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British Columbia Securities Commission
Financial and Consumer Services Commission, New Brunswick
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Office of the Superintendent of Securities, Newfoundland and Labrador
Ontario Securities Commission
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, PEI

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Via email

Dear Sirs/Mesdames:

Re: CSA Request for Comment – Proposed Amendments to Form 58-101 and NP 58-201 pertaining to board nominations, board renewal, and diversity (the "Instrument")

Thank you for the opportunity to provide comments on the Instrument. I am the N. Murray Edwards Chair in Business Law in the Faculty of Law at the University of Calgary and a member of the Alberta Securities Commission. I have spent my entire career serving on, and advising, boards of directors in Canada, the United Kingdom, and the United States. All opinions in this letter are entirely my own.

My research interests focus on corporate governance. I have recently completed a book for Cambridge University Press that summarizes what we now know about corporate governance from the thousands of empirical studies conducted since the early-1990s.

I am writing to strongly urge the securities regulators in Canada to adopt the proposed Form A. It goes without saying that the choice between the two Forms is not about whether diversity is an important political and social goal.

1. The Essential Difference Between Form A and Form B

As the Instrument notes, the principal difference between the two forms is that Form A encourages issuers to generate its diversity objectives internally, set its own measures for progress, and even (with the exception of women) define the diversity categories that are relevant and important for its business.[1] Its' defining characteristic is that it attempts to allow the board of directors flexibility in matters relating to its own composition and how best to advance the interests of the firm.

Form B, in contrast, defines diversity with reference to certain enumerated, historically marginalized groups, and requires reporting in a tabular format designed to facilitate quick evaluations of diversity by outsiders, as well as facilitating comparability across otherwise heterogenous businesses.[2] It is designed to make it easier for investors to compare a couple specific types of diversity quickly and superficially between companies.

2. The Relevant Standard for Evaluating the Merits of the Two Forms

Though the Instrument has an obvious political objective – namely increasing board diversity – the Instrument only references its expected impact on investors.[3] This focus on investors is because the securities commissions are poorly positioned to pursue political objectives outside of their narrow remit of investor protection and fostering Canada's capital markets:

- Canada's securities commissions are not elected and thus lack the legitimacy to pursue broad social and political goals;

[1] Canadian Securities Administrators, *CSA Notice and Request for Comment: Proposed Amendments to Form 58-101F1 Corporate Governance Disclosure of National Instrument 58-101 Disclosure of Corporate Governance Practices and Proposed Changes to National Policy 58-201 Corporate Governance Guidelines* (Montréal: CSA, 2023) at 4–5.
[2] *Ibid*.
[3] *Ibid* at 6.

• Commissions are expressly confined by the legislation that creates them to pursuing a narrow range of objectives that do not include political projects like advancing racial, gender, and sexual equity;[4]

• Commissions are not subject to meaningful public, media, or political oversight in their regulatory activities;

• Commissions are not particularly expert in areas outside of their core financial market remit; and

• Commissions do not, in practice, engage in the sort of wide-ranging policy considerations that are essential to competently pursuing broad political initiatives.

In relation to this last point, the Instrument does not, for example, deal with: (i) the mixed state of research on quota-based or affirmative action-types of programmes;[5] (ii) the tremendous unpopularity – across racial groups – of these sorts of programmes in places like America, where the programmes have the most salience;[6] (iii) whether a focus on a narrow range of physical characteristics ignores or makes worse other important inequities;[7] and (iv) whether making

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[4] See eg, *Securities Act*, RSO 1990, c S.5 ss 1.1, 2.1.

[5] Simone Schotte, Rachel Gisselquist & Tharcisio Leone, "Does Affirmative Action Address Ethnic Inequality? A Systematic Review of the Literature" (2023) United Nations University World Institute for Development Economics Research, Working Paper 2023/14, online: <wider.unu.edu/sites/default/files/Publications/Working-paper/PDF/wp2023-14-does-affirmative-action-address-ethnic-inequality.pdf> (discussing the state of the empirical literature in this area and its various weaknesses, including a general failure of studies to look at the impact of affirmative action beyond its narrow effect on representation in the relevant institution); Julia V Furtado, António C Moreira & Jorge Mota, "Gender Affirmative Action and Management: A Systematic Literature Review on How Diversity and Inclusion Management Affect Gender Equity in Organizations" (2021) 11:2 Behavioral Science 21 (a literature review noting the complex field of findings in the literature, including those that find quotas and affirmative action produce increased levels of prejudice); Edwin Ip, "Gender Quotas Can Work But it Depends on How Employees Feel About Them" (7 August 2017), online (blog): <theconversation.com/gender-quotas-can-work-but-it-depends-on-how-employees-feel-about-them-81386> (describing research that suggests that in many circumstances, "gender quotas can damage an organisation's performance and harm the people who are meant to benefit from the quotas"); Marianne Bertrand et al., "Breaking the Glass Ceiling? The Effect of Board Quotas on Female Labour Market Outcomes in Norway (2019) 86:1 Rev of Econ Studies 191 (finding no evidence the diversity created by Norway's board quotas produced better outcomes for women not appointed to a board and only mixed evidence the reforms had any effect on the decisions and career prospects of young women).

[6] Scott Jaschik, "Poll Finds the Public Doesn't Favor Affirmative Action" (1 May 2022), online: <insidehighered.com/admissions/article/2022/05/02/poll-finds-public-doesnt-favor-affirmative-action>; Nikki Graf, "Most Americans Say Colleges Should Not Consider Race or Ethnicity in Admissions" (25 February 2019), online: <pewresearch.org/short-reads/2019/02/25/most-americans-say-colleges-should-not-consider-race-or-ethnicity-in-admissions/> (73% of Americans, including majorities in every racial group, are opposed to affirmative action in admissions decisions).

[7] Richard D Kahlenberg, "The Affirmative Action That Colleges Really Need: Universities Want to Protection the Status Quo, Because It's Easy For Them", *The Atlantic* (26 October 2022), online: <theatlantic.com/ideas/archive/2022/10/supreme-court-harvard-affirmative-action-legacy-admissions-equity/671869/>; Rachel Brulé & Aliz Tóth, "Do Quotas in Two Dimensions Improve Social Equality? Intersectional Representation & Group Relations" (2022) Boston University Global Development Policy Center, Working Paper HCI 017, online: <bu.edu/gdp/files/2022/07/HCI_WP_017_FIN.pdf> (discussing how one-dimensional quotas, say gender only, lead to losses in other areas); Ivan Smirnov, Florian Lemmerich & Markus Strohmaier, "Quota-based Debiasing Can Decrease Representation of the Most Under-represented Groups" (2021)

decisions on the explicit basis of a person's identity or group status has the effect of increasing the salience of gender and racial divides in ways that lead to increases in social conflict and prejudice.[8]

This is not to say that quotas, affirmative action, or the regime proposed in the Instrument are wrong. It may be ideal. It is just to point out that the institutional capacities and authority of the commissions are not suited to policy objectives that lie far outside their capital markets remit. This is why the Instrument focuses on its' putative impact on investors (as opposed to the targeted minority groups) and why this letter will focus on the same thing.

It might be objected that in 2014, Canadian securities regulators passed disclosure rules designed to facilitate greater gender parity on boards, so securities regulators have already assumed a broader political role. However, the 2014 reforms were enacted by commissions under a theory that the financial performance of public companies would be enhanced by board diversity.[9] Almost no one familiar with the empirical literature now believes this is true,[10] but at the time it

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8:9 Royal Society Open Science 210821 ("quota-based debiasing based on a single attribute can worsen the representation of the most under-represented intersectional groups and decrease the overall fairness of selection" at abstract); Michael L McDonald, Gareth D Keeves & James D Westphal, "One Step Forward, One Step Back: White Male Top Manager Organizational Identification and Helping Behavior Toward Other Executives Following the Appointment of a Female or Racial Minority CEO" (2017) 61:2 Academy Management J 405. In striking down California's board diversity statute in 2022, the court specifically questioned the justification of a statute requiring inclusion of only a few specific types of minorities: Crest v. Padilla, No. 20 STCV 37513, 2022 WL 1073294, at *9 (Cal. Super. Apr. 1, 2022).

[8] Miriam K Zehnter & Erich Kirchler, "Women Quotas vs Men Quotas in Academia: Students Perceive Favoring Women as Less Fair than Favoring Men" (28 April 2020), online: <frontiersin.org/articles/10.3389/fpsyg.2020.00700/full> ("students perceived women quotas as counterproductive, derogatory, and unfair…"); V Thani Sulé et al, "When Higher Education is Framed as a Privilege: Anti-Blackness and Affirmative Action During Tumultuous Times" (2022) 45:4 Rev Higher Education 415; J Scott Carter, Cameron Lippard & Andres F Baird, "Veiled Threats: Color-Blind Frames and Group Threats in Affirmative Action Discourse" (2019) 66:4 Social Problems 503 ("affirmative action was framed as a source of competition that threatened resources held in high regard by white America"); Osamudia R James, "White Like Me: The Negative Impact of the Diversity Rationale on White Identity Formation" (2014) 89:2 NYUL Rev 425 (the diversity rationale for affirmative action increases the importance of a white identity in ways that undermine anti-racist goals).

[9] Ontario Securities Commission, *Proposed OSC Amendments to Form 58-101F1 Corporate Governance Disclosure of National Instrument 58-101 Disclosure of Corporate Governance Practices Proposed Disclosure Requirements Regarding the Representation of Women on Boards and in Senior Management: Supplement to the OSC Bulletin* (Toronto: Carswell, 2014) ("The Proposed Amendments are intended to encourage more effective boards and better corporate decision making…" at 6).

[10] Renée B Adams & Daniel Ferreira, "Women in the Boardroom and Their Impact on Governance and Performance" (2009) 94:2 J Financial Econs 291 (finding average effect on firm performance is negative); David A Carter et al., "The Gender and Ethnic Diversity of US Boards and Board Committees and Firm Financial Performance" (2010) 18:5 Corp Governance: An Intl Rev 396 (finding no support for a link between financial performance and the number of women or ethnic minorities on boards or board committees); Yi Wang & Bob Clift, "Is There a 'Business Case' for Board Diversity?" (2009) 21:2 Pacific Accounting Rev 88 (finding gender and racial diversity don't influence performance); Claude Francoeur, Réal Labelle & Bernard Sinclair-Desgangé, "Gender Diversity in Corporate Governance and Top Management" (2008) 81:1 J Bus Ethics 83 (finding no evidence female directors are connected to abnormal positive financial returns in Canada); Toyah Miller & Maria del Carmen Triana, "Demographic Diversity in the Boardroom: Mediators of the Board Diversity – Firm Performance Relationship" (2009) 46:5 J Management Studies 755 at 777 (finding that while diversity appears to be correlated with innovation, it is not related to firm performance); Kassim Hussein & Bill M Kiwia, "Examining the Relationship Between Female Board Members and Firm Performance – A Panel Study of US Firms" (2009) 18:2 African J Finance &

was arguably a reasonable belief owing to some questionable, but well-publicized research.[11] Insofar as the 2014 rules are a precedent for anything, therefore, they are a precedent for being careful about the actual capital market relevance of popular political projects urged on securities commissions by vocal members of the investment community and pressure groups.

3. Investor Use of Diversity Disclosure

As the rationale for the Instrument is to provide "information investors need to make informed investment and voting decisions," it is worth considering the evidence we have about how shareholders make use of governance disclosure like that proposed by the Instrument.[12] I will focus particularly on institutional investors, given their prominence in the debate about the Instrument, and the fact institutions own approximately half of the shares listed on the TSX. The problems of small and isolated retail investors in effecting change through the corporate governance channel are already well known.

Many corporate law scholars have noted that institutional investors do not seem particularly engaged in firm-specific corporate governance. Some of this is a matter of incentives. Several decades ago, Professor John Coffee famously noted, "the expected gains from most such governance issues are small, deferred, and received by investors [in the fund], while the costs are potentially large, immediate, and borne by money managers."[13] Indeed, research shows that the economic incentives of fund managers are to improve relative, not absolute, fund performance.[14] Funds are measured against benchmarks, and corporate governance improvements raise the value of every fund, index or benchmark that holds the improved company's stock. A corporate

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Management 20 (finding no positive and significant relationship between board gender mix and financial results in 250 firms over six years); Kathleen A Farrell & Philip L Hersch, "Additions to Corporate Boards: The Effect of Gender" (2005) 11:1 J Corp Finance 85 (looking at stock returns and finding no evidence gender diversity is "a value enhancing strategy"); Frank Dobbin & Jiwook Jung, "Corporate Board Gender Diversity and Stock Performance: The Competence Gap or Institutional Investor Bias" (2011) 89:3 NCL Rev 809 (finding that adding women does not affect profitability); Kenneth Ahern and Amy Dittmar, "The Changing of the Boards: The Impact of Firm Valuation of Mandated Female Board Representation" (2012) 127:1 Q J of Econ 137 (finding declines in Tobins Q and a deterioration in operating performance following Norway's board diversity mandates); David Matsa and Amalia Miller, "A Female Style in Corporate Leadership? Evidence from Quotas" (2013) 5:3 Am Econ J: Applied Econ 136 (finding Norway's board diversity quotas led to fewer workforce reductions and declines in profits); Charles A O'Reilly III & Brian GM Main, "Women in the Boardroom: Symbols or Substance?" (14 April 2012), The Rock Center for Corporate Governance at Stanford University, Working Paper No 117, online: <ssrn.com/abstract=2039524> (finding no evidence that adding women to the board improves firm performance, but some evidence it increases CEO pay).

[11] Lois Joy et al, "The Bottom Line: Corporate Performance and Women's Representation on Boards" (15 October 2007), online (pdf): <catalyst.org/wp-content/uploads/2019/01/The_Bottom_Line_Corporate_Performance_and_Womens_Representation_on_Boards.pdf>. The problems with this and similar studies are detailed in Daniel Ferreira, "Board Diversity" in R Anderson & HK Baker, eds, *Corporate Governance: A Synthesis of Theory, Research and Practice* (Hoboken, New Jersey: John Wiley & Sons, 2010) 225 at 235-36, 239. See also, Bryce C Tingle, "What Do We Really Know About Corporate Governance Best Practices? A Review of the Empirical Research Since 2000" (2017) 59:3 Can Bus LJ 292 [Tingle, "What Do We Really Know"].

[12] CSA, *supra* note 1 at 6.

[13] John C. Coffee, "Liquidity versus Control: The Institutional Investor as Corporate Monitor" (1991) 91:6 Colum L Rev 1277 at 1328.

[14] Ronald Gilson and Jeffrey Gordon, "The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights" (2013) Colum L Rev 113 at 889-95.

governance intervention by a fund manager – even if successful – thus does little to distinguish her fund from all the others, or to reward the fund manager for her expensive and time-consuming intervention.

An additional issue is that over the past forty years, an increasing percentage of Canada's public companies have come to be owned by large, diversified shareholders. A properly diversified portfolio is designed to eliminate firm-specific risks of the sort created by poor corporate governance. Institutional investors are *by design* not exposed to governance risks in their portfolio companies. Their situation is therefore quite different from other corporate constituencies, such as employees, who have an undiversifiable interest in their specific employer continuing to flourish. Indeed, virtually none of the core constituencies that form around a typical corporation have less of an economic interest in the corporate governance arrangements of that specific corporation than a well-diversified institutional shareholder.[15]

The result of these incentives is that institutional shareholders devote few resources to firm-specific corporate governance issues – even those that, unlike diversity, are directly related to generating absolute portfolio returns:

- Many funds effectively delegate evaluating companies' governance arrangements to proxy advisors and other third parties;[16]

- Funds end up following third-party voting recommendations, even where they conflict with the fund's own likely views on a matter;[17]

- Institutional investors evaluate corporate governance quality based on practices that are well-known to be incorrect, but which are easily measured;[18]

- Fund management companies employ very few people concerned with governance and voting decisions. (Indeed, the mismatch in the largest funds between resources expended on voting and the size of investment portfolios is enormous);[19]

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[15] For the key works on modern portfolio theory, see Harry Markowitz, "Portfolio Selection" (1952) 7:1 J Fin 77 at 81; William F Sharpe, "Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk" (1964) 19:3 J Fin 425; Jan Mossin, "Equilibrium in a Capital Asset Market" (1966) 34:4 Econometrica 768; John Lintner, "The Aggregation of Investor's Diverse Judgments and Preferences in Purely Competitive Security Markets" (1969) 4:4 J Finance & Quantitative Analysis 347.
[16] David F Larcker, Allan L McCall & Gaizka Ormazabal, "Outsourcing Shareholder Voting to Proxy Advisory Firms" (2015) 58:1 JL & Econ 173 (finding a substantial portion of institutional investors rely on proxy advisory firms for research and determining voting on their behalf); Dorothy S Lund, "The Case Against Passive Shareholder Voting" (2018) 43:3 J Corp L 493 (2017) (finding Vanguard, Blackrock and State Street are all understaffed and often outsource voting decisions to ISS and Glass Lewis).
[17] John G Matsusaka & Chong Shu, "Does Proxy Advice Allow Funds to Cast Informed Votes?" (25 October 2022), University of Southern California Law, Legal Studies Paper No 21-37, online: <ssrn.com/abstract=3866041> at 4.
[18] Bryce C Tingle, "What is Corporate Governance? Can We Measure it? Can Investment Fiduciaries Rely on it?" (2018) 43:2 Queen's L J 1.
[19] Lund, *supra* note 16 at 516 (finding Vanguard employed 15 people devoted to voting and engagement for approximately 13,000 companies, while BlackRock and State Street employed 20 for 14,000 companies and fewer than 10 for 9,000 companies respectively); Lucian Bebchuk & Scott Hirst, "Index Funds and the Future of Corporate

• Shareholder voting patterns suggest they don't spend time understanding their portfolio companies' unique governance issues;[20]

• Most voting decisions appear deliberately designed to be ineffective;[21] and

• The market value investors give minority shareholder voting rights is approximately zero.[22]

It is important to understand that these well-established facts about shareholder engagement encompass all sorts of matters, including those directly connected to core shareholder concerns, such as the election of directors. The situation in relation to engagement on issues on which investors have fewer incentives is even worse. We can see this throughout the literature on shareholder engagement with environmental and social ("ESG") issues, of which diversity issues form a part:

• Research suggests that ESG-branded, socially responsible investment funds do not, on average, hold socially better performing companies than conventional funds;[23]

• There are, in fact, several studies that find ESG-branded funds hold companies with *worse* track records of compliance with environmental and labour laws;[24]

• Supporting the idea that fund manager commitments to social and political causes are primarily a marketing strategy, researchers find that ESG funds start by holding high

Governance: Theory, Evidence, and Policy" (2019) 119:8 Colum L Rev 2029 (the average stewardship budget is "less than one-fifth of 1%—only 0.2%—of the estimated fees that each of the [three largest index funds] charge for managing equity assets" at 2077).

[20] Bryce C Tingle, "Expressive Voting and Irrational Outcomes in Corporate Elections" (2021) 67:1 McGill LJ 71 [Tingle, "Expressive Voting"].

[21] Marcel Kahan & Edward Rock, "Symbolic Corporate Governance Politics" (2014) 94:6 BUL Rev 1997 at 2041 (discussing the ways shareholder governance initiatives are designed to be ineffective).

[22] Tingle, "Expressive Voting", *supra* note 21 at 74–75.

[23] Sebastian Utz & Maximillian Wimmer, "Are They Any Good at All? A Financial and Ethical Analysis of Socially Responsible Mutual Funds" (2014) 15 Journal of Asset Management 72; Hao Liang, Lin Sun & Melvyn Teo, "Responsible Hedge Funds" (2 May 2022), online: <ssrn.com/abstract=3610627> (finding many hedge funds that sign UN PRI have low levels of ESG investments); Aneesh Raghunandan & Shivram Rajgopal, "Do Socially Responsible Firms Walk the Talk?" (10 December 2022), online: <ssrn.com/abstract=3609056> (finding the largest ESG ETF and mutual fund demonstrate no correlation between their stock ownership and trading and ESG quality); Soohun Kim & Aaron Yoon, "Analyzing Active Fund Managers' Commitment to ESG: Evidence from United Nations Principles for Responsible Investment" (20 December 2021), online: <ssrn.com/abstract=3555984> (PRI signatories do not improve the weighted-average ESG scores in their portfolios). See also, Tim Quinson, "Why the Biggest US ESG Fund has No Direct Renewable Holdings", *Bloomberg News* (3 March 2021), online: <bloomberg.com/news/articles/2021-03-03/biggest-esg-fund-has-no-direct-renewable-holdings-green-insight-kltcg25d> (the largest ESG fund in America has no direct investments in renewable energy companies).

[24] Aneesh Raghunandan & Shivram Rajgopal, "Do ESG Funds Make Stakeholder-Friendly Investments?" (31 May 2022), online: <ssrn.com/abstract=3826357>; Rajna Gibson et al, "Do Responsible Investors Invest Responsibly?" (9 September 2022) European Corporate Governance Institute, Finance Working Paper 712/2020, online: <ssrn.com/abstract=3525530>; Kim & Yoon, *supra* note 23 (finding active managers that sign the PRI experience an increase in environmental controversies among the companies in their portfolios).

social responsibility companies for their first two years, but once established, there is a steep decline in the ESG quality of portfolio companies;[25]

• Shareholder voting support for all kinds of social and environmental measures is very low.[26] Indeed, investment managers who sign the UN's Principles of Responsible Investment actually "*decrease* their support of pro-governance proposals compared to the pre-signing period."[27]

• Shareholders almost never vote in favour of ESG proposals.[28] Over a three-year period, of the 633 ESG proposals brought to vote in the companies making up the Russell 3000, just 2.5% received enough votes to pass.[29] The number of ESG shareholder proposals have actually been declining over the period that ESG marketing language from investment funds has been increasing.[30]

• Funds branded as socially responsible vote unreliably on board diversity measures.[31] (For example, one of the earliest diversity funds, the State Street Gender Diversity ETF, voted against or abstained on many resolutions asking for reports on gender pay equity, sexual harassment, and employee diversity.)[32]

• The ESG ratings on which institutional investors depend for their portfolio selection and voting, are invalid. More than a dozen studies have found the average correlation between ESG rating firms to be less than 50%.[33] (This means that different ESG rating

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[25] Maximillian Wimmer, "ESG-persistence in Socially Responsible Mutual Funds" (2013) 3:1 J Management & Sustainability 9. This is the reason for the SEC's efforts to protect investors from investment fund greenwashing: Better Markets, "At Upcoming Meetings, SEC Should Adopt Strong Enhancements to ESG Mutual Funds and ETFs 'Names Rule' to Protect Investors from Greenwashing" (18 September 2023), online: <bettermarkets.org/newsroom/at-upcoming-meeting-sec-should-adopt-strong-enhancements-to-esg-mutual-funds-and-etfs-names-rule-to-protect-investors-from-greenwashing/>.

[26] See eg, Cydney Posner, "How Do the Largest Fund Families Vote on Shareholder Proposals Related to ESG?" (2 March 2020), online (blog): <jdsupra.com/legalnews/blog-how-do-the-largest-fund-families-90960/>.

[27] Kim & Yoon, *supra* note 23 at 4 [emphasis in original].

[28] Geeyoung Min and Hye Young You, "Active Firms and Active Shareholders: Corporate Political Activity and Shareholder Proposals" (2019) 48:1 J Leg Stud 81 at 109; Caleb N Griffin, "Environmental and Social Voting" (16 June 2020), online (blog): <clsbluesky.law.columbia.edu/2020/06/16/environmental-and-social-voting-at-the-big-three/> (Vanguard supports 7.5% of ESG proposals, Blackrock supports 7.1% and State Street supports 22.7% of ESG proposals); Rao, *supra* note 31; Tao Li, S Lakshmi Naaraayanan & Kunal Sachdeva, "Conflicting Objectives of ESG Funds: Evidence from Proxy Voting" (6 February 2023), online: <ssrn.com/abstract=3760753>.

[29] Oliver Hart & Luigi Zingales, "Companies Should Maximize Shareholder Welfare Not Market Value" (1 October 2017), European Corporate Governance Institute, Finance Working Paper No 521/2017, online: <ssrn.com/abstract=3004794>.

[30] Gibson Dunn, "Shareholder Proposal Developments During the 2020 Proxy Season" (4 August 2020), online: <gibsondunn.com/wp-content/uploads/2020/08/shareholder-proposal-developments-during-the-2020-proxy-season.pdf>.

[31] Gita R Rao, "A Surprise About Some ESG Funds – They Actually Vote Against Environmental and Socially Conscious Resolutions", *Market Watch* (18 December 2020), online: <marketwatch.com/story/a-surprise-about-some-esg-funds-they-actually-vote-against-environmental-and-socially-conscious-resolutions-11608306020>.

[32] *Ibid.*

[33] See eg, Feifei Li & Ari Polychronopoulos, "What a Difference an ESG Ratings Provider Makes!" (January 2020), online: <researchaffiliates.com/publications/articles/what-a-difference-an-esg-ratings-provider-makes>

firms rate or score a particular company the same way less than 50% of the time. Thus, at least one, and maybe both ESG ratings must be wrong. For comparison, the correlation among credit rating firms is 99%).[34] ESG ratings also fail to predict future corporate social and environmental performance.[35] These failures of ESG ratings are well-known, but investors still rely on them, which tells all you need to know about the actual incentives and resources that investors can bring to bear on matters like board diversity.[36]

• A very recent paper looked at Socially Responsible Investment ("SRI") funds and, among other failures, found that "an exogenous increase in SRI capital leads to zero significant changes in employee well-being or board diversity. Furthermore, when we split our estimates between funds that do claim to engage with their portfolio firms and funds that do not, we find that the estimated treatment effects for both types of funds are

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(constructing two portfolios, each on the basis of a different ESG data providers' rankings and finding very low correlation of returns); Florian Berg, Julian F Kölbel & Roberto Rigobon, "Aggregate Confusion: The Divergence of ESG Ratings" (26 April 2022), online: <ssrn.com/abstract=3438533> (looking at the ratings provided by six different ratings providers and finding correlations as low as 0.38 with an average of 0.54); Gerhard Halbritter & Gregor Dorfleitner, "The Wages of Social Responsibility – Where Are They? A Critical Review of ESG Investing" (2015) 26 Rev Financial Econs 25 (looking at the data from three ratings firms and finding considerable variation); Gregor Dorfleitner, Gerhard Halbritter & Mai Nguyen, "Measuring the Level and Risk of Corporate Responsibility – An Empirical Comparison of Different ESG Rating Approaches" (2015) 16 J Asset Management 450 (finding significant differences in various ESG ratings concepts); Jennifer Bender & Stefano Maffina, "The ESG Data Challenge: The Importance of Data Quality in ESG Investing" (April 2023), online: <ssga.com/library-content/pdfs/esg-data-challenge.pdf> (two researchers from State Street Global Advisors' ESG team compare the five leading ESG data providers and finds a low correlation of scores generated by MSCI and Sustainalytics translating into their ratings only being consistent about half the time); Arthur Hughes, Michael A Urban & Dariusz Wójcik, "Alternative ESG Ratings: How Technological Innovation Is Reshaping Sustainable Investment" (2021) 13:6 Sustainability 3551 (finding low commensurability between different styles of creating ESG ratings); Doron Avramov et al, "Sustainable Investing with ESG Rating Uncertainty" (2022) 145:2 J Financial Econs 642 (finding "substantial variations across different rating providers" that are "quite persistent throughout the entire [18 year] sample period" with an average rating correlation of 0.48 at 643); Rajna Gibson Brandon, Philipp Krueger & Peter Steffen Schmidt, "ESG Rating Disagreement and Stock Returns" (2021) 77:4 Financial Analysts J 104 (looking at seven rating firms and finding the average correlations on environmental ratings is 0.46); Lies Bouten et al, CSR Performance Proxies in Large-Sample Studies: 'Umbrella Advocates', Construct Clarity and the 'Validity Police'" (31 January 2018), online: <ssrn.com/abstract=3107182> (comparing two prominent ESG data providers and finding low correlations and even that in environmental scores the two are *negatively* related to one another); Dane Christensen, George Serafeim & Anywhere Sikochi, "Why is Corporate Virtue in the Eye of the Beholder? The Case of ESG Ratings" (2022) 97:1 Accounting Rev 147 ("rating agencies tend to have strikingly different views on a given firms' ESG performance" at 157).

[34] Berg et al, *supra* note 33.

[35] Aaron K Chatterji, David I Levine & Michael W Toffel, "How Well Do Social Ratings Actually Measure Corporate Social Responsibility" (2009) 18:1 J Econ & Management Strategy 125; Raghunandan & Rajgopal, *supra* note 23 (finding a negative association between high ESG companies and environmental violations); David J Vogel, "Is There a Market for Virtue? The Business Case for Corporate Social Responsibility" (2005) 47:4 California Management Rev 19 at 36-37; Tatiana Botelho & Alessandra Magrinni, "Assessing Oil: A Review of Sustainability Ratings Evaluation of Oil Companies" (2011), online (pdf): <crrconference.org/Previous_conferences/downloads/crrc2011botelhomagrinni.pdf> (finding BP led or ranked very highly in several sustainability indexes before Deepwater Horizon); Cheri Hasz, "The U.S. Oil and Gas Industry Should Be a Leader and Follow the EU's Lead on ESG Disclosure" (2021) 29:1 Tul J Intl & Comp L 135 ("prior to the Deepwater Horizon catastrophe in 2020, British Petroleum (BP) had achieved high scores in certain ESG standards" at 142–43).

[36] See Bryce C Tingle, "Are Shareholders the Solution to Environmental and Social Problems?" (forthcoming in (2023-2024) 58:1 Georgia Law Review) for a more extensive discussion of the problems with ESG ratings.

nearly identical and again near zero."[37] This means that funds which advertise themselves as engaging with management on social issues like diversity, cannot show any evidence of that engagement.

The weight of empirical evidence, therefore, supports the relatively common-sense view that institutional shareholders focus nearly all their attention on the activities that generate relative portfolio performance, and do not invest much in the way of resources on other activities. Where an investor must do something in relation to ESG (because of their fund's own marketing strategy or the pressure of outside groups), the fund managers look for the kinds of shortcuts that produce deeply-flawed ESG ratings and disclosure rules like the Instrument's Form B, which do not require much engagement with the unique circumstances and strategy of specific companies.[38]

4. The Structure of Corporate Law

In contrast to shareholders, directors have both legal duties and powerful economic and reputational incentives to focus on firm-specific governance. Corporate law has long recognized this fact and provides directors with the discretion and power to manage their firms, free from the legal interference of shareholders and other parties, with the exception of the shareholders' limited role in electing the directors and approving certain fundamental transactions.[39]

The essential fact of a business corporation is that it requires the contributions of various constituencies to create products and compete in markets. These constituencies vary depending on the company and its business, but they almost always include employees, equity investors, creditors, suppliers, and customers. The interests of these constituencies conflict, and the importance and bargaining power of each of these constituencies vary from firm to firm.

Some group or individual must reconcile the diverging interests of these constituencies and bring them into an equilibrium that will permit the company to succeed in its various markets. Throughout the developed world, this chosen body is the corporate board of directors. The directors oversee the bargains struck with each group and adjust those bargains as conditions change. Professors Blair and Stout observed that "the directors are trustees *for the corporation itself*—mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together."[40]

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[37] Davidson Heath et al, "Does Socially Responsible Investing Change Firm Behavior?" (2023) Rev Finance 1 at 3–4.

[38] Jill E Fisch, "Promoting Corporate Diversity: The Uncertain Role of Institutional Investors" (April 2023) forthcoming Seattle U L Rev, online: <https://ssrn.com/abstract=4398364> (discusses other issues with institutional investors acting on diversity matters including issues arising from their status as agents of the beneficial owners of their funds).

[39] Stephen M Bainbridge, "Director v Shareholder Primacy in the Convergence Debate" (2002) 16:1 Transnational Lawyer 45 (shareholder control rights in incorporation statutes are still "so weak that they scarcely qualify as part of corporate governance" at 48); Jeffrey M Lipshaw, "The False Dichotomy of Corporate Governance Platitudes" (2021) 46:2 J Corp L 345.

[40] Margaret M Blair & Lynn A Stout, "A Team Production Theory of Corporate Law" (1999) 85:2 Va L Rev 247 at 280–81 [emphasis in original]. See also, Stephanie Ben-Ishai, "A Team Production Theory of Canadian Corporate

Corporate law did not start with the directors in charge. Referring to the changes that began around the beginning of the 20th century to create the modern American corporation (and thus the modern Canadian corporation), Professor Vasudev notes the "shift of corporate powers from the shareholders to the directors".[41] This was accomplished by significantly reducing the matters shareholders were permitted to vote on, replacing a requirement for shareholder unanimity with majority rule, permitting the creation of non-voting shares and dual-class voting structures, removing fetters on issuing new shares, and providing directors with new areas over which they had complete discretion.[42]

The Supreme Court of Canada's most important recent decisions on corporate law, *Peoples Department Stores Inc (Trustee of) v Wise* and *BCE Inc v 1976 Debentureholders*, are part of this long legal trend.[43] The effect of these decisions is to reaffirm that the directors' duty to advance the best interests of the corporation requires them to take into account the interests of all constituencies, not just a decision's impact on a single constituency. By making it clear that shareholder primacy is not the law in Canada, the Supreme Court also reinforced the traditional independence of the board of directors.

Form A has the obvious advantage of leaving the board in charge of how the corporation manages diversity. It thus reflects the law in Canada and the legal consensus that has evolved over a century of experiments with the corporate form. As we have seen in considering the record of shareholders in corporate governance, there is little in the empirical literature that would lead us to conclude the current state of corporate law in Canada is mistaken in its assessment of who is best situated to manage the governance of Canadian companies.

The level of analysis required by Form B is far below what is expected of a competent board of directors. Retired corporate law scholar and past OSC Chair, Ed Waitzer correctly characterizes Form B's likely effects as "gaming…the metrics and 'dumbing down'…governance requirements."[44] He is also correct in noting that Form B is likely to discourage innovation in diversity practices and that it will stand in the way of promoting other types of diversity, including the protection of emerging categories of discriminated minorities.[45]

In contrast, Form A places the onus on directors and requires them to consider and define the kinds of diversity relevant for the business, and to advance those diversity goals in ways calculated to advance the long-term interests of the company. To the extent shareholders are

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Law" (2006) 44:2 Alta L Rev 299; Stephen M Bainbridge, "Director Primacy: The Means and Ends of Corporation Governance" (2002) 97:2 Nw UL Rev 547; Stephen M Bainbridge, "Director Primacy and Shareholder Disempowerment" (2006) 119:6 Harv L Rev 1735.

[41] PM Vasudev, "Corporate Law and Its Efficiency: A Review of History" (2008) 50:3 American J Legal History 237 at 268. See also, D Gordon Smith, "The Dystopian Potential of Corporate Law" (2008) 57:4 Emory LJ 985 ("[s]ubstantive statutory constraints on board power have largely been abandoned or eviscerated in modern corporation statutes" at 992).

[42] Vasudev, *supra* note 41 at 270–73.

[43] *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68; *BCE Inc v 1976 Debentureholders*, 2008 SCC 69.

[44] Ed Waitzer, "Too-rigid Metrics on Corporate Diversity Disclosures are Counterintuitive", *The Globe and Mail* (10 May 2023), online: <theglobeandmail.com/business/commentary/article-corporate-diversity-measures-counterintuitive/>.

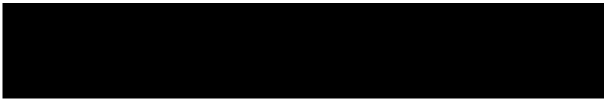
[45] *Ibid*.

actually engaged with board diversity (something that the research cited earlier brings into question), this engagement should not be privileged above the needs and interests of other constituencies. Directors should be permitted to reconcile diversity goals with other corporate objectives.

Finally, to the extent Form B is intended to apply pressure on boards to make certain kinds of diversity appointments, Form B creates conflicts with directors' duty to advance the best interests of the corporation.

In conclusion, it is not obvious why the flexibility, innovation, and firm-specific decision-making of corporate boards should be impaired in an effort to make a superficial analysis of diversity more convenient.

Yours Sincerely,



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