companies, will enhance our quality of life and enhance company operations.

The COVID-19 pandemic has graphically exposed many fractures in society and has underscored the urgency for dealing with these issues. The pressure comes from workers seeking employers they can believe in, consumers shopping with their values, investors exercising expanded notions of stewardship, regulators seeking to rein in negative corporate impacts, and others who will make their needs known in the coming years.

360° Governance is our contribution to the wide-ranging discussion that is taking place about the many social and environmental challenges society faces. The corporate sector can be amongst the leaders in this discussion and in the ensuing reforms. Because boards of directors will be instrumental in leading the corporate response to this challenge, we have focused our efforts on proposing guidelines that are designed to assist them in this duty. At the same time, these guidelines are not meant to deflect responsibility from governments to set the rules of the game, from stakeholders to advocate for their interests or from investors to create the right expectations of the companies in which they invest.

These guidelines are just what their name implies: suggested steps that a board can take in overseeing the management of the corporation. In implementing the suggestions, boards will want to modify them to fit their company's circumstances. Unless otherwise already set in law and regulation, the guidelines are not mandatory. Yet, to ignore the suggestions is a risky course of action. We believe that all corporations need to have a position on the issues raised by the guidelines. We also recognize that our list is not exhaustive. Each corporation will have its own set of issues reflecting the various contexts in which the corporation operates.

With these guidelines, we have tried to describe the stakeholder pressures that corporations face and create a roadmap for boards to oversee the corporate response to these pressures. Our objective has always been to help the corporation to sustain itself over the long term and to create value for its stakeholders.

The challenges facing corporations in the 21st century are myriad. Boards must be prepared. Around the world, reforms are proceeding apace, and Canada should keep up or, we hope, even aspire to lead. We are optimistic that our proposals will contribute to the ongoing reform process. Canada—with its deep and diverse pool of talent and its aspiration to be a global leader in the creation of an inclusive and sustainable economy—is well-positioned to meet the challenges facing the corporate sector. Corporations that embrace our guidelines will benefit, creating more value for all stakeholders.

Resources

Our guidelines are built on important work done by many organizations in Canada and around the world. Many of these organizations have developed detailed playbooks to guide implementation. Below is a partial list of references that may be useful to boards of directors. (All links active as of January 15, 2021)

Advancing Reconciliation in Canada: A Guide for Investors
Reconciliation & Responsible Investment Initiative, April 2020.

Audit Committees and Effective Climate Governance: A Guide for Boards of Directors
Canada Climate Law Initiative, By Janis Sarra, December 2020.

BlackNorth pledge
BlackNorth Initiative, July 21, 2020.

Canada 2030. Embedding Sustainability into Corporate Governance
The Conference Board of Canada, May 2018.

Directors' Playbook
Canadian Gender & Good Governance Alliance, 2017.

Directors' Liability and Climate Risk: Canada Country Paper
Commonwealth Climate and Law Initiative, by Janis Sarra and Cynthia Williams, April 2018.

Guiding Principles on Business and Human Rights "Ruggie Report"
Office of the High Commissioner, United Nations Human Rights. June 2011.

Integrating ESG issues into executive pay: Guidance for investors and companies
UNPRI, June 2012.

King Report on Corporate Governance for South Africa - 2016
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Lead from the Top: Building Sustainability Competence on Corporate Boards
Ceres, by Veena Ramani, September 2017.

Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation
World Economic Forum White Paper, September 2020.

Recommendations of the Task Force on Climate-related Financial Disclosures
TCFD, 2017.

Running the Risk: How Corporate Boards Can Oversee Environmental, Social and Governance (ESG) Issues
Ceres, by Veena Ramani and Hannah Saltman, November 2019.

Strategic Oversight of ESG
National Association of Corporate Directors (NACD), September 2020.

The Directors' E&S Guidebook
Canadian Coalition for Good Governance, May 2018.

Endnotes

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Published February 2021