

Divided on diversity: alternative proposals from Canadian securities regulators to update diversity disclosure requirements

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On April 13, 2023, the Canadian Securities Administrators (the CSA) served up for comment two alternative approaches to updating diversity and director nomination process requirements under Canadian securities laws — neither of which is likely to satisfy investors. Comments on the proposals are due by July 12, 2023.

The CSA's proposals were published in a notice and request for comment (the Request for Comment) on proposed amendments to Form 58-101 *Corporate Governance Disclosure* of National Instrument 58-101 *Disclosure of Corporate Governance Practices* (Form 58-101F1) and complementary changes to National Policy 58-201, *Corporate Governance Guidelines* (NP 58-201).

The proposed amendments are set out in the form of two alternative proposals, the principal thrust of which is to elicit information regarding how non-venture issuers approach diversity beyond gender and their board nomination process.

Proposals retain existing emphasis regarding women in leadership roles

Under the existing diversity disclosure requirements (reflected in Form 58-101F1), non-venture issuers are required to provide annual disclosure relating to the representation of women on boards and in executive officer positions. The existing requirements have been adopted by all CSA jurisdictions other than British Columbia and Prince Edward Island.

In our annual reports on Diversity Disclosure Practices in Canada, Osler has tracked disclosure provided by issuers under the existing requirements since disclosure began to be required on January 1, 2015. We have noted slow but steady progress on the representation of women on boards over the past eight years. Last year, we reported that women hold 26% of board seats among TSX-listed companies, 32.9% among S&P/TSX Composite Index companies and 36% among S&P/TSX 60 companies. In addition, we reported some progress in recent years on the representation of women among executive officers, with women now representing 20% of the executive officers on average among TSX-listed companies.

The CSA proposals recognize that, while there has been progress on the representation of women in senior leadership positions, there is continued interest in disclosure focused on women as there is still a long way to go to reach gender parity. For this reason, while the proposed amendments would remove or reframe some of the existing disclosure requirements which did not elicit meaningful disclosure, both proposals largely retain the substantive elements of the existing requirements relating to disclosure of women in

leadership positions.

Increasing focus on diversity beyond gender

From the outset of reporting on the representation of women in senior leadership roles, we were asked about the representation of other diverse groups. We have tracked in our annual diversity disclosure reports various initiatives with respect to the representation of other diverse groups, including

- the work of the Parker Review Committee in the U.K. which, in 2017, set a target of “One by ‘21” for FTSE 100 companies, being one director from an “ethnic minority background” on each FTSE 100 company board by December 2021
- the adoption of diversity disclosure requirements under the *Canada Business Corporations Act* (the CBCA) which became effective January 1, 2020, making Canada the first jurisdiction worldwide to require diversity disclosure beyond gender, including a focus on visible minorities, Canadian Indigenous peoples and persons with a disability
- the final report of the Capital Markets Modernization Taskforce released in January 2021, which recommended that Ontario securities legislation be amended to require annual disclosure in relation to the representation of those who self-identify as (i) women, (ii) Black, Indigenous and people of colour, (iii) persons with disabilities or (iv) LGBTQ+ and the adoption of an aggregated target of 50% women and 30% collectively for the other underrepresented groups
- the adoption in 2021 of new NASDAQ listing rules requiring statistical disclosure on diversity beyond gender in a prescribed matrix focussing on different ethnic groups and persons identifying as being LGBTQ+ and narrative disclosure to the extent a listed issuer fails to satisfy prescribed minimum levels of board diversity
- the adoption of new U.K. listing rules requiring disclosure in company annual reports for financial years starting on or after April 1, 2022, of narrative disclosure regarding diversity, including whether at least 40% of the directors are women and at least one director is from a minority ethnic background, as well as tabular disclosure of the number and percentage of board members and executives who are (a) men, women, other categories or prefer not to say and (b) white, mixed/multiple ethnic groups, Asian, Black, other ethnic group or prefer not to say

We have also tracked growing investor interest in such disclosure over time, including

- requests from shareholder advocates in the U.S. over the last few years to companies to release data from their U.S. Equal Employment Opportunity Commission (EEOC) reports
- revisions to the proxy voting guidelines for Institutional Investor Services (ISS) for meetings of companies in the S&P/TSX Composite Index held on or after February 1, 2024, which state that ISS will generally vote against or withhold from the chair of the nominating committee where the board has no apparent racially or ethnically diverse members

In light of these influences and trends, it is not surprising that the CSA is proposing to address disclosure with respect to diversity beyond gender.

Diverging views on diversity disclosure

The CSA has proposed two alternative approaches to addressing diversity disclosure with respect to characteristics beyond gender.

Form A: The ‘flexible’ approach

The Form A amendments are premised on providing issuers with flexibility — both to define “identified groups” (other than women) which are meaningful to the issuer’s diversity strategy and to design tailored approaches to achieving or maintaining diversity among its directors and executive officers. Form A contemplates narrative disclosure describing the issuer’s diversity objectives, mechanisms for achieving those objectives and any written policies, processes and targets adopted by the board relating to women and individuals from the identified groups. If the issuer collects data on the number and proportion of directors and executive officers from its identified groups, that information must also be disclosed.

Form B: The ‘standardized’ approach

Form B is a more prescriptive alternative that models the approach under the CBCA by mandating disclosure on targets and the representation of “designated groups” on the issuer’s board and holding executive officer positions. The designated groups for disclosure purposes align with the CBCA by including, in addition to women, racialized persons, Indigenous peoples, and persons with disabilities, but go beyond the designated groups under the CBCA by also including LGBTQ2SI+ persons. Reporting on designated groups would be based on voluntary self-disclosure by directors and executive officers and disclosed on an aggregated basis. To further promote consistent and comparable diversity disclosure, Form B is largely premised on a standardized, tabular reporting format. Disclosure of the issuer’s written board diversity strategies, policies and objectives would be provided in narrative form.

Challenges with each approach

Diversity is a multifaceted issue and a key challenge with respect to disclosure is deciding which diversity characteristics should be the subject of disclosure. A focus on certain categories or characteristics necessarily means that others will not receive attention.

Form A

Form A purports to address this issue by leaving it up to individual issuers to decide which characteristics to include in their diversity strategy. While there is merit to providing issuers some flexibility in this regard, the absence of a standardized “default” list of diversity characteristics for which each issuer must provide disclosure can reduce the overall quality and, perhaps more importantly, the comparability of the disclosure across issuers, making progress difficult to measure across the market as a whole. While market practice and investor expectations may lead to a degree of standardization over time, we believe that the lack of comparability is a significant weakness in Form A.

The experience in the U.S. is also instructive, as the approach in Form A is similar to existing disclosure rules under U.S. securities laws. This approach has been criticized for not resulting in meaningful disclosure. That criticism prompted the U.S. Securities and Exchange Commission to provide guidance encouraging the disclosure of self-identified characteristics

of board candidates in 2018. The existing U.S. approach has also resulted in other initiatives to try to fill the gap, such as the NASDAQ listing requirement on diversity and investor pressure on issuers to publish EEOC data.

Form A also contemplates that disclosure with respect to non-gender diversity characteristics is to be provided on a collective basis for all individuals falling within one or more of the designated groups. The advantage of that approach is that it addresses the problem of double or triple counting where a single individual who is a member of two or more designated groups is counted as one person in each of those designated groups. By contrast, Form B addresses this concern by requiring issuers to disclose the number of directors who are members of more than one designated group.

However, this approach is unlikely to satisfy the interest of investors or other stakeholders who wish to understand the representation of particular groups, such as the degree to which visible minorities, Indigenous peoples or persons with disabilities are represented in senior leadership roles. Disclosure on a collective basis for all members of the designated groups would be inconsistent with the trend towards requiring disclosure based on individual characteristics, rather than group characteristics, in the U.K. and under NASDAQ listing requirements, and with the diversity disclosure requirements applicable to publicly-traded CBCA companies (which represent a meaningful proportion of the issuers subject to the disclosure requirement), which require disclosure separately with respect to each designated group.

Form B

Form B, on the other hand, requires disclosure based on substantively the same definitions used for disclosure required under the CBCA plus the additional category of LGBTQ2SI+. The Request for Comment notes that while Form B contemplates reporting on specified designated groups, an issuer may voluntarily choose to provide disclosure with respect to other characteristics, just as permitted by the CBCA guidelines.

Having a prescribed list of designated groups for which disclosure is required helps mitigate some of the concerns arising under Form A. However, based on our experience reviewing disclosure by CBCA companies over the past three years, we do not think it is likely that issuers will provide diversity disclosure with respect to characteristics beyond those mandated.

Form B also specifically requires that disclosure on the number of individuals in each designated group who are directors or executive officers be provided as at the end of the prior fiscal year. While the requirement for disclosure for each designated group is likely desirable from an investor and regulatory perspective, investor voting for directors will be based on the candidates nominated for election rather than the historic composition of the board, with the result that the going-forward composition of the board is likely to be of greater interest.

Form B does not, however, require specific disclosure of the percentage of directors and executive officers who are women or members of the other designated groups. Although this information is calculable based on the tabular disclosure contemplated by Form B, also requiring disclosure based on the percentage of directors would be desirable to provide for more ready comparison across issuers.

New corporate governance guidance on diversity

National Policy 58-201 *Corporate Governance Guidelines* (NP 58-201) has been revised in both proposals to include as guidance recommendations that the board

- adopt a written diversity policy, although Form A contemplates adoption of a diversity “process” as an alternative
- set objectives for achieving, or regarding, diversity

The guidance in Form B is more prescriptive than in Form A. While Form B states that objectives regarding diversity must be specific, measurable and time-bound, Form A only outlines alternative mechanisms for achieving diversity objectives, including setting targets or the adoption of other diversity-related initiatives. Form B also expands the items that should be addressed by a written board diversity policy to include

- discussing the ability of the board or nominating committee to engage independent advisors to assist in identifying candidates and require advisors to present a diverse slate of candidates for consideration
- setting out the responsibility of the board or nominating committee to consider any changes to the policy, the board composition and recruitment process that are necessary to achieve the objectives outlined in the policy
- considering the board and nominating committee’s effectiveness at implementing the policy during regular assessments

Revised approach to disclosure of the director nomination process

Under the proposals, it would no longer be necessary to describe the responsibilities, powers and operation of the nominating committee. Instead, issuers would disclose whether the board has a written policy respecting the nomination process. If the board does not have a written policy respecting the nomination process, the issuer would have to explain how the board carries out the nomination process.

In addition, the issuer would need to disclose

- how the board manages any conflicts of interest that arise or could arise during the nomination process
- whether the board has a composition matrix setting out the mix of skills, knowledge, experience, competencies and attributes that the board currently has and is looking to obtain in its membership
- the skills, knowledge, experience, competencies and attributes of candidates that are considered when evaluating a candidate

These changes are accompanied by substantial revisions to the guidance included in NP 58-201 respecting the role and responsibilities of nominating committees. Additional new responsibilities that have been expressly assigned to the nominating committee include

- board succession planning, which plan should
 - provide a transparent process and timeline for replacing board members so as to

ensure that necessary skills, knowledge, experience, competencies and attributes are maintained

- maintain a mix of longer-serving directors with a deep understanding of the issuer and its business and newer directors with fresh ideas and perspectives
- maintain the board's independence from management
- orientation and continuing education for directors

The changes to NP 58-201 also provide that

- a board should have a composition matrix setting out the mix of skills, knowledge, experience, competencies, attributes and independence that the board currently has or is looking to achieve in its membership. In order for the board to effectively fulfill its mandate and address existing and emerging business and governance issues relevant to the issuer, the board should regularly review the composition matrix and use this review process to recruit new directors or provide continuing education opportunities to existing directors
- a board should adopt a written policy respecting the director nomination process that sets out the process used in relation to director appointments and the board's approach to succession planning
- recommendations for appointments to the board should be based on objective criteria, with consideration for whether or not each new nominee to the board can devote sufficient time and resources to their duties as a board member

With respect to board renewal, there is a puzzling new addition to NP 58-201 setting out the factors that "may be considered" if an issuer establishes term limits, including the size and composition of the board, the composition matrix, board independence from management and the issuer's ownership structure, characteristics of the issuer (including its industry, size and stage of development) and the existence of other mechanisms to ensure the effectiveness of board members.

Although the CSA do not explain the reasoning behind the new requirements with respect to the board nomination process, we expect the changes are intended to provide additional transparency on a process that is sometimes criticized as being a mysterious "black box" in order to enhance the rigour of the director nomination process and to encourage persons from underrepresented groups to come forward as candidates. However, the proposed disclosure rules and guidance contemplate a degree of formality that we have not seen in Canada. While many issuers utilize a director skills matrix for assessing the capabilities and needs of the board, including with respect to certain diversity characteristics, there is a limit to the range of skills, knowledge, experience, competencies and attributes that are included in the matrix, leaving some of these elements to be assessed in a less formal fashion. We also expect few, if any, issuers have adopted a written policy regarding the nomination process.

Conclusions

It is clear that the CSA have been unable to agree on a path forward to updating their existing approach to diversity disclosure. Neither alternative is likely to fully satisfy issuers, investors and other stakeholders. Investors and other stakeholders may be dissatisfied with the nature and extent of the disclosure likely to be provided under Form A, while Form B has certain limitations of its own. And the proposed amendments to NP 58-201 are perhaps

unduly prescriptive in some key respects. We hope that the CSA will be able to settle on proposed rules that afford flexibility to issuers in describing their approach to diversity and director nominations, while still providing meaningful statistics on the representation of defined designated groups to provide sufficient comparability that allows for a meaningful assessment of an issuer's progress on diversity on an absolute basis over time and relative to its peers and the market more broadly.