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Outlook 2021: Enhanced Focus on Environmental, Social, and Governance (ESG) Initiatives by All Market Participants

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Environmental, social and governance (ESG) practices have become the key factors used to measure the sustainability and ethical impact of a business. News and articles relating to ESG issues and initiatives in the public markets have been almost a daily source of content in the past year, from high-profile shareholder activist challenges to address climate change, notably Exxonmobil and Chevron, to the increased focus of regulators on ESG risk and other disclosure, as discussed below.

This ESG focus has created a significant opportunity for those who genuinely embrace and tackle ESG issues. It is now the reality that corporations *must* adopt and evolve ESG policies to remain competitive and compliant. While factors such as return on investment and profits remain significant measures of a corporation's success, investors are increasingly looking to other metrics (such as commitment to net-zero carbon emissions and increasing diversity amongst corporate boards) when making investment decisions. Canada's most powerful pension funds have jointly called for issuers to provide broader and more consistent information to investors. Shareholder activism is another pressure point requiring increased corporate and board attention to ESG issues.

This article discusses increased regulatory initiatives to mandate climate-related disclosure and enhance other ESG-related disclosure and provides an update on corporate diversity initiatives. It is clear that the application of ESG considerations to business strategy and decision-making is not a trend or passing phase; it is here to stay.

Regulatory Action Toward Increased ESG-Based Disclosure

On October 18, 2021, the Canadian Securities Authority (CSA) published for comment a proposed rule that would mandate climate-related disclosure.[1] National Instrument 51-107 *Disclosure of Climate-Related Matters* will implement a "comply-or-explain" regime, under which public issuers will be required to disclose their greenhouse gas (GHG) emissions and the related risks or explain why they have not done so. The implementation of these additional disclosure requirements will be phased in on a three-year basis.

The proposed requirements address the need for more consistent and comparable information to help inform investment decisions, and contemplate disclosure by issuers related to the four core elements of the recommendations developed by the Task Force on Climate-related Financial Disclosures[2]: governance, strategy, risk management, and metrics and targets. Further, the proposed requirements reflect the CSA's aspiration to align Canada's capital markets with the growing international movement toward similarly mandated climate-related disclosure.

The inconsistencies and deficiencies of the current optional ESG-based disclosure regime highlight the need for mandatory disclosure requirements. For example:

- of the 222 companies listed on the S&P/TSX Composite Index, only two-thirds have disclosed their greenhouse gas emissions;[3] and
- only 27% of TSX companies have stated emissions targets, only 15% of which have stated a detailed plan for achieving those targets.[4]

The current patchwork of ESG disclosure has come under criticism from various market participants for its lack of uniformity, including from the Canadian Institute of Chartered Accountants, which has called for a universal approach mirroring that currently in place for accounting practices.[5] Similarly, the Chief Investment Officer at Wealthsimple Inc. has publicly criticized the inconsistent approach and the difficulty this imposes on investors looking to invest in a socially responsible manner. The proposed climate-related disclosure requirements seek to address these concerns, at least in part, providing for a means of delivering more consistent and comparable information to allow for more informed investment decisions.

ESG Investment Mediums: Green and Sustainability Bonds

The increasing investor interest in "green investing," such as ESG-linked investment mediums, is also being addressed by regulators, as demonstrated by the OSC approved amendments to the TSX Rule Book to accommodate trading of these types of mediums.[6] Issuers have responded by issuing "Green Bonds" and "Sustainability-Linked Bonds" (SLBs), both of which have been firmly embraced by Canadian investors. The value of sustainable funds has increased exponentially, which brings its own regulatory challenges and risks, including greenwashing, as discussed below.

Green Bonds essentially require that the investment proceeds are allocated for use only in "green" or sustainable initiatives, and they require the issuer to track and to report on that use. SLBs provide a more flexible vehicle without the ongoing disclosure obligations of Green Bonds, but require the issuer to set ESG-based goals with an accompanying timeline to realize those goals. The availability of both bonds has resulted in quantifiable and significant growth in this segment of the Canadian market:

- in August 2020, Brookfield Renewable announced its commitment to issuing $425 million in Green Bonds by August 2022;[7]
- the Canadian market for Green Bonds has risen from $2.6 billion in the first quarter of 2021 to a record $4.9 billion in the second quarter of 2021;[8]

- Dream Industrial Real Estate Investment Trust issued $400 million in Green Bonds in June of 2021, while Allied Properties REIT issued $600 million in Green Bonds in January of that year;[9]
- in June 2021, Telus Communications Inc. sold $750 million in SLBs, and Enbridge Inc. sold $1 billion worth of SLBs;[10]
- in the first three quarters of 2021, there were five separate ESG-linked corporate debt deals in the Canadian market where $500 million or more in bonds were issued, this compares to only one ESG-linked deal of this size in all of 2020;[11]
- in September 2021, the Ontario Teachers' Pension Plan (OTPP) stated its intention to issue Green Bonds as a way of funding some of its investments in climate solutions and sustainable companies,[12] this comes only months after the OTPP became an anchor investor in Brookfield Asset Management's Global Transition Fund, the largest pool of private money globally aimed at accelerating the shift to a net-zero economy;[13] and
- as of the end of September 2021, BMO, National Bank of Canada, and RBC had each raised more than $750 million through the issuance of ESG-linked bonds.[14]

The proliferation of these ESG-related investments is largely a positive development for both investors and issuers but like any emerging trend, also increases risk of investor manipulation through misleading disclosure about the nature of investors. Further, a failure to meet stated ESG-related goals can lead to not only regulatory attention and public criticism, but also shareholder activism.

Greenwashing, whether intentional or inadvertent, erodes investor confidence in the markets and detracts from genuine efforts to support ESG causes by responsible market participants.

The CSA have signalled their intention to focus on enhanced ESG-related disclosure and enforcement efforts to address greenwashing and other misleading ESG-related disclosure. For example, the OSC and the AMF are both members of the Sustainable Finance Task Force created by the International Organization of Securitas Commissions, which includes a focus on improving sustainability-related practices and disclosure in the asset management industry.[15]

Corporate Diversity: More Progress is Needed

Diversity of representation at the corporate board level and in the "C-suite" remains another key ESG-related priority for investors and regulators alike. Unfortunately, despite several years of attention and focus on this issue, lack of board diversity remains an issue for both new and old public companies:

- the results of a follow-up report to the 2020 "BlackNorth" initiative, a pledge by many Canadian corporations to increase diversity at the board and management levels, showed little progress, with many companies declining to comment. Of the 209 signatories to the BlackNorth initiate, 105 reported having neither increased the number of Black employees nor elevated Black people to executive roles or the Board level. Only about 15 companies reported having more Black senior employees or having increased Black representation at the Board level;[16] and

- a study conducted in August of 2021 on the 61 companies newly listed on the TSX in 2021 revealed that, of the 318 board seats amongst those companies, 79 (25%) were held by women. For newly public companies, this number was only 19% of available seats. Further, only 3 of the 61 companies had a woman as Chair of the board. These statistics are consistent with the numbers seen across all Canadian public companies; in fact, 27% of Canadian public companies do not even have a single female director at all.[17]

The pace of progress in achieving racial and gender diversity in the Canadian public markets is concerning; however, there is momentum for further change. Proxy advisers Institutional Shareholder Services and Glass Lewis & Co have stated their intention to increase their requirements for gender diversity in Canadian companies in 2022. Glass Lewis has indicated that it intends to recommend that investors vote against the Chair of a company's nominating committee, unless there are at least two female directors.[18] Board diversity is likely to remain a key priority for shareholder activism in 2022.

Looking Forward in 2022

In 2020, we predicted that ESG-related issues would continue to gain steam in 2021, and we have certainly seen a heightened awareness of, and reaction to, ESG issues like those discussed above. While these issues are challenging and systemic, it appears that regulators, issuers, and investors alike are genuinely focussing their collective efforts on addressing and progressing ESG issues, and we look forward to this trend continuing in 2022.

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[3] "With increased global demands for climate data, new research shows Corporate Canada must step up its game," *Institute for Sustainable Finance*, April 8, 2021, online: <https://smith.queensu.ca/centres/isf/news/tsx-emitters-report.php>.

[4] *Ibid*.

[5] "Accountants have had enough. It's time to develop global standards for corporate reporting on ESG Issues," *Globe and Mail*, June 24, 2021, online: <https://www.theglobeandmail.com/business/commentary/article-canadas-accounting-sector-seeking-better-consistency-in-esg-reporting/>.

[6] OSC, Notice of Approval, "TSX Inc – Trading of Sustainable Bonds on TSX," November 12, 2020, online: <https://www.osc.ca/sites/default/files/2021-01/788.pdf>.

[7] Securities Law Newsletter, "SECNWS 2021-01," May 2021.

[8] "Canadian Green Bond Market Riding High After Record Quarter," *Reuters*, July 12, 2021, online: <https://www.reuters.com/business/sustainable-business/canadian-green-bond-market-riding-high-after-record-quarter-2021-07-12/>.

[9] "'The ESG Focus Has Exploded': Sustainability-linked Bonds Bringing New Issuers to the Table," *National Post*, July 29, 2021, online: <https://financialpost.com/fp-finance/the-esg-focus-has-exploded-sustainability-linked-bonds-bringing-new-issuers-to-the-table>.

[10] "Telus, Enbridge Greenium Boosts Sustainability-linked Bonds," *BNN Bloomberg*, June 30, 2021, online: <https://www.bnnbloomberg.ca/telus-enbridge-greenium-boosts-sustainability-linked-bonds-1.1623766>.

[11] "'The ESG Focus Has Exploded': Sustainability-linked Bonds Bringing New Issuers to the Table," *National Post*, July 29, 2021, online: <https://financialpost.com/fp-finance/the-esg-focus-has-exploded-sustainability-linked-bonds-bringing-new-issuers-to-the-table>.

[12] "Ontario Teachers' Releases Ambitious Interim Net-zero Targets," *Ontario Teachers' Pension Plan*, September 16, 2021, online:

<https://www.otpp.com/news/article/a/ontario-teachers-releases-ambitious-interim-net-zero-targets>.

[13] "Brookfield Announces Initial US$7 Billion Closing for Brookfield Global Transition Fund," *Ontario Teachers' Pension Plan*, July 27, 2021, online: <https://www.otpp.com/news/article/a/brookfield-announces-initial-us-7-billion-closing-for-brookfield-global-transition-fund>.

[14] "'The ESG Focus Has Exploded': Sustainability-linked Bonds Bringing New Issuers to the Table," *National Post*, July 29, 2021, online: <https://financialpost.com/fp-finance/the-esg-focus-has-exploded-sustainability-linked-bonds-bringing-new-issuers-to-the-table>.

[15] June 30, 2021 Consultation Report.

[16] "Companies Show Little Progress on Diversity A Year After Committing to BlackNorth Initiative," *Globe and Mail*, July 20, 2021, online: <https://www.theglobeandmail.com/business/article-companies-show-little-progress-on-diversity-a-year-after-committing-to>.

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[18] *Ibid*.
