EXECUTIVE SUMMARY

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

December 2022

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.

INSTITUTE OF CORPORATE DIRECTORS | INSTITUT DES ADMINISTRATEURS DE SOCIÉTÉS

THINK BEYOND THE BOARDROOM. | PENSER AU-DELÀ DE LA SALLE DU CONSEIL.

TMX THE FUTURE IS YOURS TO SEE.®

* 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.