Charting the Future of Canadian Governance: **A Principled Approach to Navigating Rising Expectations for Boards of Directors**

REPORT OF THE COMMITTEE ON THE FUTURE OF CORPORATE GOVERNANCE IN CANADA

A JOINT INITIATIVE OF TMX GROUP LIMITED AND THE INSTITUTE OF CORPORATE DIRECTORS

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Introduction from the Co-Sponsors

Canadian businesses and not-for-profit organizations must now survive and thrive in an increasingly dynamic and digital world marked by a range of new geopolitical, environmental, and social challenges, all while being measured against rising expectations from a diverse group of stakeholders. This dramatic pace of change is forcing boards of directors to think differently about how they master their jobs as directors, how they assess risk, how they evaluate strategy, how they select executive leadership and measure performance, and how the organizations they oversee are ultimately governed.

While Canada has a strong track record in corporate governance, the status quo for boards in this country is not an option. They must evolve to meet the challenges of today and position themselves to meet the even higher expectations that will be placed on them tomorrow. It is no easy task, but it is essential.

Knowing this and that more than 25 years have passed since the foundational "Dey Report" by The Toronto Stock Exchange Committee on Corporate Governance led by Peter Dey, the Institute of Corporate Directors and TMX Group Limited convened a diverse committee of 13 leading corporate directors from across the country in the fall of 2020. The committee was tasked with assessing the state of corporate governance in Canada and providing guidance for strengthening Canada's governance practices, ensuring Canadian boards are well equipped to meet rising expectations. This guidance is applicable for companies and organizations of all types and sizes, from coast to coast to coast.

This group shared a common belief: that good governance drives better performance and helps Canadian companies compete in a more challenging world. This performance creates sustainable long-term value, not just for shareholders and other stakeholders, but for society as well. While the fundamental legal duties of Canada's directors have not changed, boards need to determine if they are effectively guiding organizations to a better, a more competitive and more sustainable future. This may require changes to the way they think and function.

The committee's report is the product of more than two years of work and critical evaluation. It reflects the views of a cross-section of some of Canada's most esteemed directors and governance experts, as well as valuable commentary from a broad range of stakeholders. Importantly, it is a report written by directors, for directors.

The final report is the product of considerable, healthy debate. It is a nuanced and thoughtful distillation of views and contributions from an engaged group, one that is intended to help shape the discussion around the evolution of corporate governance in Canada.

As the title suggests, the committee's report takes a principled approach to fostering and advancing this important discussion. It is not intended to provide a step-by-step guide for implementing changes. It is designed with purpose to clarify and validate key aspects of corporate governance that directors need to focus on to meet this new set of expectations in a rapidly changing world. Importantly, and being mindful of the wide range of companies and organizations that make up Canada's unique business community, the principles set out in this report are relevant for companies and organizations of different types, sizes, in different sectors, serving different stakeholders.

On behalf of both our organizations, we would like to thank the committee, and the many others who shared their expertise and views, for the time and energy that has gone into producing this critically important report. We would also like to acknowledge Barbara Stymiest for her steadfast leadership throughout the report's development.

The launch of this report is not the end of this work; it is the beginning. It is our hope that the discussions and actions taken by boards that flow from this report will shape the future of corporate governance in this country.

We look forward to our continued work in driving this change forward.

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* TMX Group is participating in this initiative as part of its role in Canada's capital markets to promote long-term sustainable investment. TMX Group is committed to embracing progressive change and as such is embarking on this Committee to connect with its various stakeholders with a goal to provide recommendations on good corporate governance practices. However, we note that any views and recommendations advanced by the Committee may serve as a tool and/or guidelines for issuers listed on Toronto Stock Exchange and/or TSX Venture Exchange (the "Exchanges").

Given the Exchanges' role in regulating listed issuers, together with their responsibility for ensuring the integrity of the market and the public interest while considering the interests of multiple different stakeholders, the Exchanges are of the view that boards of directors of listed issuers are best situated to determine what, if any, of the resulting recommendations stemming from the Committee are in the best interest of their respective corporation, shareholders and other constituents. Should the Exchanges decide to adopt any recommendations as an Exchange requirement for listed issuers, the Exchanges will follow the established procedures set out in the various recognition orders when seeking to amend their policies or procedures, including where applicable, publishing such changes for public comment.

A Note on Our Work

TMX Group Limited and the Institute of Corporate Directors brought us together as 13 committee members in the spring of 2020. Our mandate was in three parts: study the current state of corporate governance in Canada, recommend practical guidance to address the challenges of today, and bring this country's practices into line with the highest international standards.

We recognized from the start that as the corporate sector adapts to a fast-moving world, so too must the principles that underpin exemplary governance. And it has been nearly three decades since our system of corporate governance was built on the foundations laid by the 1994 report of the Toronto Stock Exchange on Corporate Governance, chaired by Peter Dey.

Governance issues are like all business issues: the journey to excellence never ends. Ongoing effort is needed to respond to the profound and often divisive issues that confront society in today's world. In some cases, there is no de facto "right" answer in the realm of governance and we expect that will continue to be true as the world evolves.

As directors, we are stewards of the companies on whose boards we serve. We spend a lot of our time keeping abreast of current developments in all kinds of areas. As a result, each of us has been able to bring our own perspective to the current and desired future state of corporate governance in Canada.

Our diverse backgrounds led to many rich discussions on how corporate boards should evolve, which led to a set of recommended principles covering the main areas of governance.

We hope these principles will gain wide acceptance and make a lasting contribution to the stewardship of Canada's public companies. As noted by the Co-Sponsors, we look forward to joining you in the ongoing discussions that will follow the publication of our report.

The Committee on the Future of Corporate Governance in Canada

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Acknowledgements

As the committee started its work to create meaningful guidance and principles to raise the bar on Canada's existing corporate governance guidelines, there was no shortage of ideas on where to focus.

The hardest part of creating this report was to make sense of the many challenges and opportunities facing companies of all sizes in these uncertain times. Our goal was to provide directors with a cohesive narrative and one that framed the improvements we believe are necessary for boards of Canadian companies. We took into account the uniqueness of Canada's public venture market which enables small companies to become public companies.

We all agreed that the key areas of board oversight don't require change (Strategy, Risk, Performance and Leadership) but significant changes are required in how boards should go about their ever more demanding roles in these areas. Strategy and performance measurement are different in a world of multi stakeholders, risk management is evolving rapidly and oversight of the leadership and broader talent pools in organizations demands a different style of leadership, a healthy culture and a focus on diversity, equity and inclusion (DEI). These fresh challenges for boards require new corporate governance principles both for board oversight of company performance and how boards should themselves operate.

> "Our goal was to provide directors with a cohesive narrative and one that framed the improvements we believe are necessary for boards of Canadian companies. We took into account the uniqueness of Canada's public venture market which enables small companies to become public companies."

This work reflects the strong commitment of every committee member through their participation and input, with each of them bringing their specific expertise and passion to their areas of interest. We would like to make special note of a few members for their added stewardship along every step of this journey including Heather Munroe-Blum and Mac Van Wielingen who brought their expertise to ESG and Risk, Barbara Stymiest and Colleen Johnston who brought their backgrounds in finance to the evolving role of performance management, and Raymond Chan who had very strong views on how boards of both large and small companies need to evolve. Indira Samarasekera and Anne McLellan brought vigorous challenge and insight that was relentless and vital, to help find the narrative to knit together this report.

Not surprisingly, someone had to roll up their sleeves to evolve the report into one that reflected the views of the committee and consider the nine virtual roundtables of stakeholders held in the fall of 2020. To be credible and substantive, it was also important to consider the never-ending number of published reports, press commentary, and books on governance written by the many experts in this space. The committee would like to recognize Barbara Stymiest who, over the course of the past two years, became the lead author of the report. She spent countless hours ensuring the drafting, sourcing and writing of this report achieved the committee's goal to delve deeply into the relevant issues and arrive at practical and meaningful guidance for Canada's companies.

Barbara has spent much of the past year working with the committee and in discussions with several thought leaders on governance. Many of them are cited in the report or are directly responsible for guiding us toward some best-in-class thinking in the key areas of governance. To name a few, frequent discussions were had with Patricia Meredith, an expert in strategic governance, and Jonathan Goodman, Global Chair of Monitor Deloitte and leader of Deloitte Canada's Boardroom Program. The report also benefitted from Barbara's long-term friendship with Roger Martin who served on some of the same boards.

We would also like to mention John Helliwell, the Editor of the World Happiness Report and a Co-Director of CIFAR's Social Interaction, Identity and Well-Being Program which underpins what is core to employees: trust in their employer and their own well-being within inclusive organizations. We also owe a debt to Alan Grant, a Boston-based entrepreneur, who pushed us toward contextualizing much of the recommended changes for how boards should work within the new world of multiple stakeholders, which emerged later in the development of the report.

Throughout this journey to capture the rich discussion that supports the recommended principles, we especially want to credit so many great fellow directors who have taught us so much through their increasingly hard work in boardrooms and the many senior executives who we work closely with in our board roles.

Finally, this report could not have been written without the help of some key staff members of the ICD and TMX Group, Torys LLP, Bernard Simon, and our master writer, Bob Ramsay, a well-known communications consultant.

Executive Summary

A. Where We Are

Canada's system of corporate governance has long been admired. But we live in tumultuous and demanding times, and our governance practices must continually adapt to the vast and often furious changes taking place around us.

Racism, income inequality, and disinformation, among other worrying trends, are fomenting social discontent, political polarization, and populist nationalism. Mass protests, uprisings, and wars have erupted around the world. Here in Canada, we are also belatedly beginning to understand the magnitude of the impact of residential schools on our Indigenous peoples.

On another front, climate change is bringing us ever-more-damaging storms, heatwaves, fires, and floods—not just in far-off places like California and Australia, but in British Columbia and Alberta. These events are stepping up the pressure for sustainability in business practices and government policies.

A common link among all these developments is a massive shift to a digital world driven by new technologies that are upending long-established economic, social, and political systems. As former Fellow of the David and Sharon Johnston Centre for Corporate Governance Innovation and award-winning author, Dr. Patricia Meredith puts it, "As waves of advances have swept through the global economy . . . each one has transformed the whole structure of the economy and many of society's fundamental assumptions and institutions." (1) She argues that we have crossed the digital divide between the industrial age and the information age.

Meanwhile, since the spring of 2020, the COVID-19 pandemic has devastated lives and economies with the costs borne disproportionately by the disadvantaged and vulnerable.

Further, we are now watching the largest attack on a sovereign state in Europe since World War II. The resulting humanitarian disaster, sanctions, and other policy actions are having an unsettling impact on global trade patterns, supply chains, energy and food security, financial systems, and economic performance. Sadly, it is impossible to predict how and when this conflict will end.

In addition, global inflation has surged to levels not seen for 40 years, as a result of multiple factors: fiscal and monetary responses to the impacts of COVID-19 lockdowns, supply chain disruptions, and the impact of the Russia-Ukraine conflict on energy and food prices. The impact of inflation on citizens across the globe has become their greatest current concern.

All of the above present momentous challenges, but we must not be blind to the advances and strengths emerging within these challenges.

Racism, discrimination, and stereotyping are no longer acceptable. We are hopeful that the world will evolve to be more compassionate and fair. Within the corporate world, this is showing up with a real focus on diversity, equity, and inclusion.

Initiatives to manage man-made climate change have moved from aspiration to implementation as countries around the world, and certainly Canada, are taking action to reduce emissions and drive innovation in the energy space. The focus on reducing climate risk has stepped up awareness and actions relating to all adverse environmental impacts.

The digital transformation is hugely disruptive, but the benefits are everywhere—from enabling more flexible work arrangements to extraordinary breakthroughs in science and medicine. The best example is the unprecedented collaboration in the scientific community resulting in a "miraculous display of scientific prowess, when Pfizer, Moderna, and other pharmaceutical companies produced what appeared to be highly effective Covid-19 vaccines by December 2020." (2)

Russia's invasion of Ukraine and the ensuing war is a blast of realism reminding us of the perils of human aggression and the risks of complacency. The re-emergence of the strength of NATO must be viewed as an affirmation that there are countervailing forces to global threats and aggression. The go-forward government and corporate response to geopolitical risk will come at a cost but should increase resiliency.

The re-emergence of inflation is another ghost of the past. But government responsiveness and support for households and businesses through the pandemic downturn created a level of stability that must be appreciated. We have learned, though, that the long-embraced understanding of fiscal and monetary responsibility is very real.

Our report accounts for not only these momentous developments in the world at large, but also the great challenge facing everyone involved in business—namely, the need to restore trust in capitalism. A growing number of powerful voices, supported by populist movements in many countries, are rallying for corporations to do more to serve everyone, rather than be preoccupied with shareholder interests.

Companies must figure out how to succeed in a world that rewards not just investors, but everyone else with an interest in their business, whether employees, suppliers, customers, or local communities. The name of the game has become multi-stakeholder capitalism.

Corporate boards must figure out how to continue to be trusted fiduciaries as they oversee this potentially decades-long transition to a more inclusive form of capitalism.

Much is at stake. We believe that in a world marked by upheaval and ever-rising expectations, Canadian companies—and thus, by definition, their boards—are changing and must continue to change if they wish to compete successfully.

Driving this belief is the connection between Canada's companies and its overall economy. How those companies are governed—from big banks to tiny start-ups—makes a real difference to those who deal with them, those who work for them, and those who invest in them. In other words, the quality of corporate governance over small, medium, and large companies can contribute greatly to a prosperous and sustainable future for all of us. Better boards make better decisions, make better companies, and make a better Canada.

Other jurisdictions have already moved forward with changes to their corporate governance codes. Examples include the United Kingdom, which adopted a new code in 2018, and Australia, where a fresh set of principles and recommendations was implemented in 2019. (3) (4)

In the United States, business leaders and regulators have become more vocal in urging companies to raise their game. Larry Fink, chair of BlackRock, one of the world's largest asset managers, noted in his 2018 letter to CEOs that "without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders." (5) In August 2019, the US Business Roundtable issued a groundbreaking *Statement on the Purpose of a Corporation* where 181 CEOs pledged to run their companies for the benefit of all stakeholders—customers, employees, suppliers, communities, and shareholders. (6)

In late-September 2022, the National Association of Corporate Directors released its report, *The Future of the American Board: A Framework for Governing into the Future,* to help boards address the range of challenges facing corporations and employees, as well as the nation and the planet. (7)

The University of Oxford's Professor Colin Mayer told the 2020 World Economic Forum that "business-as-usual is no longer adequate for the challenges of the 21st century. Purposeful, trustworthy businesses will play a key role in delivering ambitious programmes for decarbonisation, creating meaningful and fulfilling work, developing new technologies that solve entrenched problems, improving health and well-being, and achieving inclusive growth." (8)

Here in Canada, many voices are calling for changes too.

Even before our committee came together, many of us were involved in Tony Gaffney's 2020 report *High Performance in the Boardroom.* (9) Based on interviews with many of Canada's leading directors, this report was designed to create a catalogue of "contemporary best practices of high-performing boards in a time of accelerating change."

As our committee set to work, strategic governance expert, Patricia Meredith, drew our attention to "the fatal flaws within the traditional hierarchical corporate governance model and how to fix it for the information age." Her book, *Better Boardrooms,* published in December 2020, provided our committee with many valuable insights.

In February 2021, Peter Dey and Sarah Kaplan published another call to action—*360° Governance: Where Are the Directors in a World in Crisis?* This document lays out a set of guidelines based on the principle that companies must account for the interests of all stakeholders that surround them (hence the 360-degree reference). (10)

Besides these incisive analyses, a growing body of literature offers advice to corporations and their boards on how to meet the rising expectations of stakeholders. A few examples:

- *Directors' Oversight Role Today: Increased Expectations, Responsibility and Accountability—A Macro View,* published May 2021 by the Harvard Law School Forum on Corporate Governance. (11)
- *Stewards of the Future: A Guide for Competent Boards,* a 2022 book by Helle Bank Jorgensen. (12)
- *Putting stakeholder capitalism into practice,* a January 2022 interview with Bruce Simpson, CEO of the Stephen A. Schwarzman Foundation and senior adviser to McKinsey & Co. on ESG issues. (13)

The McKinsey interview covers many of the most topical issues for boards today, including the trade-offs between short- and long-termism, and purpose and sustainability. Simpson notes that "stakeholder and shareholder interests do align in the long term. If you have happy employees, collaborative suppliers, satisfied regulators, and devoted consumers, then they will help you deliver higher benefits over a longer-term period."

This is a critical perspective that we embrace in this report.

There is no easy way to sort through the major tenets of this new generation of corporate governance, and many are interconnected. Even so, this report aims to capture the major areas where top boards are focused and where many boards need to do more to keep up with the times.

This work tries to respond to the changing world and society's rising expectations by challenging the status quo. As some boards know, the time has come to move away from hindsight and compliance, and instead keep their focus more firmly on the future. Directors will have to exercise foresight and wise judgment if they are to balance stakeholders' legitimate and urgent interests, but also sometimes competing ones as well.

This report is written to be a wake-up call for everyone with corporate governance responsibilities. The list of interested parties begins with board members and chairs, but also includes management, the investment community, standard setters for the accounting profession, and policy-makers and regulators who must ultimately codify and enforce the necessary changes.

B. Highlights

Good corporate governance encompasses a wide range of issues. We have concentrated on the most pertinent areas facing boards today, as well as those where there is little or no guidance on the changes needed to adapt to current conditions. Our report clarifies these issues and suggests some ways of responding to them.

CHAPTER 1 underscores the imperative for boards to act in the interest not just of shareholders, but of the entire corporation and all its stakeholders. We underline the need to identify the right shareholders and other relevant stakeholders. We also emphasize the need for effective engagement to determine collectively how to create value beyond the narrow confines of the share price.

CHAPTER 2 discusses the concept of ESG (environmental, social, and governance) and the need to align stakeholder and shareholder interests in the long term. Its place on the corporate agenda is rising faster than ever. Within the realm of ESG, climate change has become the biggest E factor. We have called for companies to take a more comprehensive and strategic approach to these issues, rather than just provide the disclosures that many investors and stakeholders are clamouring for today.

> "Companies must figure out how to succeed in a world that rewards not just investors, but everyone else with an interest in their business, whether employees, suppliers, customers, or local communities. The name of the game has become multi-stakeholder capitalism."

CHAPTER 3 reflects on a board's number-one responsibility: to challenge and ultimately ratify the corporate strategy. Whatever strategy a company had before the pandemic has been thrown into doubt by a world full of uncertainties, such as accelerating technological change, the breakdown of old business models, and dramatic shifts in workplace practices. Enlightened boards and managements are using this once-in-a-generation moment to move quickly in adjusting long-held assumptions and their strategic choices on how to win given these new realities. And as we note in **Chapter 1,** a strategy designed to solely drive shareholder returns is no longer enough. The path forward must now embody the choices needed to create and share value among *all* relevant stakeholders.

Our discussion on strategy offers guidance on how to shape better collaboration between the board and management. It also sets out key areas for directors to consider in determining whether the strategy, coupled with enhanced performance measurement systems, is going to achieve its goals and meet its stakeholders' expectations. Importantly, we also call for boards to explicitly consider and approve how management allocates the company's talent, technology, capital, and other resources to achieve its desired outcomes.

CHAPTER 4 calls for boards to ensure that management is effectively identifying, managing, and mitigating the risks facing the company. There is a new generation of frameworks for effective risk oversight. They are designed to take account of the links between various types of risk, the use of risk appetites, and the necessity to be prepared for material downside risks, especially those that are hard to quantify, through adequate capital and liquidity buffers; the diversification across markets, products, and supply chains; and the appropriate redundancy in systems with the right depth of talent.

CHAPTER 5 explains why boards must go beyond their traditional responsibilities for overseeing past performance using generally accepted accounting principles, or GAAP. As management evolves its systems to encompass a more inclusive view of value creation to include the interests of all stakeholders, board oversight will have to be broadened. And the time has come for closer alignment of corporate strategy and performance measurement with compensation practices that reward strong performance for all its relevant stakeholders.

CHAPTER 6 acknowledges the complexity of the world that surrounds business and the consequent need for a new kind of chief executive to drive change across the broadest possible front. Likewise, boards will need to hold management accountable for these broader responsibilities.

CHAPTER 7 underlines the need for boards—the ultimate stewards and decision-makers—to transform themselves, given the changing world and rising expectations of stakeholders. We offer some principles on the need for and selection of diverse directors and to guide boards in monitoring their own performance. Importantly, we call for both management and boards to support continuous learning and to be fully committed to diversity, equity, and inclusion.

Today, the role of the chair, as the board's guiding hand, is becoming even more critical. Accordingly, we set out a number of principles to guide boards in selecting and setting the expectations for a high-performing chair.

CHAPTER 8 examines the importance of culture to the success of any organization. The time has come for boards to go much further than their traditional oversight of conduct where the focus has been only on setting boundaries for unacceptable conduct. Boards today should also oversee the organization's overall culture and values, given their close connection to business performance. While a great strategy is always critical, it must be coupled with a strong culture to ensure successful execution that achieves sustainable value creation.

Finally, in **CHAPTER 9,** we recognize that board members can't be expected to simply pile new responsibilities onto their existing ones. They must apply careful judgment to determine the most consequential issues on their crowded agendas. Directors should spend every moment in the boardroom discussing the most pressing issues their companies face.

Navigating skillfully through the breadth of these issues demands that directors balance the inherent tensions that arise while making the necessary trade-offs to arrive at the optimal decisions owned by the board. The trade-offs are built in and always there. But great boards will use strategic foresight and holistic thinking to optimize the company's value creation across the broad spectrum of interests of both its shareholders and other stakeholders.

"…great boards will use strategic foresight and holistic thinking to optimize the company's value creation across the broad spectrum of interests of both its shareholders and other stakeholders."

C. Recommended Principles

This report does not offer a checklist for directors to use and assess how well the board is performing. The changes we are advocating are strategic, not tactical. We are asking directors to think in a completely different way about how they do their jobs, and to begin that transformation from a set of principles.

We have set out those principles below, arranged by chapter:

CHAPTER 1

Principles for boards to improve stakeholder identification and engagement:

- Determine whether management's investor relations activities take account of the composition and nature of the company's shareholders. Those activities should also focus on shareholders who are fundamentally aligned with the company's long-term success.
- Determine whether management has a robust process to identify other relevant stakeholders and their material interests and engage regularly with them.
- Expect management to report on the frequency and nature of its engagements with shareholders and stakeholders and determine whether there is alignment between their expectations and actual performance.
- Determine whether the company has a specific mechanism for fostering relationships with Indigenous peoples where appropriate to ensure that corporate activities take account of their interests and rights.
- Continue to meet the obligation in the National Policy on Corporate Governance Guidelines adopted by Canada's provincial securities commissions for companies to "establish a process to permit stakeholders to directly contact the independent directors." This process could include a dedicated email address or some other mechanism to contact the independent chair or lead director. Where appropriate, meetings could be arranged between directors and stakeholders with a mutually agreed-upon agenda, to ensure that the board is aware of any misalignment between stakeholders and management.

CHAPTER 2

Principles for board oversight of ESG:

- Determine whether management has clearly identified the ESG issues relevant to the company's purpose, its financial and competitive positioning, and of importance to stakeholders. This process includes determining whether the corporate strategy reflects these choices, how relevant outcomes are measured, and assessing whether the outcomes are meeting the expectations of its stakeholders.
- Assess the appropriateness of management's support of or challenge to the government in areas where there is a clear need for policy action. This process is critical because government and regulatory policies can have a significant impact on the company's business, whether in the context of its sector or the wider economy.
- Determine whether the measurement and disclosure of information on the company's ESG priorities conform with recognized standards and frameworks. Also, assess whether effective controls are in place for the preparation and review of this information. Management will need to monitor and adapt their processes to meet the evolving standards of Canadian regulators and standard setters, Canadian Sustainability Standards Board (CSSB), and from the International Sustainability Standards Board (ISSB).
- Assess the adequacy of the company's resources and expertise to fulfill its ESG-related commitments.

Principles for board oversight of climate change:

- Determine whether management has considered climate risks and opportunities adequately.
- Assess the effectiveness of the action plans and quality of measurement designed to adapt to relevant climate change developments, including transition activities. This would include monitoring progress toward achieving net-zero emissions targets and future environmental targets as they emerge.
- Determine whether measurement and disclosure standards for public information on climate risks are comparable to those for the company's other ESG priorities.

CHAPTER 3

Principles for the board's role in strategy:

- Directors should use their experience and expertise to offer guidance to management as it devises and implements the company's strategy.
- Assess the appropriateness of trade-offs in corporate decisions with a view to satisfying both shareholders and relevant stakeholders to produce shared success.
- Assess the appropriateness of the allocations of talent, technology, capital, and other resources to achieve the outcomes expected by shareholders and stakeholders from the company overall as well as from each business unit.
- Regularly consider whether the corporate strategy is aligned with the company's stated purpose or goals and aspirations. Approve adjustments to them as circumstances change.
- In order to determine if management's assumptions are valid, periodically test the corporate strategy against a plausible range of future scenarios through scenario planning exercises in close co-operation with management. If they are not, consider changes in strategy to respond to new or emerging realities.
- Where appropriate and at least once a year, approve the strategy and related allocations of investment and resources to ensure they reflect the company's purpose or goals and expected benefits to stakeholders.
- Determine whether the company's performance measurement systems and processes provide clarity on the drivers and outcomes of the company's performance in achieving its purpose or goals and meeting the value creation expectations of its shareholders and stakeholders.

CHAPTER 4

Principles for improved oversight of risk management:

- Directors should apply their external perspectives and expertise to collaborate with management to identify the principal risks facing the business. Directors should determine whether management is doing enough to address these risks in a timely and effective manner. Virtually every company needs to specifically address the risks and remediation measures related to cyber security and climate change.
- Determine whether management appropriately considers the interconnectedness of risks to achieve the results expected by shareholders and other stakeholders.
- Consider forming a risk committee of the board to monitor the various risks affecting the business and their impact on its performance. The risk committee should have the same status as the audit committee, given their complementary roles. Audit committees review the business' past performance, while risk committees assess management's preparedness to address current and future risks.
- At least once a year, approve a risk and capital management framework that delineates roles and responsibilities for maintaining an accurate taxonomy of risks. The framework should outline the nature and amount of each risk the organization is prepared to take (in other words, its risk appetite) and the processes it uses to measure risks (its risk profile). The risk management framework should also describe how to mitigate the risks facing the company.
- Where risks are measurable, the limits on risk-taking delegated from the board to management should be included in the risk management framework. It should also spell out the process for periodically reviewing the plans to deal with risks that are interconnected or hard to quantify through assessing the adequacy of capital and liquidity; the robustness of redundant systems and the depth of talent; and the breadth of the diversification across markets, products, and supply chains.
- Boards should require management to present regular reports assessing the company's risk profile against its risk appetite as a way of monitoring risk-taking activities. These reports should also detail the outcome of mitigation measures undertaken by management.
- Where appropriate, boards should approve adjustments to the company's risk appetite and risk-taking limits to account for changes in the business or its external environment.

CHAPTER 5

Principles for better oversight of performance measurement and reporting:

- Consider the appropriateness and quality of information that management uses to determine whether the company is achieving its purpose or goals and achieving optimized outcomes for its stakeholders.
- Assess whether management is considering the evolving standards to monitor and report on value creation for all stakeholders. These standards go beyond the traditional measurement of financial performance using GAAP and should include the measurement of client outcomes and their alignment with the company's purpose or goals and the measurement of employee well-being.
- Determine whether the company's compensation policies align with the way value creation is measured for both shareholders and other relevant stakeholders.

CHAPTER 6

Principles for board oversight of corporate leadership:

- Determine whether the CEO's competencies and character are suitable for the new world of multiple stakeholders and society's rising expectations of corporate responsibility.
- Regularly determine whether robust succession plans are in place for the CEO and other key executives, which should include candidates who are diverse across gender, ethnicity, age, and background.
- Consider how well management embraces continuous learning across the organization.
- Determine whether the company's leaders embrace diversity, equity, and inclusion and how these principles relate to all stakeholders.
- Determine whether the performance of the CEO and other senior leaders is aligned to meet the expectations of all its relevant stakeholders.

CHAPTER 7

Principles to drive high-performing boards:

- Individually and collectively, spend enough time on continuous learning related to the specifics of the company and its industry. This should include efforts to stay current on changes in the broader external environment that could affect all businesses.
- At least once a year, assess the performance of individual directors and of the board as a whole, including determining whether board deliberations take account of the views of all its members. Self-evaluations should be considered for determining the performance of the chair, board committees, and committee chairs.
- Consider periodically inviting independent third parties to facilitate candid responses from individual directors.
- In recruiting new directors, consider each candidate's ability to understand and contribute meaningfully to the full spectrum of issues relevant to the company. Boards should strive to achieve a mix of newer and longer-serving directors in order to encourage diversity of thought and experience.
- Every board should reflect the diversity of the company's stakeholders and the communities where it operates. To achieve diversity within a reasonable time, set targets for the makeup of the board to have no less than 40% of people who identify as women and no less than 40% of people who identify as men, which leaves room for individuals from the 2SLGBTQI+ community. In addition, aim for at least 30% representation from underrepresented racial groups, Indigenous persons in Canada, and disabled persons.
- Consider limiting the term of board members to a maximum of 12 years, while maintaining the flexibility for an extension in rare cases where such an extension is in the company's best interests.

Principles for selecting a high-performing chair:

- Consider each candidate's understanding of the company's industry, its business model, and the environment where it operates.
- Consider each candidate's experience and ability to shape and prioritize the shifting agenda of the board and its committees.
- Consider each candidate's ability to make the best use of the entire board's talents and experience through an inclusive approach, quality facilitation, and inspiring leadership.
- Consider how well each candidate embodies the company's culture and values.
- Consider each candidate's relationship with the CEO given the importance of the chair-CEO relationship. Board chairs and other directors should function as both mentors and sounding boards while being able to dispassionately assess the performance of the CEO and other senior leaders.
- Ensure robust succession planning for the position of chair. Identify candidates with deep knowledge of the business and industry, as well as the skills and experience to harness the talents of the entire board.

CHAPTER 8

Principles for board oversight of culture and conduct:

- Determine whether the CEO and other senior management embody the company's culture and values, and that this culture is imbued in the company's purpose and strategy.
- Consider whether compensation design and awards reflect management's expected behaviours and values.
- Receive periodic reports from management on the state of the company's culture at all levels. Where a gap exists between current and desired culture, monitor management's progress in closing that gap.
- Determine the effectiveness of communication and training materials related to the expectations for the company's culture, values, conduct, and ethics. This should include annual approval of communication materials.
- Monitor the completeness of the annual attestations of employees and directors confirming their acknowledgement that their behaviours, values, and conduct meet the company's expectations.
- Monitor the appropriateness of any exceptions or waivers to the company's expected culture and conduct.
- Monitor the frequency and nature of incidents where employees' behaviours and values are inconsistent with the corporate culture and/or are violations of conduct and ethics. Assess the timeliness and appropriateness of the consequences for the relevant employees.

1

Engaging with All Relevant Stakeholders

For more than 25 years, Canadian boards have responded to the recommendations in the seminal 1994 report on corporate governance *Where Were the Directors?* authored by Peter Dey, a former chair of the Ontario Securities Commission and chair of the Toronto Stock Exchange's committee on corporate governance. (1) Thanks to this report, many boards have invested serious resources to upgrade their governance systems and assert their independence from management.

A subsequent report, *360˚ Governance: Where Are the Directors in a World in Crisis?,* published in 2021 and authored by Peter Dey and Sarah Kaplan from the Rotman School of Management, underscored the imperative for boards to act not just in the interests of shareholders, but in the best interests of the corporation.

In addition, decisions of the Supreme Court of Canada and amendments to the Canada Business Corporations Act have reinforced that other stakeholders matter. This has profound implications for all boards. (2) The Dey/Kaplan report also highlighted that Canada's Indigenous peoples are not just another stakeholder group, but have special status with inherent rights. (3)

> "The value of a company today is heavily influenced by stakeholders' views of how well it is contributing to the betterment of society. This means that boards and management must focus more sharply and respond more quickly to the fast-moving and volatile nature of communications and change."

Considering the interests of stakeholders and Indigenous peoples is becoming a central tenet of corporate governance in Canada. Legal scholars would argue that beyond shareholders, other stakeholders matter. However, a company must fully determine who and what priority other stakeholders may have. To do this, the company must engage with the parties concerned.

Before the interests of stakeholders and shareholders can be considered, they must be known. These days, however, it is not easy to know either who are the beneficial shareholders of corporations or who are the relevant stakeholders. This chapter discusses the challenges and implications of identifying and engaging with both.

Let us first deal with the evolution in share ownership and the transformation of the ways that shares are traded.

Not long ago, most shareholders were either individuals or institutions investing for the long term. However, pension funds have grown enormously, and retail holdings have become increasingly institutionalized, earlier in the form of mutual funds and more recently in exchange-traded funds (ETFs). This movement has concentrated more capital in fewer hands. In fact, institutions today account for the bulk of trading in public markets.

The massive shift from active to passive investing continues apace. It increasingly concentrates power in the hands of the largest asset managers, such as BlackRock, Vanguard, and State Street. According to Moody's, the value of passive funds is approaching and may even exceed funds earmarked for active investing. These giant passive investment pools are able to wield ever greater power over boards and corporations.

Large institutional investors fall into two broad categories. One focuses primarily on traditional metrics, such as a company's strategy, business model, and financial and operational performance. The other group is also concerned with the company's environmental, social, and governance—known as ESG—performance. These two groups and their proxy advisers, such as Institutional Shareholder Services (ISS) and Glass Lewis, have different agendas, with very different ways of measuring corporate performance.

Nonetheless, momentum is now rapidly building for companies to satisfy both constituencies—in other words, to deliver strong financial returns to shareholders, and to perform well on the ESG measurements that are a central concern of other stakeholders. Institutional investors of all stripes increasingly demand both good governance and sustainable profitable growth. Their focus is on a company's core purpose, and they are increasingly willing to base investment decisions on factors beyond traditional financial performance.

Thanks to their power, institutional investors hold much greater sway over companies than in the past. They pay attention to a broader range of issues, such as say on pay, the gender and racial composition of boards of directors, and environmental goals such as carbon reduction. A growing number now refuse to invest in companies that fail to show significant progress in meeting these goals. And even those who do are more likely to call companies to account for their foot-dragging, first in private but also increasingly in public.

They rarely divest due to the strictures imposed by their portfolio guidelines or because they are passive investors. Instead, they are typically inclined to step up their pressure, including demands for board representation and efforts to influence decisions on capital allocation.

Running parallel to this growing institutionalization of investments is the growth of private capital. According to McKinsey, in North America, private equity has grown at a CAGR of 20% since 2016 and 39% in 2021. (4) At close to $7 trillion globally, it now represents over 5% of the Global Equity Market Cap for public companies. In a recent presentation to Deloitte's Podium Club, David Beatty recently noted that in each of the past four years, more than 3,000 Canadian companies have raised over $1 billion from private-equity funds, wealthy individuals, sovereign wealth funds, and other private sources.

These large pools of capital offer issuers an alternative to public markets, enabling them to circumvent many public disclosure and other regulatory requirements. This trend not only clouds price transparency—how do we know what a share in a private company or private fund is worth?—it also reduces insight into a company's performance, whether by its private shareholders or the broader community.

In fact, the growth of private capital increasingly pits it against public capital.

The growth of private capital means that many public corporations may now face a competitive disadvantage against privately funded rivals who are not subject to many onerous disclosure requirements. This is a growing concern in Canada, which has one of the world's most developed and efficient markets for raising public capital and boasts a unique market in the form of the TSX Venture Exchange for small and start-up companies.

To complicate matters, pressure from stakeholder groups for more public disclosure and stricter guidelines may have the unintended consequence of exacerbating this trend. Yet, paradoxically, many private investors today are setting more rigorous standards, not less, for the measurement of performance.

There's another relevant factor in this context: dual-class share structures.

According to the National Bank of Canada's Canadian family index, families controlled 43 publicly traded Canadian companies in March 2018. Many of these companies use dual-class share structures to enable the founding families to exercise voting control while owning only a minority economic interest. The purpose of these structures is to facilitate access to capital markets while maintaining control over strategy far into the future.

Dual-class shares have existed in North America for almost 100 years, ever since Dodge Bros. Motor Car Company listed on the New York Stock Exchange in 1925 with the Dodge family holding 7% of the equity but total voting control. These structures are also popular in other parts of the world, including Europe, Hong Kong, and Singapore. According to Jay Ritter, Cordell Professor of Finance at the University of Florida, dual-class share structures are increasingly common, particularly in initial public offerings by technology companies. His data claims that between 35% and 40% of IPOs between 2015 and 2019 involved dual-class shares.

These structures are popular among family-owned businesses, and many deliver strong performance over the medium to long term. Based on the NBC Canadian Family Index, the total return of family-owned businesses from June 2005 to June 2018 was more than triple the total return of the S&P/TSX composite index. Importantly, independent directors have a major role to play in these companies: to balance the interests of the controlling (family) shareholder with the interests of minority shareholders.

So, yes, who the shareholders are has changed beyond recognition in recent years. But so has how shares are traded.

The Toronto Stock Exchange began electronic trading in 1977. It was the first major exchange in the world to do so, but it continued with its open-outcry system until the floor closed in 1997. With the floor closure coming on the heels of a decision to move from trading in eighths of a dollar to decimals, trading volumes exploded.

Today, the flow of shares and the technology behind that flow play a much greater role in setting prices than in the past. Shareholders can change from one millisecond to another. Also, they are easily anonymized. They can even be weaponized to fight broader social conflicts via the financial world.

And it's often difficult these days even to identify who actually owns shares since so many are held by institutional service firms as nominees of beneficial shareholders.

The combination of dominant institutional investors, the rise of private capital, the surge in computerized trading, and the expansive role played by the institutional service firms makes it hard for many companies to identify who their shareholders are. That, in turn, makes it hard to know who they should engage with on issues of corporate governance.

While it makes little sense to pay much attention to ultra-short-term investors, such as "velocity" traders, there is compelling logic for a company to explicitly incorporate a commitment to long-term, enduring success in their investor relations activities.

Public corporations must make every effort to satisfy both their traditional long-term investors and the new breed of shareholders often described as "activists." The number of activist hedge fund campaigns is on the rise, averaging around 500 a year in North America and over 800 a year globally since 2015. These activists claim to see a significant opportunity for a change in structure or strategy to create significantly more value.

McKinsey claims that management has emerged victorious in fewer than a third of these campaigns. As our committee member Colleen Johnston notes, companies must focus on all significant shareholders to understand their perspectives, and "they ignore activist investors at their peril."

Turning now to other stakeholders, many companies are ramping up their efforts to identify and engage with all their relevant stakeholders. As the Business Roundtable noted in 2019, companies still remain focused on "generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate." (5) Nonetheless, they're becoming even more attentive to other key constituencies.

Most businesses have long understood the fundamental need to deliver value to their customers and to ensure that they take customers' needs and expectations into account as they devise their strategy to deliver their corporate purpose.

Employees, too, are another critical group of stakeholders. The most successful companies are committed to developing high-trust cultures between management and employees because they understand the relationship between employee well-being and sustained performance.

High-performing companies also recognize the key role played by suppliers and creditors and are increasingly attuned to dealing fairly and ethically with them. Companies in regulated industries especially understand their accountability to policy-makers and regulators, another key group of stakeholders. Finally, companies are paying more attention to the communities where they operate or that have a stake in their operations.

Taken together, these various stakeholder groups are pushing companies inexorably toward adding ESG principles to their agendas.

In tandem with a growing recognition of who these primary stakeholder groups are, companies are recognizing the need for more dynamic engagement with them. These deeper relationships are both more attuned to and more accommodating of stakeholders' priorities. Deep and sustained dialogue allows a company to do what was rarely thought possible in years gone by—namely, to collaboratively devise solutions that optimize and share value creation.

The added complexity these days is the proliferation of stakeholder groups.

Social media, political action groups, and leaders of previously marginalized social groups are just some of the players who now exert considerable influence and power. In doing this, they are playing a more central role in a company's operations and its future direction. They are no longer all peripheral players; some may be important new partners of lasting interest and opportunity.

Most stakeholder groups have interests that warrant a company's attention, if not their action. But the specific interests of each group are unique. This means that robust processes are needed to ensure that these interests are aligned with the corporation's ability to deliver its strategy and fulfill its purpose.

The value of a company today is heavily influenced by stakeholders' views of how well it is contributing to the betterment of society. This means that boards and management must focus more sharply and respond more quickly to the fast-moving and volatile nature of communications and change.

One example of the swift impact that social change can now have on corporate strategy is the reaction to the murder of George Floyd in the spring of 2020. His killing sparked immediate protests in Minneapolis and spread within days across North America and the world. In corporate Canada, managements and boards were soon under pressure to explain what they were doing to promote racial justice.

Likewise, the discovery of 215 bodies at a former residential school in Kamloops, British Columbia, in May 2021, followed by similar discoveries in other parts of the country, and likely more to come, is forcing a reckoning with Canada's Indigenous peoples.

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Such events show that customers, employees, suppliers, and even ordinary citizens have become far more active in pushing companies to change their ways. The range of issues includes traditional "close-in" concerns, such as a mining or forestry company initiative that impacts Indigenous land and local communities or poses a potential environmental threat. In these cases, stakeholders may force the company to conform to much higher expectations and standards than in the past.

While the bar may be set higher, the fundamental issues can be hundreds of years old. Even today, millions of Canadians view their relationship with corporate Canada as one of exclusion and inequity. These include many women, minority racial groups, and the 2SLGBTQ+ community. Indigenous peoples are being heard, often for the first time, as they confront corporations on matters as diverse as economic benefits and environmental stewardship. In the past year alone, these groups have forced businesses into real change.

Our committee wholeheartedly supports the fourth principle in the 2021 Dey/Kaplan report, which called for companies to set up a mechanism to foster relationships with Indigenous peoples. The report noted that Indigenous groups are different from other stakeholders in that they have special status with specific constitutional, treaty, and legal rights. This puts Canadian businesses under an obligation to meet the requirements of the Truth and Reconciliation Commission set out in 2008 as well as the UN Declaration on the Rights of Indigenous Peoples in 2007.

Black Canadians and other underrepresented groups are also making their voices heard, not only as employees and customers, but also drawing attention to their abysmally low representation in corporate boardrooms.

Women, who have been especially hard hit by the pandemic, are pushing more forcefully for fairer representation on boards and in top management jobs.

Given this major reorientation to stakeholder interests, every board today has a heavy responsibility to ensure that management puts in place an effective stakeholder engagement program.

Boards of Canadian public companies are already mandated to "set out measures for receiving feedback from stakeholders" and "may wish to establish a process to permit stakeholders to directly contact the independent directors." (6) Unfortunately, in too many cases this requirement has fallen off board agendas at the very time it should be prioritized.

Because of the rising importance of multiple stakeholders and because many of them are flexing their muscles, any interaction with these groups must be done carefully to arrive at acceptable outcomes for both.

Many of these groups will undoubtedly gain an even louder and more powerful voice over time. To this end, the board should determine whether management is directing its engagement efforts to stakeholders who can be most helpful to the company's reputation or those who can potentially do it the most harm.

These judgment calls should be based on the concept of materiality, since it is neither productive nor possible to meet all stakeholder demands, nor to do so on their timelines.

Engaging with the most relevant stakeholders has tangible benefits:

- It makes dialogue and compromise possible, thereby defusing conflict, building trust, and enhancing a company's credibility.
- It helps boards identify potential risks and avert issues that threaten to flare up into crises or impede progress.
- Boards can learn first-hand about stakeholders' concerns, helping to prevent a problem from turning into a crisis.
- Management can better understand their company's impact on particular groups and on society at large, providing valuable input for the development and execution of its strategy.

The most important element of the engagement process is consistency of actions and information. The company's statements involving relations with stakeholders should clearly spell out the conditions for engagement. Those conditions include mutual respect, acceptance of appropriate responsibility, a commitment to being responsive, open, and honest, and, finally, the goal to achieve mutual benefit.

Principles for boards to improve stakeholder idenification and engagement:

- Determine whether management's investor relations activities take account of the composition and nature of the company's shareholders. Those activities should also focus on those shareholders fundamentally aligned with the company's long-term success.
- Determine whether management has a robust process to identify other relevant stakeholders and their material interests and engage regularly with them.
- Expect management to report on the frequency and nature of its engagements with shareholders and stakeholders and determine whether there is alignment between their expectations and actual performance.
- Determine whether the company has a specific mechanism for fostering relationships with Indigenous peoples where appropriate to ensure that corporate activities take account of their interests and rights.
- Continue to meet the obligation in the National Policy on Corporate Governance Guidelines adopted by Canada's provincial securities commissions for companies to "establish a process to permit stakeholders to directly contact the independent directors." This process could include a dedicated email address or some other way to contact the independent chair or lead director. Where appropriate, meetings could be arranged between directors and stakeholders with a mutually agreed-upon agenda, to ensure that the board is aware of any misalignment between stakeholders and management.

ESG and Climate Change to the Fore

Almost every company is facing pressure from its institutional investors and external stakeholders for more alignment between traditional corporate interests and current societal interests. This pressure is not meant to divert or dissipate their efforts to create economic value in the form of profits, jobs, and taxes. Rather, it's to expand their focus to include the impact of ESG matters that will create more alignment with stakeholders and help drive long-term business value and competitiveness.

And as we described in the previous chapter, a company needs to work hard to identify and engage with its other stakeholders and many of them also have high expectations for performance on ESG matters.

As our fellow committee member Mac Van Wielingen wrote in the context of Canada's energy policy: "ESG, resiliency and sustainability are fantastic essential aspirations. But to become real they must be grounded in the practical realities of economics.… Economics should be an explicit and integral part of ESG, not an afterthought; accordingly, ESG should be expanded to include economics. The new construct thus becomes E-ESG, 'economics-environment, social and governance.'" (1)

The practical implication is that economics should not be the sole focus, and nor should ESG. They need to be considered together. As this understanding takes hold, it's not surprising that ESG has shifted from the margins of consideration to being central to strategy and the very core of board deliberations.

In addition to their oversight of economic value creation, boards will also oversee:

- The protection and improvement of the physical environment (the *E* in ESG).
- The social impact and associated risk from societal actions concerning employees, customers and the communities in which it operates (the *S* in ESG).
- Adherence to strict standards of governance and business morality in a world of rising ethical expectations (the *G* in ESG).

But speaking of the speed of change, recently ESG has been attacked as a stalking horse for so-called woke capitalism. Corporations and specifically some investment managers are being accused of insincerity and even exploiting the ESG construct to maximize profits, without in fact delivering better ESG outcomes. More broadly, ESG has become embroiled in the polarized politics of America, which will complicate and shape the pace of adoption of ESG parameters. Some of those complications can be expected to spill across into Canada.

Many companies and their boards are well aware how important ESG is to their stakeholders. So boards will expect management to apply an enhanced strategic lens to determine which ESG matters make sense for their business and use their collective judgment to prioritize these ESG areas, just as they would for any significant business consideration.

Fulfilling the governance part of ESG is relatively well understood. Much of the information about a board's membership, structure, and processes is disclosed in proxy circulars, enabling stakeholders to judge whether the company's practices meet their expectations.

However, the areas of *E* and *S* can be trickier and more frustrating for companies on the receiving end of stakeholders' escalating and varied expectations. Some companies are reluctant to even try and share a clear narrative about their *E* and *S* strategy because they haven't yet determined what matters to their stakeholders.

Companies need to focus on the environmental and social issues that are most material to their stakeholders, that are controllable, and where they can make the biggest impact. They need clear and specific action plans, followed by demonstrable progress. It may require substantial investments in research and innovation to change either inputs or production processes that are damaging to the environment or have negative social consequences. To that end, many companies are also well advised to overhaul their government relations priorities with a view to steering public policy towards the most workable and effective environmental and social responsibilities.

From a reporting perspective, many companies are frustrated because the measurement tools and reporting method are too complex or are not standardized.

Many of Canada's largest companies have been publishing ESG or sustainability reports for well over 20 years. Indeed, Canada has one of the highest sustainability reporting rates in the world. A 2021 Survey of Business Conditions by Deloitte and the Canadian Chamber of Commerce concluded that Canadian businesses are not opposed to setting up environmental programs while also seeking financial returns.

However, this study also showed that smaller companies are lagging in ESG measurement and disclosure; the smaller the company, the less likely it is to spend the money required to keep track of its ESG initiatives. The Chamber has called for government programs to help smaller firms undertake these ESG practices while remaining competitive, an initiative we strongly support.

Those companies that have taken the plunge choose to measure their performance against one of a mushrooming array of ESG rating systems, some of dubious quality. As the *Globe and Mail* noted in April 2022: "Ratings from organizations such as Sustainalytics, MSCI and S&P are used by investment pros to gauge whether a stock is a suitable addition to an ESG fund or ETF. But a *Globe and Mail* investigation shows the methods these ratings providers use vary to the point where the same company can be judged as both an ESG leader and a laggard, depending on who's doing the measuring." (2)

Clearly, business needs a better and more consistent approach to measure and report on ESG.

A welcome first step was the announcement in November 2021 during the UN Climate Change Conference of a new International Sustainability Standards Board (ISSB). The ISSB is creating a set of investor-focused common sustainability standards to improve comparability, transparency, and consistency. While the new organization's headquarters are in Frankfurt, it is setting up an operational office in Montreal, a clear nod to Canada's accounting and legal expertise, its highly developed capital markets, and its significant role in sustainable finance.

The announcement of the creation of the ISSB was followed by a further announcement in March 2022 by the Global Reporting Initiative (GRI) about creating an interconnected approach for sustainability disclosures. (3) While the ISSB will be responsible for the global baseline of investor-focused standards for the capital markets, GRI's Global Sustainability Standards Board will lead on standards for multi-stakeholder-focused reporting.

Here in Canada, the Financial Reporting & Assurance Standards Canada announced the creation of the Canadian Sustainability Standards Board (CSSB) in June 2022 and aims to be operational by April 2023. (4)

The pressure from investors has been growing strongly over the past few years as asset managers direct investments to companies with strong environmental and social agendas, and away from those who do not. This is particularly true in respect of climate change.

The discussions and activity around the corporate world's role in combating climate change has evolved beyond recognition. Climate change deniers have been all but silenced, and attitudes have progressed from considering climate change as just one *E* factor that may carry reputational risks for companies, to being the issue at the top of the *E* list.

But Bill Gates's recent book *How to Avoid a Climate Disaster* takes a more thoughtful and comprehensive view that goes beyond relying solely on disclosure and market forces to drive an effective global response to climate change. (5) Gates argues forcefully for a series of policy changes and greater encouragement of innovation both through supportive government policies and within businesses. He believes the three levers of market forces, policy changes, and innovation need to be pulled in the same direction and at the same time.

In respect of global climate action, momentum is growing on all three fronts. The turning point was the 2015 Paris Agreement on Climate Change signed by close to 200 countries, including Canada. The signatories pledged to limit the rise in global temperature to 2°C degrees above pre-industrial levels by achieving net-zero carbon emissions by 2050.

> "Many companies and their boards are well aware how important ESG is to their stakeholders. So boards will expect management to apply an enhanced strategic lens to determine which ESG matters make sense for their business and use their collective judgment to prioritize these ESG areas, just as they would for any significant business consideration."

Also in 2015, the Financial Stability Board, which monitors the global financial system, took a big step forward by setting up the Task Force on Climate-Related Financial Disclosures (TCFD) to recommend a set of international standards for climate reporting. (6) The task force's initial report, published in 2017, proposed 11 broad assessment categories, from carbon footprints to climate-risk management. Regulators like this system because it focuses on material risks rather than environmental impacts, and because it asks for information about companies' future plans.

The TCFD also requires "scenario analysis," where a company tests its strategy against potential future outcomes, such as a hotter world or higher carbon prices. According to *The Economist,* financial firms have backed the TCFD disclosures as "their clients and regulators are egging them on to adopt the standard, so the financial firms in turn are prodding companies to do so, too, causing an uptick in its use." (7)

Meanwhile, extreme weather continues to proliferate—in Canada's case, especially in British Columbia, which was hit in 2021 by severe flooding, vast forest fires, and an oppressive "heat dome." The loss of life, the damage to homes and communities, and the massive disruption to supply chains have been devastating.

Canadian policy-makers have not sat idly by. Back in 2019, the federal government set up its Expert Panel on Sustainable Finance, which made a number of recommendations to align Canada's financial system with a low-carbon future. (8) Ottawa has also unveiled its carbon pricing plans to 2030 and adopted a new target of reducing Canada's emissions by 40% to 45% below 2005 levels by 2030.

This goal exceeds Canada's target under the 2015 Paris Agreement. In response to an expert panel recommendation, the government also launched a Sustainable Finance Action Council in May 2021. (9)

The financial services industry and its regulators, including central banks, now clearly recognize that climate change poses a systemic risk to the global economy and, therefore, to the stability of the financial system. In Canada, for example, the Office of the Superintendent of Financial Institutions (OSFI) recently led a climate-scenario planning and stress-testing exercise for the industry.

On the international stage, Mark Carney, the UN special envoy on climate action and finance, has led the formation of the Glasgow Financial Alliance for Net Zero (GFANZ). It now includes more than 450 banks, insurers, and fund managers overseeing assets of US$130 trillion. (10)

GFANZ's goal is to use its collective muscle to speed up the global transition to a net-zero emissions economy. If all goes to plan, its members will provide ample funds to encourage green innovation and prevent the worst effects of climate change.

Within GFANZ, groups have been formed representing banks, asset owners, and insurance companies. Canada's six largest banks joined GFANZ in October 2021 through the Net-Zero Banking Alliance and pledged to reach net zero in their lending and investment portfolios by 2050 and set intermediate targets for 2030 or sooner. Although these pledges were expected to have an immense impact on Canadian companies that borrow from the banks and raise equity on our capital markets to finance their activities. But more recently, our "Big banks are having second thoughts about Carney's green alliance" over fears they could face legal action tied to their GFANZ membership. (11)

However, securities regulators are also taking a growing interest in climate change. The US Securities and Exchange Commission released its climate disclosure proposals, including details for board oversight, in March 2022, with the expectation of being in force by the end of the year. However, there's a strong and pervasive backlash to these proposals, so the effective date may slip, or they may defer to the new ISSB standard on climate change.

Here in Canada, the Canadian Securities Administrators is awaiting the outcome of the US deliberations and are also watching the progress toward the adoption of the ISSB standard.

All of the discussion above is included to underscore that while the changes that may ensue are not yet clear, they will likely have a significant impact on corporations and their boards.

A cautious approach by our regulators is warranted. The burden of compliance may prove to be seriously regressive for boards that have been struggling to "add value" beyond compliance, primarily through increased time and focus on strategy. The emerging reality of additional compliance is going in the opposite direction. It could further limit public listings and contribute to the growth of private capital as noted in Chapter 1, and potentially push investment into jurisdictions with less burdensome governance and lower ESG standards.

Companies will need to carefully consider all the implications of these trends. They will need to develop and implement plans to reduce or eliminate the costs of climate change, work with lenders and investors to meet stakeholders' expectations, work with regulators to ensure smart regulation, and yet must also plan for the reality of additional regulation.

All in all, business leaders should be aware that climate change is likely to be only the first of a number of ESG issues that will come to be seen as risks—but also opportunities—that will require active responses and disclosure.

The broad effort is an understandable response to pressures for more alignment between corporate and societal interests. The intangible benefit should be more trust, which will enhance the value of corporations in the capital markets, within the communities they operate in, and with all of their stakeholders.

Principles for board oversight of ESG:

- Determine whether management has clearly identified the ESG issues relevant to the company's purpose, its financial and competitive positioning, and of importance to stakeholders. This process includes determining whether the corporate strategy reflects these choices, how relevant outcomes are measured, and assessing whether the outcomes are meeting the expectations of its stakeholders.
- Assess the appropriateness of management's support of or challenge to the government in areas where there is a clear need for policy action. This process is critical because government and regulatory policies can have a significant impact on the company's business, either in the context of its sector or the wider economy.
- Determine whether the measurement and disclosure of information on the company's ESG priorities conform with established standards and frameworks. Also, assess whether effective controls are in place for the preparation and review of this information. Management will need to monitor and adapt their processes to meet the evolving standards of Canadian regulators and standard setters, the Canadian Sustainability Standards Board (CSSB), and from the International Sustainability Standards Board (ISSB).
- Assess the adequacy of the company's resources and expertise to fulfill its ESG-related commitments.

Principles for board oversight of climate change:

- Determine whether management has considered climate risks and opportunities adequately.
- Assess the effectiveness of the action plans and quality of measurement designed to adapt to relevant climate change developments, including transition activities. This would include monitoring progress towards achieving net-zero emissions targets and future environmental targets as they emerge.
- Determine whether measurement and disclosure standards for public information on climate risks are comparable to those for the company's other ESG priorities.

High-Quality Strategy for a Multi-Stakeholder World

The importance of a sound strategy has never been in doubt.

Answering the questions—"Why do we exist?" and "What set of actions will deliver a 'winning' strategy to meet a corporation's aspiration or corporate purpose?"—is not simple.

A sound strategy must guide a corporation to deliver strong economic returns and move it toward a resilient future where it creates value for all stakeholders, and not only investors. Corporate failures almost always occur when there is a divergence between a company's assumptions about its future and how the future actually unfolds, and the company fails to adapt or evolve. In other words, corporate failures are all too often the result of a failure of strategy or of its execution.

These days especially, the penalties for getting strategy wrong can be fierce. Determining whether bad strategy leads to a failed company requires careful reflection. The Innosight report, *2018 Corporate Longevity Forecast: Creative Destruction Is Accelerating,* noted that the average tenure of a company on the S&P 500 index narrowed from 33 years in 1964 to 24 years in 2016 and is expected to shrink to just 12 years by 2027. (1)

A 2021 McKinsey report on corporates' demise in the United States also examined the trend over the past 20 years. (2) Its analysis is more nuanced, noting the high drop-off in public company listings from 2001 to 2010, particularly in the banking, industrial, and technology sectors.

The McKinsey report also makes the point that the number of IPOs has remained relatively stable (at about 200 a year) but that their size has recently grown, perhaps signalling that some of the early value may be flowing to private investors. It notes that overall, "the decline [in the number of public companies] is not as steep as pundits suggest, and the shifts simply reflect the natural ebb and flow of markets and corporate business strategies."

While both of these reports use US data, we would expect the trend to be much the same in Canada.

But whether or not the declining number of public companies is cause for concern, their financial performance comes as a shock. The fact is, stocks rarely outperform treasury bills in the long run.

According to a 2018 report by Hendrik Bessembinder of Arizona State University, based on the lifetime returns of 26,000 stocks listed on US exchanges since 1926, only four in 10 were able to beat T-bills. (3) Less than one-third of 1% of these stocks accounted for over half the wealth creation from all equities. Over the course of almost a century, just 1% of listed stocks accounted for 75% of all value creation.

What does this tell us about corporate strategy?

However well intentioned, there are a number of bad strategies around, and chances are that every single one has been proposed by a management team and approved by a board.

The rising rate of corporate failures and continuing weak financial returns suggest that devising and implementing a winning strategy is becoming even more difficult. As Clayton Christensen, Harvard professor and architect of the theory of disruptive innovation, noted: "At best, one company in 10 is able to sustain profitable growth…. The odds of success are frighteningly low."

Given these odds, devising the right strategy is not just harder, but also more crucial and urgent than ever. The world we live in is complex and fast-moving and full of massive uncertainties. So, a one-and-done strategy, which assumes little change, will very likely fail, even with brilliant execution.

There is no shortage of examples of the uncertainties that businesses face today:

- New and unfamiliar technologies, and the related explosion of data.
- The geopolitical landscape as the United States and China fight for global influence, and the ripple effects of the Russia-Ukraine conflict around the world.
- Far-reaching damage to our environment if we continue to delay action on climate change.
- Changes in society's values and expectations, magnified by social media.
- The threats to human health and health systems posed by pandemics.

In other words, the pressure on companies to manage through uncertainties coupled with fast-paced and ceaseless change is relentless.

Boards and management simply have no choice but to adjust to this unpredictable world and shouldn't allow an outdated governance guideline to get in the way.

Back in 1994, Peter Dey's report *Where Were the Directors?* urged board members to "adopt a strategic planning process and approve, on at least an annual basis, a strategic plan." His recommendation was adopted within Canada's existing corporate governance guidelines. (4)

Unfortunately, having a process and approving a plan sets a very low bar. Many boards have followed this guideline but have failed to meet the equally critical duty of contributing to an ever-evolving strategy for their companies. Discussing strategy once a year is like taking a photograph of a movie. Given the astounding speed of change, odds are that you will fail to capture the defining scene.

Engagement on strategy is the most important thing that management and boards do together. Most directors understand this. But many are frustrated by how little attention management can sometimes pay to them, or in some cases weak strategic acumen of their CEO and management team. This needs to change.

Asking directors and management to collaborate more closely on strategy should not blur the lines of each group's responsibilities. As always, management's job is to initiate and implement strategy and to identify and manage the main risks to the business. The board is responsible for approving the strategy, monitoring its implementation, and holding management accountable for its success.

We believe that continuing dialogue between a management team and the directors can produce a better strategy with a higher likelihood of success. As one committee member put it: "Our board was not having these big, elevated discussions about how we could progress and succeed in this very complex world with all these challenges. So, we ensure that the first afternoon of each board meeting is devoted to strategy. It is our first priority, not just something we get to if we have time."

Directors can often take a broader and more detached view than management since they are not enmeshed in running the company. If anything, their contribution comes from their outside perspectives and experiences. The dialogue on strategy also becomes more productive when management and the board are equally committed to continuous learning and to diversity, equity, and inclusion, which are now essential attributes for effective leadership.

Roger Martin, former dean of the Rotman School of Management and considered one of the world's top management thinkers, has recently compared the interaction between board and management on strategy to the relationship between a writer and editor.

His analogy tries to capture the complexity and the necessary interplay that is demanded in a world of uncertainties. In a simpler, more static world, it was relatively easy for directors to ask a few probing questions, resulting in a couple of drafts with a few edits. Today, the strategy must constantly evolve to take account of uncertainties as they arise and, if necessary, force long-held assumptions to be cast aside.

The existing guideline is also silent on the linkage between strategy and purpose. The absence of a reference to purpose has led some companies to craft strategies that are confined to boosting profits and market share for the benefit of shareholders.

However, this narrow focus on shareholders does not reflect what we noted earlier, that the duty of a board in Canada is to consider the interests of the company as a whole and, by implication, all its stakeholders.

Nor does it align with the definition of purpose articulated by Oxford's Colin Mayer, considered the leading expert on corporate purpose. At the 2020 World Economic Forum he acknowledged the immense confusion around what role the corporation should play. His simple definition is that "a corporation must produce profitable solutions to problems."(5) He further noted that the process of embedding purpose into a company builds trustworthiness with employees and other stakeholders.

"We believe that continuing dialogue between a management team and the directors can produce a better strategy with a higher likelihood of success. As one committee member put it: "Our board was not having these big, elevated discussions … So, we ensure that the first afternoon of each board meeting is devoted to strategy. It is our first priority, not just something we get to if we have time."

Many Canadian companies have begun paying more attention to their broader responsibilities since BlackRock's CEO Larry Fink, in his 2018 letter to CEOs, urged every company to "show how it makes a positive contribution to society….and articulate and pursue its purpose." (6) More and more companies are declaring themselves to be "purpose-driven" and are subscribing to the mantra that addressing the interests of the broader set of stakeholders should also be good for shareholders as their interests converge over the long term.

Fink has continued to hammer home this message. His 2021 letter observed that "the more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders." (7)

His message appears to be getting through. Nowadays, most companies communicate their purpose, which implicitly encompasses a commitment to deliver value to both shareholders and other stakeholders.

Roger Martin made the point in his recent post on Medium that purpose is a key choice in strategy but he "[doesn't] care at all what you call it—purpose, aspiration, mission, vision. These terms tend to be used relatively interchangeably." (8)

So whatever term is used, a company's strategy must capture the synergistic alignment of initiatives that solve for both financial returns and for the broader outcomes for its stakeholders and society at large.

But as we said at the outset, crafting great strategy is hard, especially in a complex world filled with uncertainties.

One of the biggest uncertainties is rapidly changing technology.

Keeping abreast of technology is not an end in itself, and nor is strategy. But it is a powerful enabler of change, competitiveness, and performance. While the computing and communications technologies that ushered in the digital age have been with us for several decades, the explosion of data and the more recent emergence of cloud computing, artificial intelligence, blockchain, and cryptocurrencies have brought massive changes to businesses of all kinds.

As a result, many companies are well on their way to becoming digital enterprises. The effect is profound shifts in how they interact with customers and how they manage, analyze, and protect their data. Likewise, securities analysts who constantly evaluate companies' performance are now focusing on digital business models using different data sources as proxies for the drivers of business results.

Within the rise of the digital economy, the emergence of platforms such as Uber, Airbnb, Google's Android operating system, and the ecosystem surrounding Apple is forcing us to rethink the economics of exchange. As these platforms grow, control over global trade in goods and services is shifting. This, in turn, is leading increasingly to countries pursuing a platform strategy.

This pursuit is creating a second area of uncertainty—the geopolitical landscape. If a company depends on doing business in China or relies on sourcing from China, a decoupling of China from the West creates very real uncertainty.

The implications of doing business with China can't be divorced from the uncertainties stemming from new technologies. According to a 2020 Brookings Institution paper: "No country is [pursuing a platform strategy] as effectively as China…. aggressively exporting its digital infrastructure [such as 5G], playing a critical role in the development of technical standards, and developing unique points of control in the digital economy…. This strategy extends across four key themes: trade, payments, smart cities, and social credit…. Understanding this dynamic will be key to…getting the US relationship with China right." (9)

The uncertainty around the intersection of technology and geopolitics can manifest into the strategy of many corporations even if they do not operate directly in China. Growing international trade and commerce will likely be impacted by the e-commerce platforms of Alibaba and Ant Group as they challenge the traditional global payments systems.

There may also be significant impacts on the largest American credit card firms and global infrastructure institutions such as SWIFT, which supports both the US dollar payments system and the US dollar as the international reserve currency. China is an early adopter of a state-backed digital currency known as Digital Currency Electronic Payment, and there will likely be others. We need only consider the recent events in Russia and Ukraine and how Russia is being impacted by the sanction to remove its access to SWIFT.

So yes, the one certainty we can rely on today is that we live in a very uncertain world.

While many pundits claim to have a "secret sauce" for crafting a sound strategy, no widely accepted formula has yet emerged. But what is clear is that boards must approve two levels of strategy: first, a business unit (or competitive) strategy and, second, an all-encompassing corporate strategy. The latter must answer two questions posed by Peter Drucker in *Theory of the Firm:* "If you were not in this business, would you get into it today?" If the answer is no: "What are you going to do about it?" (10) Michael Porter takes a similar approach, best summarized as: What businesses should we be in, and how should they be organized? (11)

After companies affirm or reaffirm their purpose or goals, they generally focus on their individual business unit strategies. This process centres on assessing the factors that hopefully will enable the business to outperform its competition, deliver goods or services valued by customers, and produce satisfactory financial returns to shareholders. The financial projections for each business unit are then rolled up into a consolidated format with an articulation of the resources needed (skills, technology, financial, and so on) to achieve the desired outcomes.

Unlike income statements and balance sheets, which many companies use as a proxy for measuring planned outcomes, the best way of judging the choices and drivers embedded in a strategy is not well defined. Nor is there much consistency in the processes companies use to arrive at a winning strategy. These vary widely between organizations and even within organizations.

Roger Martin has counted no fewer than 561 business schools in North America. They employ thousands of professors who are teaching different ways to devise a successful strategy.

Among them: the five forces model pioneered by Michael Porter, the SWOT model, the resource-based view of the firm, emergent strategy, and many others. To confuse matters further, these models tend to be steeped in theoretical analysis rather than providing practical guidance.

Many Canadian business leaders are familiar with Roger Martin's more practical playbook, which uses a cascade of choices to craft, implement, and continuously improve effective business strategies. Much of this advice was first described in Playing to Win, written in 2013 by Martin and former Procter & Gamble CEO AG Lafley. (12) The book sets out five essential questions that, when answered in an integrated way, should drive a successful corporate strategy:

- What is our winning aspiration?
- Where will we play?
- How will we win?
- What capabilities must we have in place to win?
- What management systems are required to support our choices?

Once individual business units have formulated their strategies, boards and management must turn their attention to the corporate strategy. This means understanding the relative weight and allocations of capital and other resources across the portfolio of businesses as well as the assumptions that the overall strategic plan is based on.

Naturally, directors should work closely with management in making these choices. The board's input can be especially valuable when addressing uncertainties that may be hard to quantify but that carry major strategic, financial, or reputational risk. The critical tool to unpack these unknowns is robust scenario planning.

With the help of this long-established planning tool, management and boards can work together to assess a range of plausible outcomes for future events. Sound scenario planning often leads in unexpected directions, forcing a company to rethink key elements of its business, whether markets or products or allocation of resources.

The bottom line is that corporate leaders must move from hindsight to foresight.

As one committee member put it, “A focus on strategy is the antidote to the preoccupation that now exists on history, on results that have already happened, and on short-term thinking.”

To that end, boards should insist that scenario planning forms part of the process of developing strategy. It is likely the best, and perhaps the only, tool that can overcome the main cause of corporate failures—namely, the failure to adapt when the future unfolds differently from the assumptions underlying the strategy. We call this "strategic risk," which isn't the same as the risks that face individual business units in their day-to-day activities.

Chapter 2 describes the importance of an overarching ESG agenda. In that context, crafting strategy for all stakeholders isn't dramatically different from the narrower focus on growth and shareholder value. But it requires a separate focus to make clear choices on the ESG matters that are relevant and material to their corporation in a planned and logical way.

For this to happen, management will need to spell out which choices on their ESG agenda are aligned with their purpose and which create value (or avoid destruction of value) for their key stakeholders. While measuring value creation for stakeholders is much less advanced than for the former, management will have to quickly get up to speed on how to measure it and then put in place the systems and processes to manage and report on it.

Creating value for *shareholders* lies in the answer to the question: "What are we delivering to our shareholders, who entrust us with their risk capital?" The answer must go beyond raw percentages and, at the very least, should involve the stability or predictability of returns. This understanding captures the "return for risk" dynamic, which is the most fundamental guideline for managing private or public capital.

On the other hand, creating value for *stakeholders* lies in the answer to a different question: "What are we delivering to customers, to employees, to the communities where we operate, and to society as a whole that is in line with our purpose and justifies our continued existence?"

The answer to that question covers the company's impact on the environment, the type of culture it nurtures, organizational processes that encourage inclusivity and active participation and foster employee well-being, and initiatives to support healthy and sustainable communities.

Achieving high scores on all those counts is a hard and complex challenge. To date, researchers have done little work on the best way of dealing with multiple stakeholders. Many onlookers tend to think of the process as a zero-sum game where management's role is to adjudicate and recommend the transfer of value between stakeholders. If that is true, then the board's role is to supervise and approve, where appropriate, those value transfers.

The alternative view is that stakeholder relationships are so suboptimal that there is plenty of room for improvements that will benefit more than one party at the same time. No more zero-sum, but win-win—in other words, to find ways to create and share value that results in the outcomes that increase shared success. If this approach is correct, management and boards have a duty to understand the nature of the untapped opportunities and implement practical measures to reap the win-win benefits for multiple stakeholders.

Under these circumstances, strategy can be defined as the process where a company can both achieve its purpose and help *all* its relevant stakeholders succeed over an extended period. At the same time, because the world can suddenly shift beyond recognition, we need to treat strategy as a continuous, advancing process that is never completed. Directors must keep measuring progress against the goal of shared stakeholder success, ensuring that basic assumptions remain intact and that the company keeps advancing in the right direction.

This role is in addition to the critical function of resource allocation essential to capital efficiency and profitability. Directors have the advantage of being able to see the whole, to understand what is most important, and to strengthen the connections between the various components of the strategy.

Directors are not administrators or spectators, and certainly not guests in the boardroom. Nor are they an extension of the regulatory system. They are in the game, as real players, making decisions that directly affect performance. As one member of our committee observed: "Given this reality, how can corporate directors justify being on the sidelines preoccupied with compliance-based activities when it is very likely that 'Rome is burning'? In fact, the default perspective of a corporate director should be to assume that Rome is burning unless it can be proven otherwise."

In the end, the board is an authority-based, strategic decision–making body that leads in partnership with management. The job of management is to initiate and execute—in other words, to make it all happen, but only within parameters set by the board. Directors have distinctly different responsibilities on strategy and virtually everything else.

Principles for the board's role in strategy:

- Directors should use their expertise to offer guidance to management as it devises and implements the company's strategy.
- Assess the appropriateness of trade-offs in corporate decisions with a view to satisfying both shareholders and relevant stakeholders to produce shared success.
- Assess the appropriateness of the allocations of talent, technology, capital, and other resources needed to achieve the outcomes expected from the company overall as well as from each business unit.
- Regularly consider whether the corporate strategy is aligned with the company's stated purpose or goals or aspirations. Approve adjustments to the purpose or aspirations as circumstances change.
- In order to determine if management's assumptions are valid, periodically test the corporate strategy against a plausible range of future scenarios through scenario planning exercises in close co-operation with management to determine whether management's assumptions remain valid. If they are not valid, consider changes in strategy to respond to new or emerging realities.
- Where appropriate and at least once a year, approve the strategy, which is expected to achieve the company's purpose and deliver the shared value creation to stakeholders as well as the related allocations of investment and resources.
- Determine whether the company's performance measurement systems and processes provide clarity on the drivers and outcomes of the company's performance in achieving its purpose or goals and meeting the value creation expectations of its stakeholders.

Raising the Bar on Risk Management

Managing strategic risk is fundamental to ensuring a company's long-term sustainability. The previous chapter noted that while management is responsible for initiating and executing business unit (or competitive) strategy and corporate strategy, the board has a different role—namely, to challenge and, if appropriate, ratify both levels of strategy and monitor their implementation.

But there is a complication. The development and execution of strategy always takes place amid the brutal certainties of today and the uncertainties of tomorrow. The ability of companies to grow and prosper varies widely, and they can be doomed by upheavals in a particular industry (remember the video rental business?) or by poor strategy or poor execution.

This means that after a board has considered the strategic risks facing its company, the directors must turn their attention to oversight of the risks embedded in each business unit and in the corporation as a whole. This is the meaning of enterprise risk management (ERM) and, as the name implies, it belongs with management.

Canada's corporate governance guidelines recommend that a board should determine whether its company has identified and is managing the principal risks. (1) However, this is a static requirement, offering little guidance on how the board or management should manage those risks in a complex, continuously changing world.

Management will often present a list of risks to its board, often in the form of a risk register. These risks are typically ranked from most to least serious, based on their potential impact to the business. There is little uniformity in this process or in how management undertakes to manage or mitigate the identified risks. The result is often a focus on risks with the highest probability or highest impact, while those considered less likely or less damaging—such as a pandemic—tend to be ignored.

Very few companies explicitly consider the implications of risks intersecting one another in complex and compounding ways. This is despite the evolution and use of newer frameworks and models involving multiple risks, such as dynamic risk management and VUCA (volatility, uncertainty, complexity, and ambiguity). (2) (3) Even more recently, McKinsey notes that leading companies are moving from defensive risk management to a forward-looking stance based on strategic resilience. The holistic approach to building resilience advances the company from a narrow focus on risk, controls, governance, and reporting to a longer-term strategic view of the total environment. (4)

The 2008–09 global financial crisis presents an example of interconnected risks. Experts initially expected the upheavals would be largely limited to the US financial system. But the troubles at some large US investment banks ended up cascading into a collapse of credit and liquidity in financial markets around the world.

COVID-19 has also opened everyone's eyes to the profound and unsettling way in which risks can be connected to one another. We are now dealing with multiple repercussions from the pandemic. These include the way we work, notably the explosion of remote work arrangements; the impact on our healthcare systems; the crisis in mental health; the impact on global supply chains; and the consequences to our governments whose coffers have been drained by support for individuals, businesses, and the healthcare system. There is no question that business will be dealing with fallout from the pandemic on many fronts for years to come.

Likewise, climate change is a risk that will affect all businesses and likely be material to many of them. Fires, floods, and extreme weather, which used to be occasional events and typically small in scale, are now more frequent and massive, imperilling not only companies but entire land areas. As sudden and extreme climate events become more commonplace, they will force companies to move away from narrow thinking on how to manage the risk of business disruption. Companies must now understand, measure, and ultimately reduce their impact on global warming and its ultimate impact on the environment.

> "The board's expertise is one valuable way of improving risk assessment. Its perspective is another. Precisely because directors are not concerned with the pressures of day-to-day operations, they can provide a more measured and far-sighted view of the risks that may confront the business."

The potential for serious disruption lurks in many other places too. As companies come to rely more heavily on digital infrastructure, they expose themselves to the risk of cyber attacks and the consequent loss of valuable records and other data. All companies now have to devote massive resources to protect their digital assets. While necessary, these measures are unlikely to prevent all attacks so they must also invest heavily in detection and remediation capabilities.

For more than two years, supply chain bottlenecks have disrupted operations at businesses around the world. Many experts forecast that the problems will persist as the finely calibrated networks of world trade struggle to overcome shipping backlogs, labour shortages, and geopolitical tensions. Russia's invasion of Ukraine and its impact on energy prices and energy security underline just how serious and long-lasting these risks may be. What's happening in energy in Europe has spilled over into food prices globally and is driving high levels of inflation. This and other factors may lead to a global recession, another clear example of the interconnectedness of risks that are difficult to foresee.

Another growing risk, commonly known as reputation risk, stems from society's rising expectations of companies and their leaders.

The image of companies and their brands is heavily influenced by their behaviour and the stands that they take on the issues of the day. Thanks to social media, the fallout from a controversy can be almost instantaneous. It can then quickly ripple through to the public's perception of the company, its relationships with employees, customers, and other stakeholders, and, ultimately, its value. The cost can be enormous.

The strength of a company's balance sheet in the form of adequate capital and liquidity provides a buffer to the potential damage from both known and unknown risks. But determining whether that buffer is adequate for the wide range of possible risks requires careful judgment.

Since the precise impact of future risks cannot be known or measured, many companies routinely test the adequacy of their buffers to withstand likely and unlikely risks and the harm they may cause, both individually and collectively. This "stress testing" is an important tool that can contribute to holistic and forward-looking thinking.

As the risks of doing business grow, strong and effective ERM has become essential. But the ERM bar needs to be raised higher. Boards must hold management accountable on a number of counts:

- To demonstrate smart risk acumen. In other words, management should take risks only with the fullest possible knowledge and consideration of their interconnectedness, collectively forming an acceptable risk appetite.
- To take risks with purpose with a view to generating acceptable risk-adjusted returns.
- To proactively manage and measure, where possible, the risks that the company is prepared to accept, while trying to minimize the impact of the risks it can't avoid, such as cyber security and climate change.
- To proactively take into account the possible impact of uncertainties and unmeasurable risks by holding sufficient buffers of capital and liquidity, building redundancies for key systems, having appropriate depth of talent, and by ensuring appropriate diversification in markets, products, and supply chains.
- To be transparent in risk-taking activities and to regularly communicate the company's risk profile compared to its risk appetite.

Holding management to a higher standard does not have to involve more work on the part of the board. It can be done as part of regular ERM oversight. However, the board needs to ensure that either the full board or a dedicated risk committee has explicit oversight of ERM.

Management can benefit enormously in the entire arena of risk when the board is able to marshal its collective expertise. Directors' engagement doesn't need to be "more," just different and deeper. Individual board members often bring specialized expertise in ESG matters, for example, or experience in technology, politics, data privacy, and ethical business practices, to name a few.

The board's expertise is one valuable way of improving risk assessment. Its perspective is another. Precisely because directors are not concerned with the pressures of day-to-day operations, they can provide a more measured and far-sighted view of the risks that may confront the business. Ideally, their perspective enables them to draw management's attention to emerging risks and provide guidance based on their years of diverse experience.

Assessing risk in today's hyper-dynamic environment involves determining if the company's risk management processes are both sufficiently robust and flexible enough. This cannot happen if management is allowed to present its assessment of risks and mitigation strategies as *faits accomplis*. What is needed is discussion and dialogue—constant and deep, conducted in the same way as discussions on strategy and performance.

Some companies, especially smaller ones, worry that ERM can become a time-consuming administrative burden. It isn't. The process involves identifying and managing or mitigating different risk factors. The ERM program can easily be tailored to the size and sophistication of the company so that it focuses on the most important risks and how they may be connected to one another.

Irrespective of size, capital management also cannot be overlooked. It is a critically important factor in board oversight, and board approval is required for capital spending and allocation decisions, and for any changes to the company's capital structure.

Given the complexity of managing risk and capital today, many companies prepare risk management and capital management frameworks.

These frameworks typically capture:

- Risk governance, accountabilities, and authorities for risk ownership, oversight, and challenge, as well as the use of independent assurance, where appropriate.
- Risk universe and risk appetite.
- Processes to identify, measure (where possible), manage, or avoid and monitor risk, including through regular stress testing.
- Processes to allocate capital to risk-taking activities and to measure risk-adjusted returns.
- Periodic reporting of risk profile versus risk appetite, and risk-adjusted returns for each main business activity.
- Plans for how material downside risks may be handled through sufficient buffers of capital and liquidity, appropriate redundancies for key systems, depth of talent, and breadth of diversification.

These frameworks need to reflect the dynamic nature of the risks that a company may face. Strong risk management must include a continuous review of how individual risks are shifting and how they are interconnected. Done properly, this process will enable companies to adjust their risk management processes and business strategies and ultimately deliver acceptable returns to all their stakeholders.

Principles for improved oversight of risk management:

- Directors should apply their external perspectives and expertise to collaborate with management to identify the principal risks facing the business. Directors should determine whether management is doing enough to address these risks in a timely and effective manner. Virtually every company needs to specifically address the risks and remediation measures related to cyber security and climate change.
- Determine whether management appropriately considers the interconnectedness of risks to achieve the results expected by shareholders and other stakeholders.
- Consider forming a risk committee of the board to monitor the various risks affecting the business and their impact on its performance. The risk committee should have the same status as the audit committee, given their complementary roles. Audit committees review the business's past performance, while risk committees assess management's preparedness to address current and future risks.
- At least once a year, approve a risk and capital management framework that delineates roles and responsibilities for maintaining an accurate taxonomy of risks. The framework should outline the nature and amount of each risk the organization is prepared to take (in other words, its risk appetite) and the processes it uses to measure risks (its risk profile). The risk management framework should also describe measures to mitigate the risks facing the company

- Where risks are measurable, the limits on risk-taking delegated from the board to management should be included in the risk management framework. It should also spell out the process for periodically reviewing plans to deal with risks that are interconnected or hard to quantify through assessing the adequacy of capital and liquidity; the robustness of redundant systems and the depth of talent; and the breadth of the diversification across markets, products, and supply chains.
- Boards should require management to present regular reports assessing the company's risk profile against its risk appetite as a way of monitoring risk-taking activities. These reports should also detail the outcome of mitigation measures undertaken by management.
- Where appropriate, boards should approve adjustments to the company's risk appetite and risk-taking limits to account for changes in the business or its external environment.

More Meaningful Performance Measurement and Reporting

Every director presumably understands their responsibility to oversee the performance of the company on whose board they serve. However, today's world demands that a company produces and communicates different information about its performance than in the past.

Stakeholders are asking for information on whether the company is delivering on its corporate purpose or aspirations and meeting their expectations for value creation. And investors want a more comprehensive view of company performance as they integrate ESG factors into their assessments. These measures go far beyond the detailed and fragmented information required by securities regulators today.

The current requirements include quarterly (unaudited) and annual (audited) financial statements based on generally accepted accounting principles (GAAP), earnings press releases, a management discussion and analysis (MD&A), and annual information forms. Boards must ensure they have financial experts and robust processes in place to oversee their public disclosures in their audit committees.

Securities regulators regularly review public companies' financial reports and sanction those that provide incomplete or misleading information. While they acknowledge that the use of non-GAAP measures can provide useful information to investors, they also set out specific disclosure requirements for these measures with the aim of improving the quality of information provided to investors.

In addition, audit firms are subject to the oversight of their responsibilities for accurate financial reporting through the Canadian Public Accountability Board and its US counterpart, the Public Accounting Oversight Board.

The challenge for users of public company reporting is that it is so comprehensive and inflexible that it often crowds out information that would better tell a company's own unique story of value creation.

But times are changing. A growing number of companies have voluntarily started issuing annual ESG/sustainability reports using one of the many reporting frameworks that have emerged in recent years. There is also the creation of the new International Sustainability Standards Board (ISSB), which is responding to the clamour for more consistency and standardization in sustainability reporting. In addition, certain requirements exist for specific disclosures in areas such as climate that form part of the existing cadre of regulatory reporting.

The ISSB has started work this year. The International Financial Reporting Standards (IFRS) Board released its first two exposure drafts (IFRS S1 and S2) and aims to finalize them in the first half of 2023. Although these standards will not be mandatory, Canadian standard setters have signalled their willingness to support them. Since IFRS apply only to public companies, it follows that the same would be true for the new IFRS sustainability standards. The proposed standards from the ISSB follow recent efforts by the European Union to strengthen sustainability reporting, which will be supplemented by disclosure standards to be drafted by the European Financial Reporting Advisory Group.

Canada has set up its own independent committee, the *Independent Review Committee on Standard Setting in Canada* (IRCSSC) to review the governance and structure of accounting and assurance standards, including sustainability standards. This committee, accountable to the Accounting Standards Board and the Auditing and Assurance Standards Board, produced a consultation paper that highlights the need for a sustainability standards board in Canada to contribute to international initiatives in this field. (1) This new body would also help fill the gap between ISSB standards, which are required only for public companies, and support private businesses that can choose the less demanding accounting standards for private enterprises (ASPE). The creation of the new Canadian Sustainability Standards Board (CSSB) was announced in June 2022.

Chapter 2 also sets out how Canada's largest banks have all joined Glasgow Financial Alliance for Net Zero (GFANZ) and committed to achieve net-zero carbon emissions by 2050 in both their investment and lending portfolios. This commitment requires them to set 2030 targets within 18 months of joining GFANZ, and new interim goals every five years after 2030 until 2050.

In March 2022, *The Globe and Mail* noted that Canada's banks were becoming serious on "how they plan to deal with their biggest climate problem—the carbon emissions from their industrial clients." Their GFANZ commitment suggests they will bring more pressure to bear on public and private companies for improved climate-related disclosure. These requirements will inevitably require new accounting standards for private enterprises to keep pace with the new ISSB standards for public companies.

The IRCSSC consultation paper also discussed the evolving need for ethics and independent standards for assurance services on sustainability information. It noted that "as sustainability reporting evolves, it will be important to respond proactively to the demands for assurance services and to continuously assess the adequacy and quality of existing assurance standards." The report predicted that markets are likely to demand such standards and that, in some jurisdictions, they may become mandatory. A growing volume of sustainability information already appears in the continuous disclosure documents of public companies, automatically making it subject to assurance requirements.

However, external reporting is just one side of the coin. The other is the more customized and detailed information on performance drawn up by senior management and overseen by the board for internal use.

Internal reporting practices generally align with individual or divisional responsibilities for performance. These are demarcated by geography, product, or a mixture of both. While internal financial reporting is generally based on GAAP, it is often augmented by non-financial measures that go far beyond profits and are not subject to any generally accepted standards. Unlike external reporting, which uses only comparisons to prior periods, internal numbers are also often measured against an agreed-upon plan, usually approved by the board, and often include detailed forecasts of future performance.

The question is: What changes can be made to meet today's demands for a more comprehensive view of performance? In other words, how can measurement and reporting move from a singular focus on GAAP earnings attributable to shareholders to other metrics that demonstrate value creation for all stakeholders?

There is still little recognition of GAAP's shortcomings as it has so far failed to respond to the digital economy. The current accounting paradigm was developed in the late 18th century as the Industrial Revolution took hold. Recording the tangible assets of the industrial economy centred on the plant, equipment, and machinery used to produce goods, and all of these were recorded on a cost basis on the balance sheet. Value realization for shareholders is measured on a transaction-centric basis when external third-party transactions occur. This system still supports banks' lending activities (based on net assets recorded on the balance sheet) and, to a lesser extent, underlies how capital markets assess valuations based on reported earnings. However, the market often reflects price-to-earnings multiples (PE ratios), which are based on "adjusted" earnings, to incorporate future growth expectations free of any "noise" in the current period.

> "Boards will have to ensure that they hold management's feet to the fire in shifting the focus from hindsight to foresight. Instead of relying on past transactional data as the principal means of measurement, boards will have to ensure that all the relevant elements of value creation (and destruction) are measured and monitored."

But in today's technology-driven economy, businesses increasingly create value through intangible assets, such as design, branding, software, and other intellectual property.

Jonathan Haskel and Stian Westlake describe the evolution in *Capitalism without Capital:* "Early in the 21st century, a quiet revolution occurred. For the first time, the major developed economies began to invest more in intangible assets…than in tangible assets…. For all sorts of businesses, the ability to deploy assets that one can neither see nor touch is increasingly the main source of long-term success." (2)

To grasp the magnitude of the asset revolution, consider the companies that make up the S&P 500 index. In 1975, intangibles made up one-sixth of their value, yet by 2015, they contributed five-sixths of the total. (3) While the combined market value of Apple, Amazon, Alphabet, Microsoft, and Facebook was over US$8 trillion in 2015, their tangible assets amounted to less than 5% of the total. This shift to intangibles has obviously continued in the years since then.

This revolution has important implications for financial reporting, and thus for corporate governance. Consider Warren Buffet's observation in his 2019 letter to shareholders: "Long-time readers of our annual reports will have spotted the different way in which I opened this letter. For nearly three decades, the initial paragraph featured the percentage change in Berkshire's per-share book value. It's now time to abandon that practice. The fact is that the annual change in Berkshire's book value…is a metric that has lost the relevance it once had."

The fact is that current methods of financial reporting were designed for a world dominated by tangible assets. The International Accounting Standards (IAS) framework created by the IFRS is the set of rules that guides accountants around the world. It defines an asset as a resource with economic value that an individual, corporation, or country owns or controls in the expectation that it will provide a future benefit. This definition clearly covers the intangible assets driving the information economy. Yet the application of this framework has not kept pace with the dramatic changes in business over the past 30 years.

According to Patricia Meredith in her recent paper *Accounting for the Digital Economy: Time for a Fresh Approach:* "The problem is not that accountants do not know how to measure intangible assets. IAS 36 spells out an approach (known as value-in-use) to valuing purchased intangibles to determine whether they are impaired. Likewise, IAS 38 provides guidance on how to recognize internally generated intangible assets and how to revalue them in a few specific situations. The real problem is that accountants have an outdated view of economic reality." (4)

Both Ms. Meredith and the London-based think tank Rethinking Capital believe a shift in mindset is needed among accountants so that they become more attuned to using existing standards and conceptual frameworks to value intangible assets. (5) Rethinking Capital has advised companies for the past 20 years to move in that direction by applying so-called "normative accounting" rules based on the following deductive logic:

- Intangibles are the assets that create and sustain value in today's economy.
- Accounting practices systematically write off investments in intangible assets as expenses.
- Depending on a company's size, between 40% and 60% of expenditures over a 3-year period can typically be capitalized.
- Current accounting practice therefore reflects a substantially negative view of assets, equity, and profitability.
- Properly capitalizing and showing the current value of intangible assets by reference to the active customer market will produce a much fairer value for intangible assets.

Yet, in today's world, we are trying to measure capitalism without counting all the capital.

According to the most basic accounting rule (IAS 1), if an asset is material—and the missing 80% to 90% of a corporation's value represented by intangible assets is surely material—it must be disclosed.

So, the time is long overdue for accountants to adjust to the new economic reality. Management and boards will need to stay abreast of accounting standards more suited to today's demands. In the meantime, companies can bridge shortcomings in GAAP by adapting their practices to measure intangibles, including such items as outlays on networks, software development, customer value propositions, branding, and so on. In the same way, management must do its best to estimate contingent liabilities, such as those that arise when a company becomes responsible for remediating potential environmental damage. These liabilities are particularly relevant for extractive industries. As they move closer to the realm of certainty and measurability, they will probably need to be recognized soon as real liabilities.

The momentum behind the newly created International Sustainability Standards Board and the Canadian Sustainability Standards Board mean that companies will have to gear up to meet the future standards. As noted above, the IFRS has already released its first two sustainability exposure drafts. They cover general requirements and climate reporting. Notably, the general requirement proposes that sustainability disclosures apply to the same period as the financial statements and should be published at the same time as those statements.

Turning again to the more detailed internal reporting, Roger Martin has argued that management systems, including performance metrics, are more than a reality check on a company's financial health. They can also measure the effectiveness of a corporate strategy. (6) Martin notes that if a corporate strategy lacks specific management systems that help build and sustain the company's distinct capabilities, then those capabilities will either not be built in the first place or they will wither and decline from disuse.

He is pointing to the necessary shift away from historical financial reporting to a broader focus on the key drivers and outcomes that provide insight on the ability to deliver a successful strategy that achieves the corporate purpose. And it's vital to ask a different question in this new multi-stakeholder world: Do a company's performance measurement systems capture the relevant value creation and its sharing across its stakeholders?

As companies adopt the new requirements for concurrent reporting of traditional financial measures and the new sustainability standards, we can envision a host of new, well-built management systems that produce the important metrics needed to monitor performance. What's more, many of these metrics will be disclosed externally to the benefit of everyone interested in how the company is faring. Implicit in the changes of how performance is measured will be the supporting rationale on how the company is managing the optimization of value creation for shared success in this multi-stakeholder world.

The evolution of these management systems will provide the information that boards need to assess whether the company's results are consistent with its strategy and whether the company itself is meeting its stakeholders' expectations. These systems are also the key tool to measure and reward the performance of employees accountable for the results.

Accountability to multiple stakeholders can involve a wide range of information.

For example:

- For an airline, the percentage of flights departing on time with all passengers' baggage, and progress towards shrinking its carbon footprint.
- For a financial institution, the benefits to clients of specific savings and payment products rather than just growth in fees and interest margins earned for its shareholders.
- For an asset manager, the returns earned by clients, net of fees, instead of just assets under management and fees earned.
- For a supermarket chain, progress in delivering healthy food options, responsible sourcing, and eliminating waste from packaging.
- For a highway operator, an airport, or some other kind of infrastructure, the ability to deliver uninterrupted service to meet users' expectations.

A critical area for all companies is the expectations of their employees and how those expectations are evolving. This has become especially important in light of the major shifts in workplace arrangements spawned by the pandemic.

Some companies place their faith in sustaining employee loyalty and performance simply by declaring that they are "purpose-driven." But research shows that employees are most highly motivated when they have deep and authentic connections to one another and a high level of workplace trust. According to Canadian economist and editor of the *World Happiness Report,* Professor John Helliwell, "while many employers believe that salary and other forms of economic reward are the cornerstone of personal and collective satisfaction, the income-equivalent values of workplace trust and belonging are very significant." In a report co-authored by Helliwell and Haifang Huang, their analysis of Canadian data shows that you would need a pay raise of at least a third to move to a new employer that has a trust rating that is lower by only one point on a 10-point scale. (7) According to Chapter 7 of the *World Happiness Report* on work and well-being, "data shows workplace belonging as the single most valued attribute among job-seekers." (8)

While flexible hours and remote work arrangements may be more important today than they used to be, the long-standing challenge of improving daily work experience and group-working dynamics still remains. In other words, measuring and reporting on the well-being of employees is vital for any company seeking to deliver an inclusive and meaningful work experience.

This is just one facet of the new mindset taking hold in business. The role of the board and its committees will need to evolve as the context changes for how value creation takes place. Boards will have to ensure that they hold management's feet to the fire in shifting the focus from hindsight to foresight. Instead of relying on past transactional data as the principal means of measurement, boards will have to ensure that all the relevant elements of value creation (and destruction) are measured and monitored.

In light of all these changes and considerations, the report urges all managements and their boards to embrace this change in how we create, share, measure, and monitor a company's sustainable value.

Principles for improving oversight of performance measurement and reporting:

- Consider the appropriateness and quality of information that management uses to determine whether the company is achieving its purpose or goals and achieving optimized outcomes for its stakeholders.
- Assess whether management is considering the evolving standards to monitor and report on value creation for all stakeholders. These standards go beyond the traditional measurement of financial performance using GAAP and should include the measurement of client outcomes and their alignment with the company's purpose or goals and the measurement of employee well-being.
- Determine whether the company's compensation policies align with the way value creation is measured for both shareholders and other relevant stakeholders.

A Changing World Needs a New Kind of CEO

Chief executives and boards are buffeted by a degree of turmoil that their predecessors seldom had to face. Issues are more complex than ever, and the speed of change is unforgiving. The upshot is that corporate leadership demands different competencies and character traits than in the past.

Canada's existing corporate governance guidelines are strangely silent on the board's role in selecting the CEO. Their job is clearly much bigger and more important than simply ensuring "the integrity of the CEO [who can]…create a culture of integrity throughout the organization." (1) David Beatty, one of Canada's leading governance experts, comes closer to the mark with his observation that "selecting the next CEO is the Sacred Board Task." (2)

A CEO is presumed to have the experience, competence, and character to lead their organization into the future. But there is a need today for a new definition of leadership, one that recognizes that CEOs need to do even more. They must understand how the world is changing around them, and then—as in so many other aspects of corporate governance—drive the changes necessary within their companies to deliver results to relevant stakeholders.

Today, every board should expect the CEO to:

- Drive a rigorous process to identify and engage with the corporation's shareholders and other key stakeholders (Chapter 1).
- Articulate the company's ESG priorities and achieve the outcomes relevant to stakeholders and in line with the company's strategy (Chapter 2).
- Demonstrate the strategic acumen and agility necessary to achieve the company's purpose and create value that meets the expectations of its relevant stakeholders (Chapter 3).
- Devise a robust risk management system (Chapter 4).
- Develop suitable performance measurement and reporting systems that provide high-quality information on the drivers and outcomes that are relevant to all its stakeholders (Chapter 5).

Meeting these expectations has never been easy. Nor will it ever be.

Nonetheless, a board should expect that the CEO will either meet its expectations or be on a clear path to improvement in areas of weakness. In addition, CEOs need to develop and mentor potential successors. Boards should insist that the company has a diverse pool of candidates who have experience in both line management and corporate roles, and represent diversity across gender, ethnicity, age, and background.

The modern-day expectations of leadership are light years away from the hierarchical, command-and-control model of the past where leaders hold all the important information and make all the crucial decisions. Instead, the emphasis should now be on flexible, decentralized, and client-centric ways of working.

Some may find this strange. But Harlan Cleveland, an American diplomat and author, wrote of it in 1984, long before the internet sparked the information revolution: "Knowledge is power…. So the wider the spread of knowledge, the more power gets diffused…. More and more decisions are made with wider and wider consultation—or they don't 'stick….' The twilight of hierarchy… is already well under way." (3)

As the world becomes more complex, leaders and their companies must also learn how to keep learning. Only organizations where non-stop learning is a way of life will be able to respond constructively to relentless change. Agility must advance from being a laudable trait to an invaluable skill.

More and more CEOs are structuring their companies to emphasize the importance of learning and diversity, and to encourage the behaviours that go with them. Even a couple of years ago, most companies made diversity, equity, and inclusion—commonly known as DEI—secondary to their commercial activities. Today, these attributes are becoming a central focus. This speaks to the force and speed of change and to the importance of DEI as an essential ingredient in the culture of all companies as modeled by their CEOs.

The new mantras of inclusivity, consultation, and continuous learning are no longer a choice that leaders can opt to embrace, or not. They mark an irreversible shift and thus an imperative for today's corporate leaders. Here are some of the actions CEOs can take to make it happen:

- Diversity: Put structures in place that encourage multiple perspectives and differing viewpoints.
- Equity: Embed processes that free the workplace of racism, gender discrimination, sexual harassment, bullying, and other unacceptable behaviours.
- Inclusiveness: Ensure that the corporate culture promotes trust and mutual respect, recognizing that each employee and many stakeholders may also hold a piece of the answer.

McKinsey's 2020 report *Diversity Wins: How Inclusion Matters* sets out the clear business case for diversity, equity, and inclusion. (4) It notes that companies that embrace DEI are likely to outperform their peers over time. The report suggests five lessons that all companies can apply based on the experience of DEI "winners":

- Ensure representation of diverse talent that carefully considers which forms of diversity to prioritize from among gender, ethnicity, age, and background. This process includes setting targets and offering incentives to managers and other employees to achieve those targets.
- Strengthen DEI leadership beyond the human resources function. Every leader in the company must support women and underrepresented minorities and must understand the bias and microaggressions that these groups face.
- Enable true equality of opportunity in terms of promotion and pay through fairness and transparency.
- Promote openness and tackle microaggressions so that open and inclusive behaviour becomes the norm. Put processes in place to ensure everyone is living up to that behaviour.
- Foster a sense of community through unequivocal support for a broad range of diversity.

In October 2021, McKinsey published an *Author Talks* interview with Indra Nooyi, the trailblazing former CEO of PepsiCo, on leadership, life, and crafting a better future. (5) Asked how companies can improve diversity and inclusion in the workplace, Nooyi offered this advice:

> *"Typically, companies appoint a D&I [diversity and inclusiveness] head and say, 'OK, it's done…. Nobody can question me now, because I can point to the fact that I have a head of D&I.' But what people forget is that diversity is a mathematical number. Are you diverse? On what metrics are you diverse? Do you have ethnic diversity? Gender diversity? Racial diversity? All that stuff. But inclusiveness is a state of mind. It's an emotion. Are you going to make everybody feel welcome and included? That requires deep involvement by all people in power to make sure that you identify bad behaviour that's not inclusive, nip it in the bud, and model the right behaviour. A D&I officer can't do it. It has to be a responsibility and a tone at the top. And boards have to ask CEOs, 'Why are your metrics not trending in the right way? Are you really looking for the right talent? What does the retention number look like? How many [diverse employees] are getting developed and promoted? Let me see the organization's health scores. Do diverse people feel included? Does everybody feel included, but particularly the diverse people? Are they underrepresented in the country?'"*

> "Boards should insist that the company has a diverse pool of candidates who have experience in both line management and corporate roles, and represent diversity across gender, ethnicity, age, and background."

Moving a company in an unfamiliar direction creates new challenges for the board and makes the selection, development, and assessment of a CEO more complex than it has been. The responsibility goes beyond assessing whether the CEO is ethical, and beyond the skills needed to oversee the typical business models of the past. The board must ensure that the CEO leads a learning organization and has the ability to leverage the diversity of thought and experiences within the organization so that its collective wisdom can navigate today's uncertainties and deliver long-term sustainable performance.

In our view, the guidance below is more in line with the realities of today's world.

Principles for board oversight of corporate leadership:

- Determine whether the CEO's competencies and character are suitable for the new world of multiple stakeholders and society's rising expectations of corporate responsibility.
- Regularly determine whether robust succession plans are in place for the CEO and other key executives, which should include candidates who are diverse across gender, ethnicity, age, and background.
- Consider how well management embraces continuous learning across the organization.
- Determine whether the company's leaders embrace diversity, equity, and inclusion and how these principles relate to all stakeholders.
- Determine whether the performance of the CEO and other senior leaders is aligned to meet the expectations of its relevant stakeholders.

Fresh Challenges for High-Performing Boards

While the CEO has primary responsibility for coming to grips with today's complex and volatile environment, the role of the board as the ultimate decision-maker is also crucial and must change with the times.

It's no longer enough for management to produce the "perfect" analysis and expect the directors to ratify and monitor their actions. Instead, management should be looking to their boards for help in contributing their insights and judgment to find the path forward on the wide range of material issues that will determine the company's future.

To do this well, every board must keep building on its ability to do two things well: tackle the complexities of constant change and disruption and meet the challenges of society's rising expectations as it broadens its responsibilities beyond shareholders. This includes continuous learning about the company, the industry it operates in, and relevant changes in the external environment.

Canada's existing corporate governance guidelines call for each board of directors to conduct a periodic self-assessment. (1) This assessment process should be dynamic enough to reflect the company's changing operational environment and to measure its performance against stakeholders' rising expectations.

But even continuous learning and a robust self-evaluation process aren't enough. Every group of directors should also carefully consider who should be sitting at the boardroom table.

Canadians have long expected boards to be made up of high-quality individuals with the experience and skills needed to help achieve the company's long-term goals. But today's boards must also ensure that members bring the diversity of thought, experience, and perspectives needed in a multi-stakeholder world.

In trying to achieve those goals, governance committees can sometimes face a dilemma: a candidate who adds diversity to the board may not always have the traditional background or skills listed in the skills matrices that most companies use to identify new directors. But boards must ensure that new directors bring appropriate experience and judgment as these skills are too important to compromise on.

> "…every board must keep building on its ability to do two things well: tackle the complexities of constant change and disruption and meet the challenges of society's rising expectations as it broadens its responsibilities beyond shareholders. This includes continuous learning about the company, the industry it operates in, and relevant changes in the external environment."

This potential trade-off spawns others. For example, where a company uses and discloses specific diversity targets for board positions and management roles, will these targets promote diversity without fuelling the corrosive perception of tokenism that many marginalized groups have endured for years?

Concerns about tokenism are not a reason to slow down a board's urgent and persistent need to achieve diversity. It is past time for boards of public companies to achieve true and meaningful gender diversity and to include persons from underrepresented groups who adequately reflect their stakeholders and the communities in which they operate. But progress overall remains slow and spotty.

According to a report by Osler, Hoskin & Harcourt on Diversity Disclosure Practices in 2021, women held just 23.4% of board seats on TSX-listed companies that disclose the number of women on their board. This is a rise of less than 2% from the previous year. No information is available on the representation of underrepresented minority groups on boards. (2) Clearly, this is a very low base from which to start a real and lasting transformation.

This imbalance has led several other jurisdictions to move towards mandated targets, with about a quarter of the 38 OECD (Organisation for Economic Co-operation and Development) countries now imposing some type of quota. The European Union has now agreed to its first-ever quota for the number of women on corporate boards. In the United States, Nasdaq proposed a new listing rule in December 2020 that requires every board to include at least one person who self-identifies as a woman and at least one director from specific underrepresented minorities.

In Canada, the Ontario Securities Commission published a "comply or explain" rule in 2015. It obliges companies listed on the Toronto Stock Exchange to either disclose information related to gender diversity, including the number of women on their boards and their policy on diversity, or to explain why they aren't doing so. The Canadian Securities Administrators announced an initiative in May 2021 for further research and consultation with stakeholders to make boards and senior management more diverse.

Noting that "diversity in the workplace makes good business sense," Canada's Ministry of Innovation, Science and Economic Development has recently launched a 50-30 Challenge to encourage Canadian organizations to achieve gender parity (50%) on boards and senior management, and significant representation (30%) among other equity-deserving groups. (3) Ottawa has also called for proposals to develop resources that can help implement equality, diversity, and inclusion in the workplace.

Canadian companies need to move faster and more decisively and set targets to achieve diversity within a reasonable amount of time. Given the evolution of gender identity and gender expression, we believe that boards should strive to be comprised of no less than 40% of their directors who identify themselves as women and no less than 40% of their directors who identify themselves as men, which leaves room for individuals from the 2SLGBTQ+ community. As well, boards should include a minimum of 30% of its directors from Indigenous persons in Canada, disabled persons or people from underrepresented racial groups.

Any discussion of diversity on boards should include the issue of term limits for directors. If few board positions come open for diverse candidates to fill, the pace of change will remain slow.

The main argument for setting and disclosing limits on the terms of directors is to ensure that board members can remain independent enough to carry out their fiduciary duties. Another benefit is that as directors come to the end of their terms and step off the board, they create space for more diverse replacements and others whose skills may be more relevant in a world that will likely change more in the next five years than it has in the last five.

We recognize that term limits may create tensions. So, we are in favour of allowing each board to set limits for their own members. Our recommendation is a 12-year limit for each member, with some flexibility for appropriate extensions. The fact is that any limit on a director's term is arbitrary, in the same way as forcing people to retire when they turn 65. Whatever the limit, every board should still work to ensure that its members bring a combination of fresh ideas and different perspectives, as well as deep experience and corporate memory.

Some boards have already come up with ways to achieve the right mix between newer and longer-serving directors. One is to ensure that one-third of members have 0 to 5 years of service, another third 5 to 10 years, and the remaining third 10 or more years.

As directors seek to sharpen their own effectiveness as the de facto decision-makers of the corporation, the role of the board chair takes on special importance. Since a high-performing board matters to the performance of the corporation, the selection and performance of its leader who shapes and directs its performance is critical.

A recent article in *Fortune* notes that "it's imperative that boards change the way they think about what it takes to succeed in the role of chair, how the role is structured, and the process of finding the right candidate."

It adds:

> *"Only by making changes in all of these areas can boards and their current chairs ensure their next leader will be able to tackle all the issues that companies are facing…. [Boards] are no longer defaulting to the longest-tenured director or only considering current board members. Instead, we are seeing boards look outside to name chairs, or recruiting new directors who have long-term potential. Indeed, companies are undertaking a succession planning process for the chair role similar to what we see among companies with strong CEO succession plans." (4)*

A high-performing chair must be an effective and inspiring facilitator, and ultimately be able to drive high-quality outcomes in the decision-making process of the board. The best chairs promote an inclusive culture in board discussions where every director's voice is heard. They will push for more clarity and deeper insight into what is "real and true" in the issues that come before the board.

That said, there is an absence of guidelines in Canada that could help shape the selection and role of the board chair. So below, in addition to principles for high-performing boards, are some specific recommendations for high-performing chairs given their criticality to strong corporate governance.

Principles to drive high-performing boards:

- Individually and collectively, spend enough time on continuous learning related to the specifics of the company and its industry. This should include efforts to stay current on changes in the broader external environment that could affect all businesses.

- At least once a year, assess the performance of individual directors and of the board as a whole, including determining whether board deliberations take account of the views of all its members. Self-evaluations should be considered for determining the performance of the chair, board committees, and committee chairs.

- Consider periodically inviting independent third parties to facilitate candid responses from individual directors.

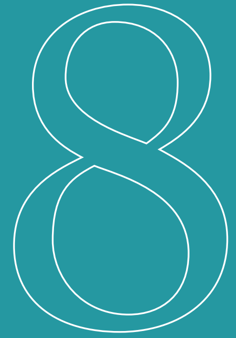
- In recruiting new directors, consider each candidate's ability to understand and contribute meaningfully to the full spectrum of issues relevant to the company. Boards should strive to achieve a mix of newer and longer-serving directors in order to encourage diversity of thought and experience.

- Every board should reflect the diversity of the company's stakeholders and the communities where it operates. To achieve diversity within a reasonable time, set targets for the makeup of the board to have no less than 40% of people who identify as women and no less than 40% of people who identify as men, which leaves room for individuals from the 2SLGBTQI+ community. In addition, aim for at least 30% representation from underrepresented racial groups, Indigenous persons in Canada, and disabled persons.

- Consider limiting the term of board members to a maximum of 12 years, while maintaining the flexibility for an extension in rare cases where such an extension is in the company's best interests.

Principles for selecting a high-performance chair:

- Consider each candidate's understanding of the company's industry, its business model, and the environment where it operates.
- Consider each candidate's experience and ability to shape and prioritize the shifting agenda of the board and its committees.
- Consider each candidate's ability to make the best use of the entire board's talents and experience through an inclusive approach, quality facilitation, and inspiring leadership.
- Consider how well each candidate embodies the company's culture and values.
- Consider each candidate's relationship with the CEO given the importance of the chair-CEO relationship. Board chairs and other directors should function as both mentors and sounding boards while being able to dispassionately assess the performance of the CEO and other senior leaders.
- Ensure robust succession planning for the position of chair. Identify candidates with deep knowledge of the business and industry, as well as the skills and experience to harness the talents of the entire board.



Overseeing Both Culture and Conduct

Most management teams and boards understand the importance of a high-performance culture to their company's success. But there is little consistency among the views of what constitutes a high-performing corporate culture.

Edgar Schein, professor emeritus at MIT's Sloan School of Management and the foremost expert on organizational culture, thinks of it as "learned patterns of beliefs, values, assumptions, and norms that drive behavior." (1) A corporate "culture" is usually taken to mean the collective expected behaviours of all employees to one another and to the company's stakeholders. "Values," on the other hand, refer to the selected dimensions of character that are expected from each of its employees.

A high-performing culture generally encourages a high level of accountability focused on achieving preferred outcomes. It welcomes diverse perspectives and embraces openness and inclusiveness. It embodies a set of corporate values that will attract the best employees and help earn their loyalty. This, in turn, helps to attract and retain customers and serve other stakeholders well.

Attracting and keeping great talent gives companies a competitive edge at a time when the pandemic has washed away many of the traditional barriers to pursuing new work opportunities. Changing jobs today, even changing careers, is often as easy as changing your login on your computer.

"…companies must strive to achieve twin goals: first, setting out the aspirational behaviours and values that drive high performance and earn the trust of stakeholders; and second, adhering to the conduct and ethical standards that have always been expected from business."

As companies become less hierarchical and more collaborative, culture plays a bigger role in their success. Employees and customers are increasingly unwilling to accept inappropriate behaviour, whether from corporate leaders or their juniors. Bullies, harassers, and creators of toxic work environments are gradually being forced out. As team members spend less time in their offices and work more directly with clients, their shared values, beliefs, and actions come to define their employer. Put another way, as companies engage with an expanding universe of stakeholders, a strong and healthy culture will help align its interests with those stakeholders.

The Canadian Securities Administrators' corporate governance guidelines tend to centre on "integrity and deterring wrongdoing." They emphasize "conduct"—in other words, compliance with existing laws and regulations—and refer to "ethics" to cover emerging areas where laws and regulations may not yet be codified. They are about what is not acceptable versus what is desirable.

Boards are required to satisfy themselves "as to the integrity of the chief executive officer and other executive officers" and to "adopt a written code of business conduct and ethics." Further, they are "responsible for monitoring compliance with the code" and whatever waivers are granted. (2)

Board practices have evolved into approving codes of conduct each year, which are mainly centred only on compliance with laws and ethical behaviours. Boards also oversee processes to monitor conduct, which include ensuring employees confirm that they have read and understood the code; receiving reports on violations of the code and actions taken to resolve them; and reviewing requests for waivers as they arise.

But not behaving badly is not the same as behaving well. Ticking the boxes on a code of conduct and ethics is not the same as overseeing the growth of a winning culture. Simply being in compliance with a code of conduct does not prevent bad behaviour, whether it is illegal, unethical, or inappropriate. If it did, far fewer CEOs and senior managers would find themselves shown the door.

Compliance processes to monitor conduct do little to improve trust in the business. Rather, they function as a static control mechanism for employees to operate within rules and regulations that, if not obeyed, could damage their own career prospects and potentially subject the company to significant legal consequences. In other words, compliance is the cop on the corner.

Beyond a few extreme examples, complying with a code of conduct is not enough to nurture a culture that contributes to operating a growing, sustainable business.

We also take issue with the belief that corporate success is largely driven by great execution and that successful execution is all about having a great culture. Proponents of this view often quote Peter Drucker, one of history's great management thinkers, who supposedly said that "culture eats strategy for breakfast." Yet the Drucker Institute has determined after exhaustive research that Drucker never said such a thing. (3) The fact is that even the healthiest culture cannot trump a bad strategy or a failing industry structure.

Great strategy is indispensable (see Chapter 3), but it must go hand in hand with a healthy culture to enhance its implementation and chance of success. Strong culture builds trust in a business to the point where it can either raise or lower the company's entire risk profile.

To sum up, companies must strive to achieve twin goals: first, setting out the aspirational behaviours and values that drive high performance and earn the trust of stakeholders; and second, adhering to the conduct and ethical standards that have always been expected from business.

This shift away from just a narrow view of conduct toward a dual focus on conduct and defining and sustaining a healthy culture can have another powerful benefit. It sends a signal not just through the company but to outside stakeholders that this is a flexible business eager and able to adapt to a fast-changing world.

Even casual observers are now aware of the reputational risk and debilitating fallout that can follow when a company's well-meaning aspirations collide with daily realities that reward or even insist on unethical, selfish, or duplicitous behaviour.

A culture that rewards overly aggressive growth can lead to rule-breaking and unethical practices, such as bribing government officials. A culture that glorifies a bullying CEO can encourage harassment and abuse throughout the organization. Similarly, a culture that doesn't embrace diversity, equity, and inclusion and that fails to penalize racial discrimination, sexual misconduct, and other inappropriate behaviour is likely to stand in the way of the company's commercial success. Explicit responses are needed to address the seminal social shifts that have coalesced into Black Lives Matter and the #MeToo movement, and uncovered the injustices of Canada's residential schools.

The behaviours and values embodied by the CEO, generally established by the founder of the organization and continually demonstrated over time by the ensuing generations of leaders, are critical. Their behaviours are the unspoken yet strongest signal to an organization about what behaviour is acceptable and what is not. The CEO should "be" the very best of what the company is or wants to become.

The right behaviours can achieve something extraordinary: an environment that fosters constructive dialogue both inside the company and between the company and its stakeholders. This, in turn, can forge a durable connection between a company's purpose, its strategy, and ultimately its value, with each component reinforcing the others. To quote David Beatty from the Rotman School of Management, shifting a corporate culture from conduct and compliance to one that is aspirational and high performing enhances management's ability "to propel their rockets while at the same time seeing their red flags."

For this to happen, the board needs to play an expanded oversight role in bringing together strategy, purpose, culture, and values.

That said, management must make the first moves, as follows:

- Articulate and communicate the company's aspirational behaviours and its selected values, and ensure they are up to date.
- Measure and assess the health of the culture. This includes identifying any shortcomings in the desired culture and taking action to address those shortcomings.
- Ensure that when employees attest to their compliance with the company "code" each year, they are making a commitment both to conduct and ethics as well as to the corporate culture.
- Ensure that robust monitoring of conduct and culture is in place so that there is transparency about the current state of both. Identified gaps to the desired state should be addressed with appropriate action plans. There should be robust incident monitoring processes—formal approaches (such as whistleblower lines) and informal ways to channel complaints through trusted leaders and human resource partners.
- Ensure that robust processes are in place to encourage the right behaviours and appropriately penalize misbehaviours. Reinforce good behaviours and sanction bad ones through awards and incentive programs.
- Ensure that consequences for substantiated misbehaviours are timely, appropriate, and consistent.

The 2018 UK Corporate Governance Code has already considered the constructive guidance from the Financial Reporting Council's 2016 report entitled *Corporate Culture and the Role of Boards.* (4)

For further guidance on the link between culture and outcomes, see *The Leader's Guide to Corporate Culture,* published by the Harvard Business Review. (5)

Principles for board oversight of culture and conduct:

- Determine whether the CEO and other senior management embody the company's culture and values, and that this culture is imbued in the company's purpose and strategy.
- Consider whether compensation design and awards reflect management's expected behaviours and values.
- Receive periodic reports from management on the state of the company's culture at all levels. Where a gap exists between current and desired culture, monitor management's progress in closing that gap.
- Determine the effectiveness of communication and training materials related to the expectations for the company's culture, values, conduct, and ethics. This should include annual approval of communication materials.
- Monitor the completeness of the annual attestations of employees and directors confirming their acknowledgement that their behaviours, values, and conduct meet the company's expectations.
- Monitor the appropriateness of any exceptions or waivers to the company's expected culture and conduct.
- Monitor the frequency and nature of incidents where employees' behaviours and values are inconsistent with the company's culture and/or are violations of conduct and ethical policies. Assess the timeliness and appropriateness of the consequences for the relevant employees.

Navigating Tensions and Trade-Offs

The key message of this report is that boards need to change how they work to deal with the changing world and the rising expectations for corporations. Collectively, companies are key to restoring trust in capitalism.

Companies must broaden their horizons to consider the interests of everyone with a stake in their company's success—including customers, employees, suppliers, local communities, and investors.

Ideally, directors and senior executives will be on the same page as they shift gears to deal with the tensions and trade-offs that inevitably arise in balancing the demands of multiple stakeholders. But they must also navigate the uncertainties of today's world and manage a multitude of risks while overhauling performance measurement systems.

The essential skill in juggling these many challenges is to be able to decide what is most important and then work with management to set agendas and expectations. In setting these priorities, the board should always foster a dialogue that respects diverse perspectives.

As always, management's job is to initiate a strategy that is intended to deliver long-term value to stakeholders. Once the board has approved it, management implements the strategy and the board monitors the outcomes against its expectations. Thereafter, the board and management must continuously review the strategy in response to new realities. When those realities are meaningfully different from the assumptions the strategy is based on, adjust it accordingly.

> "The key message of this report is that boards need to change how they work to deal with the changing world and the rising expectations for corporations. Collectively, companies are key to restoring trust in capitalism."

These changes mean that in the future, board agendas will be driven by strategic foresight. The days of focusing on compliance and hindsight are numbered.

To repeat a vital point made at the start of this report: the governance changes that have been put forth should not require directors to spend more time on their board duties.

According to a 2014 study by the Korn Ferry Institute, Canadian directors devote 304 hours a year—equal to 38 eight-hour days—to each board they serve on, or roughly 8 days longer than their US counterparts. (1) This time commitment should be sufficient for them to act as "stewards of the future."

The shift may involve taking on some new responsibilities related to a company's strategy and its accountabilities to a broader set of stakeholders. But other responsibilities should fall away. This is why we have called for a "shift" in directors' responsibilities rather than just adding to their workload.

Setting a board agenda is hard and preparing for board meetings can take hundreds of hours. Boards always insist that management provides high-quality, succinct materials, but that has become a real challenge as management often posts huge volumes of material on the company's electronic board portals. Boards can often be overwhelmed to the point where simply skimming the materials leaves them little time for reflection and sober judgment. One of our committee members serves on a board that has imposed a 10-page rule for any single agenda item.

All of us understand the underlying principal-agency conflict that exists within companies and the challenge of information asymmetry between management and its board. This is why Canada's current governance guidelines recommend that independent directors make up a majority of board members. (2)

Boards also hold an in-camera session at the end of each meeting to reflect on their own and management's performance. What's more, most mandates provide for boards and committees to hire independent experts who can act as a sounding board on sensitive issues, especially executive compensation.

So in the face of the massive challenges that most companies deal with, boards and management must collaborate closely to effectively navigate their massive change agendas through the ever-present tension of oversight and execution. The key to successful collaboration is the strength and transparency of the CEO and the senior management team. Together they must ensure that every hour spent in the boardroom is relevant to what's important and they must also be willing to confront the toughest issues.

The most powerful tool to put those steps into action is the company's culture. The right culture can replace disruptive tension with constructive dialogue by encouraging diverse viewpoints and, if necessary, compromise.

To summarize:

This report focuses on the need to gain a better understanding of who a company's stakeholders are and to engage meaningfully with them in order to appreciate their different priorities.
This process is the precursor to crafting a strategy that delivers optimal value to all relevant stakeholders including shareholders. Once the strategy is in place, it must be constantly reviewed and refreshed. In particular, all companies must respond thoughtfully to stakeholders' concerns on environmental, social, and governance ESG issues and, specifically, on climate change.

We have also outlined how companies can strengthen their risk management processes and how their boards should carry out their risk oversight responsibilities.

At the same time, companies need to change how they measure and report performance. Measuring the outcomes for stakeholders that deliver the purpose of the organization is far different than just measuring the financial outcomes to shareholders. This includes making careful trade-offs to optimize value creation for their many stakeholders.

Today's complex world calls for a shift to a new style of leadership, attuned to continuous learning and the precepts of DEI. Well-informed board members with different perspectives can play an invaluable role in challenging management to raise its game. Likewise, an effective and inspiring chair can lead the way to more inclusive board discussions that will produce the wisest possible decisions.

We make the case for the board to oversee not just employees' conduct and ethics, but to understand and measure the culture that drives their performance. If the culture isn't where it should be, the board has a duty to steer it there. This includes an expectation that leaders will be a model for the behaviours they want to see throughout the company and the culture they want outsiders to associate with it. This process starts in the boardroom where the culture must reflect the highest standards of stewardship and support the company's purpose, aspirations, or goals.

Throughout the report we address the need for compensation design and awards to be recast in a world of multi-stakeholders and to be far more focused on rewarding the achievement of broader outcomes that are relevant in this changing world. A recent report by Torys LLP and Hugessen Consulting noted that ESG and stakeholder engagement are key priorities for boards in 2022 as "ESG matters have become an important strategic priority, and boards and compensation committees are being held accountable for their ESG commitments." (3)

So, the need for compensation changes is a clear priority but this report does not provide details or insights as to how the design and awards need to evolve. This is a complex area that we leave as a specific challenge for management, boards, and compensation consultants to find creative alternatives away from the often singular focus on existing share-based schemes that may have many more years to run.

There is also a growing gap in governance obligations between public and private companies. We have also noted in our report the trend away from public listings and the acceleration of private equity. We are conscious of the potential for new or onerous governance requirements to accelerate these trends. On this subject, Canadian and international lawmakers need to be careful in the promulgation of requirements to avoid putting public corporations at an unfair disadvantage.

Above all, Canada should not see a tsunami of new compliance rules where the cost outweighs the benefits and that might cause directors to take their eyes off their primary duty of overseeing long-term sustainable and resilient performance that matters to its shareholders and other relevant stakeholders.

The committee believes strongly in the value of sound governance. As we said at the outset, much is at stake for Canadian companies and their boards. They must continue to change if they wish to remain competitive and contribute to Canada's prosperity. We also recognize that Canadian governance must take into account our unique mix of small- to large-cap companies. Equally, we believe that we should keep pace with the best and most current international practices.

The importance of the board achieving exemplary governance is singular and critical. As our fellow committee member Mac Van Wielingen puts it, the board is a company's ultimate decision-maker. "The quality of director decision-making has always been a driver of long-term success," he notes. "In today's deeply interconnected work, directors simply must know what is most important and insist that this be included in their companies' strategy and decision-making. This is holistic thinking in action, and it is a vital skill all directors must embrace."

Being the ultimate decision-maker in today's complex and changing world is a tough job, and it is becoming even tougher. But directors who do it right will have the satisfaction of knowing they are performing an invaluable service not only for their own company but for all those around it and, indeed, for society at large.

The Road Ahead

As we stated at the outset, this report reflects the collective views of our committee, developed after much reflection, dialogue, and, at times, debate. We have also drawn on the valuable insights of investors, government officials, regulators, community leaders, advocacy groups, and other stakeholders. A number of them took part in the nine virtual roundtables, at which they offered views and suggestions on how to improve the way Canadian companies are governed. To say we appreciate their effort, input, and patience is an understatement.

Many corporate directors devote a good deal of time to staying abreast of the ever-evolving world of governance. We often meet each other at Institute of Corporate Directors events, director education programs offered by the large accounting and law firms, and other forums. We hope that this report will contribute to our regular and frequent discussions and that boards will continue to challenge themselves to revise their mandates and processes to take account of the changes in the world around us.

It cannot be that another quarter of a century goes by without continuous modernization of the core principles that underpin Canadian corporate governance. We look forward to continuing this important dialogue so that corporate governance in Canada keeps pace with the changes in the world and the expectations of stakeholders that flow from them.

APPENDIX A
Committee Members' Biographies

RAHUL K. BHARDWAJ
Co-Sponsor

Rahul Bhardwaj, ICD.D, LL.B., is President and CEO of the Institute of Corporate Directors, a Canadian not-for-profit association of more than 16,000 members committed to improving national outcomes by growing the board leadership and governance capacities within Canadian businesses, agencies and not-for-profits.

Mr. Bhardwaj currently serves on the boards of Waterfront Toronto, the Institute of Corporate Directors, the Canadian Foundation for Governance Research as well as the Leader Council at the Ian O. Ihnatowycz Institute for Leadership at Ivey Business School. He is also Chair, Global Network of Director Institutes and Director Emeritus at the Rideau Hall Foundation. His corporate governance vision has made Mr. Bhardwaj a sought-after presenter, speaker and media commentator, in Canada and across the globe.

Committee Members' Biographies

CHERYL L. GRADEN

Co-Sponsor

Cheryl Graden, LL.B., LL.M., ICD.D, is Chief Legal & Enterprise Corporate Affairs Officer and Corporate Secretary, TMX Group. She is also an officer of TMX Group Limited and its subsidiaries and a member of the TMX Group Executive Committee. Ms. Graden has responsibility for advising TMX Group on all legal and regulatory issues that arise out of its operations and business initiatives. Over the last few years, the scope of her role has expanded to include the oversight of Enterprise Risk Management, Government Relations and Corporate Communications to ensure alignment in our enterprise approach across all stakeholder groups.

Ms. Graden began her legal career at Torys LLP in 1996 and joined TMX Group in 2004 as Chief Legal Officer at NGX in Calgary. Her role expanded over the years to encompass additional responsibilities, including the Canadian Depository for Securities' legal and regulatory affairs.

In January 2013, Ms. Graden was promoted to Vice President, Cash Clearing and Energy. She is an acknowledged expert in energy and clearing and has been a regular speaker on these topics across North America.

In addition to an undergraduate degree from the University of Alberta, Ms. Graden earned Bachelor of Laws and Masters of Law (Securities) degrees from Osgoode Hall Law School and is called to the Bar of Ontario.

Committee Members' Biographies

RAYMOND CHAN

Raymond Chan, CPA, is a corporate director and has been serving on the board of TELUS Corporation since 2013. He retired from the oil and gas industry in 2019 after a career spanning almost 40 years. He was employed by Baytex Energy since 1998, serving in various capacities over the years as Chief Financial Officer, Chief Executive Officer, Executive Chair, Independent Chair, and Lead Independent Director. In addition to having served on the boards of a number of public and private oil and gas entities, Mr. Chan was also a director at TMX Group and Alberta Children's Hospital Foundation.

JP GLADU

Jean Paul (JP) Gladu, ICD.D, is Principal of Mokwateh. He previously served as the President and CEO of the Canadian Council for Aboriginal Business (CCAB) from September 2012 until April 2020. In 1993, Mr. Gladu completed a forestry technician diploma and then pursued an undergraduate degree in forestry from Northern Arizona University in 2000. He currently holds an Executive MBA from Queen's University as well as an ICD.D designation from the Rotman School of Management at University of Toronto. Currently, JP serves on the board of Suncor, the Institute of Corporate Directors, Broden Mining, First Nations Major Projects Coalition Advisory Centre, Chair of Canada's Forest Trust and the Boreal Leadership Champions, as well as BHP's International Forum for Corporate Responsibility committee. He's a senior fellow with the Macdonald-Laurier Institute and past Chancellor of St. Paul's University College Waterloo from 2017 to 2020. Earlier Mr. Gladu served on the Board of Ontario Power Generation, Noront Resources, and as Chair of Mikisew Group of Companies.

Committee Members' Biographies

DEXTER JOHN

Dexter John, LL.B., ICD.D, is the President and Chief Executive Officer of Morrow Sodali (Canada) Ltd. Mr. John is responsible for the North American business where he leads a team of experienced governance and financial professionals. With over 25 years of experience in capital markets, Mr. John has a strong knowledge of corporate law and deep corporate governance experience, including with new and innovative sectors of the economy. He is a director of Organigram, where he chairs the Investment Committee, he is a director of the Financial Services Regulatory Authority (Ontario), and recently he was Chair of Partners Real Estate Investment Trust.

COLLEEN JOHNSTON

Colleen Johnston, FCPA, FCA, currently serves on the boards of Shopify, McCain Foods, Q4 and Private Debt Partners. Ms. Johnston is Chair of Unity Health Toronto, which includes St. Michael's Hospital, St. Joseph's Health Centre, and Providence Healthcare. She previously served as the Chair of Bridgepoint Health and the Heart & Stroke Foundation of Ontario. Ms. Johnston retired from TD Bank Group in 2018. Prior to this, she was the Group Head Direct Channels, Technology, Marketing and Corporate & Public Affairs, TD Bank Group. Ms. Johnston served as TD's Chief Financial Officer from 2005-2015.

Committee Members' Biographies

MONIQUE F. LEROUX

Monique Leroux, C.M., O.Q., FCPA, F.ICD, is Senior Advisor (Non-Executive) of Fiera Capital and serves as an independent board member of global companies such as Michelin, BCE, Couche-Tard and Lallemand Inc.

She chairs Michelin's ESG Committee as well as Bell's Corporate Governance Committee. As such, she contributes her broad international business experience as Former Partner of Ernst and Young (EY), Past Chair of the Board and Chief Executive Officer of Desjardins Group and Chair of the Board of Investissement Québec.

Ms. Leroux is a Companion of the Canadian Business Hall of Fame (2018) (CBHF) and the Investment Industry Hall of Fame (IIAC).

In addition, Ms. Leroux is a Member of the Order of Canada, an Officer of the Ordre national du Québec, a Chevalier of the Légion d'honneur (France) and a recipient of the Woodrow Wilson Award (United States). She has been awarded Fellowship by the Ordre des comptables professionnels agréés du Québec and the Institute of Corporate Directors and holds honorary doctorates and awards from ten Canadian universities in recognition of her contribution to the business sector and to the community. She is also a Director Emeritus and was a member of the Executive Committee of the Rideau Hall Foundation. She has also published 3 books.

Committee Members' Biographies

ANNE MCLELLAN

Hon. A. Anne McLellan, P.C., O.C., A.O.E., F.ICD, is a Senior Advisor to Bennett Jones and serves on the board of Summit REIT II and the Institute of Corporate Directors. She has served on the boards of legacy Agrium (now known as Nutrien), Cameco and Nexen, an oil and gas company. Among her many community commitments, she is chair of the boards of Pearson College UWC, TELUS Edmonton Community Board, and the Institute for Research on Public Policy. She also serves on the board of CIFAR.

Ms. McLellan served four terms as the Liberal Member of Parliament for Edmonton Centre. During her tenure, Ms. McLellan was Deputy Prime Minister of Canada and Minister of Public Safety and Emergency Preparedness, Minister of Health, Minister of Justice, and Minister of Natural Resources.

Ms. McLellan was Dalhousie University's seventh chancellor from May 2015 until May 2020. Recently, Ms. McLellan chaired the Task Force on Cannabis Legalization and Regulation.

HEATHER MUNROE-BLUM

Heather Munroe-Blum, O.C., O.Q., PhD, FRSC, F.ICD, is Chairperson of the Board of CPP Investments, and served as a distinguished university leader for over a decade as Principal and Vice Chancellor (President), McGill University, and previously as Vice-President (Research and International Relations) at the University of Toronto. With expertise developed over decades as a senior researcher, advisor, and contributor in the fields of psychiatric epidemiology, public policy, governance, and research and development, she has served on numerous public company boards including Four Seasons Hotels, the Royal Bank of Canada, Alcan, and CGI Group, and a multitude of non-profit boards, national and international special commissions, and task forces. She is currently also Chair of the Gairdner Foundation, Special Advisor to McGill's Microbiology, Immunology and Infectious Diseases Consortium, co-founder and Co-Chair, with Lawrence Tanenbaum and Guy Rouleau, of The Tanenbaum Open Science Institute, member of the board of CASBS at Stanford, and member of the Trilateral Commission.

Committee Members' Biographies

ROBERT L. PACE

Robert Pace, C.M., D.Comm, LL.B., is past Chair of the Board of Directors of CN, Chair of the Board of Directors of High Liner Foods Incorporated, and President and Chief Executive Officer of The Pace Group (radio broadcasting, real estate development, and environmental services). He began his professional career practising law in Halifax. In 1981, he accepted an appointment to act as the Atlantic Advisor to the Prime Minister of Canada, the Right Honourable Pierre Elliott Trudeau, in Ottawa.

INDIRA V. SAMARASEKERA

Indira Samarasekera, O.C., PhD, FRSC, FCAE, is a director of Magna International, TC Energy, Intact Financial and Stelco and was a director of the Bank of Nova Scotia for over twelve years. She is a member of the advisory board for Canada's Outstanding CEO of the Year Award and the Trilateral Commission. Internationally recognized as one of Canada's leading metallurgical engineers, Dr. Samarasekera is Senior Advisor at Bennett Jones LLP where she advises clients on mining, oil and gas, and environmental matters.

BARBARA G. STYMIEST

Barbara Stymiest, C.M., FCPA, FCA, is a corporate director. She is a former member of the Group Executive for the Royal Bank of Canada, a former CEO of TMX Group, Executive Vice President and CFO at BMO Capital Markets, and Partner of Ernst & Young LLP. She currently serves on the boards of George Weston Limited, President's Choice Bank, and Sun Life Financial Inc. She is also the Vice Chair of AGE-WELL and a director of CIFAR.

Committee Members' Biographies

MAC VAN WIELINGEN

Mac Van Wielingen, F.ICD, is an investment management executive, corporate director, entrepreneur and philanthropist. He is Co-Founder and Chairman of Viewpoint Investment Partners (VIP), an investment management company offering global multi-asset risk-optimized alternatives for high net-worth families and institutional investors. He is a Founder, director (1989 - 2018), and Partner (Present) of ARC Financial Corp., the largest private equity investment management company in Canada focused on the energy sector; and a founder and former Chair (1996-2016) of ARC Resources Ltd., a leading Canadian oil and gas producer. Mr. Van Wielingen joined the inaugural Board of Directors of Alberta Investment Management Corporation (AIMCo) in 2007 and served as Chair from 2014-2017. AIMCo currently manages over $160 billion for 32 Alberta based clients. Mr. Van Wielingen served on the Board of Directors of the Institute of Corporate Directors (ICD) (2018-2022). He is a founding partner of the Creative Destructive Lab - Rockies (CDL-R) and Co-Founder and former Chair (2012-2020) for the External Advisory Group of the Canadian Centre for Advanced Leadership (CCAL) at the Haskayne School of Business at the University of Calgary. He is Co-Founder, vice chair, and director (2019-2021) and now Chair (2022) of the Business Council of Alberta (BCA), created for the purpose of "making life better" for Albertans and all Canadians. In 2019, he served on the advisory committee that created the Alberta Indigenous Opportunities Corporation (AIOC), and from March 2020 to July 2022 he served on the Premier's Economic Recovery Council in Alberta.

APPENDIX B
Endnotes

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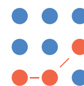

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