

# Board Diversity: Steering the Ship Under the Watchful Eyes of Shareholders, Lawmakers, and Regulators

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Recent pressure to improve diversity on boards is coming from a variety of sources, including shareholders, proxy advisory services, legislators, and regulators. This article explores these pressures and provides guidance on how effective boards can take this opportunity to consider and improve their approach to board diversity.



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The board of a public company is like the captain of a ship. A good board steers its company by keeping a watchful eye on the horizon while arming itself with relevant information, excellent navigational tools, and a healthy dose of wisdom and courage.

Increasingly, shareholders, lawmakers, and regulators are focused on board diversity as the issue is gaining momentum. Prudent boards are reassessing their course and considering if they possess the diversity needed to steer their companies to success and meet the expectations of their stakeholders and other interested third parties. As of 2018, women held 25.0% of the board seats at Fortune 100 companies. Expanding this examination to include smaller US based companies, the percentage of seats held by diverse board members declines. For example, in 2018 women represented only 22.5% of the board seats at Fortune 500 companies and 17.7% of board seats at Russell 3000 companies. Half of the Russell 3000 companies

in 2018 had none or only one woman on their board. Minorities are also poorly represented on corporate boards. As of 2018, minority directors held only 19.5% of Fortune 100 board seats and 16.1% of the Fortune 500 board seats. Minority women fared even worse, holding only 5.8% of the Fortune 100 board seats and 4.6% of the Fortune 500 board seats. (See Alliance for Board Diversity and Deloitte, Missing Pieces Report: The 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards (February 5, 2019) and 2020 Women on Boards, Gender Diversity Index (2018).) In 2015, the General Accountability Office published a report that found that, assuming women join S&P 1500 boards at the same rate as men, gender parity would not be reached before 2054 (see United States Government Accountability Office, Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements (December 2015)). The most recent data suggests that while the representation of women on boards is increasing more rapidly at the largest companies, overall, not a significant amount of progress has been made.

Although it is generally accepted that a diverse board leads to improved corporate decision-making, that alone has not been sufficient to generate meaningful diversity on boards. The following recent developments, however, suggest that change may be coming:

- Institutional shareholders proclaimed the importance of board diversity.
- Proxy advisory firms issued voting guidelines tied to board diversity.
- Legislators passed, debated, or introduced laws mandating gender diversity.
- Regulators reiterated the importance of disclosures relating to board diversity.

This article provides an overview of these recent developments and guidance for navigating through the shifting tides of board diversity.

## BACKGROUND

Diversity in the corporate boardroom has been a major topic of discussion among corporate governance commentators since at least 2009. This is when the Securities and Exchange Commission

(SEC) first adopted rules requiring disclosure of a company's diversity policies (Proxy Disclosure Enhancements, SEC Release No. Release No. 33-9089 (February 28, 2010)). To implement this disclosure requirement, the SEC amended Item 407(c)(2)(vi) of Regulation S-K (17 C.F.R. § 229.407(c)(2)(vi)) to require a reporting company to describe its nominating committee process for identifying and evaluating director candidates, including whether the committee or board considers diversity in this process and, if so, how. If the reporting company has a diversity policy for identifying director nominees, it must also describe how it implements this policy, as well as, how the nominating committee or board assesses the policy's effectiveness.

These diversity disclosure requirements were adopted as part of the SEC's effort to reinvigorate corporate governance disclosures after the 2008 financial collapse. At the time of the SEC's adoption of Item 407(c)(2)(vi) of Regulation S-K, very few companies had any policies on board diversity and it was generally expected that this new rule might foster change. The SEC explained that while the diversity disclosures were not intended to "steer behavior," added disclosure may induce positive change in board composition. The SEC stated in its adopting release that it is useful for investors to know how the board considers and addresses diversity and that investors should be given an assessment of the board's diversity policy, if any. The SEC specifically declined to define "diversity," instead allowing each company to define diversity in whatever way it considers appropriate. The rule applies to proxy statements filed during or after 2010. That year, only 18.0% of Fortune 100 companies' and 15.7% of Fortune 500 companies' directors were women, and minority women held a mere 3.4% of board seats at Fortune 100 companies and 2.9% of board seats at Fortune 500 companies. Over the nine years since the SEC adopted the disclosure requirement, the pace of change has been gradual. The percentage of women on boards from 2010 to 2018 has grown 7% for both Fortune 100 and Fortune 500 companies, with minority women seeing approximately 2% growth over that time. ((See Alliance for Board Diversity and Deloitte, Missing Pieces Report: The 2018 Board Diversity Census of Women and Minorities on Fortune 500 Boards (February 5, 2019)).

## SHAREHOLDER PRESSURE

Large institutional shareholders and proxy advisory firms are accelerating the drive to champion board diversity. When shareholders want to exert influence on corporate behavior they do so through the power of their vote. They can pressure companies either by introducing their own shareholder proposals for inclusion in the company's annual proxy statement or by voting against management proposals or nominees. For general information on shareholder proposals, see Practice Note, How to Handle Shareholder Proposals ([6-509-4830](#)). Proxy advisory firms like Glass Lewis & Co. (Glass Lewis) and Institutional Shareholder Services Inc. (ISS), which review proposals and make recommendations based on corporate governance best practices, also play an important role in the process. For general information on proxy advisory firms, see Developing Relationships with Proxy Advisory Firms ([8-517-2134](#)).

## INSTITUTIONAL SHAREHOLDERS

Over the past few years, a handful of high-profile companies have received shareholder proposals relating to board diversity that were

included in the companies' annual proxy statements. For example, in 2018 Amazon.com, Inc. included a shareholder proposal in its annual proxy statement requesting that the board adopt a policy for improving board diversity requiring that the initial list of candidates that new director nominees were chosen from "include (but need not be limited to) qualified women and minority candidates." Amazon initially resisted this shareholder proposal by recommending that its shareholders vote against it. (See Amazon.com Inc., Definitive Proxy Statement (April 18, 2018).) However, after receiving shareholder and employee resistance, Amazon changed course and its nominating and corporate governance committee adopted a diversity policy requiring the committee and any search firm it engages, to "include, women and minority candidates in the pool from which the [c]ommittee selects director candidates." (See Amazon.com Inc., Definitive Additional Materials (May 14, 2018)).

Other companies have also cited shareholder engagement as a reason for recently amending their diversity policies. For example, in 2018 PepsiCo, Inc. amended its Corporate Governance Guidelines "as a result of collaboration with [its] shareholders and other stakeholders" to explicitly state a commitment to choosing board nominees from a pool that includes "highly qualified women and minority candidates, as well as candidates with diverse backgrounds, skills and experiences" (see PepsiCo, Inc., Definitive Proxy Statement (March 16, 2018)).

Major institutional investors are also increasing pressure on companies to improve board diversity by amending their voting guidelines. For example, BlackRock, Inc. (BlackRock) and State Street Global Advisors (State Street) have both announced publicly that they expect that the companies they invest in will have female directors. BlackRock's January 2019 guidelines encourage companies to have at least two female directors, while State Street's March 2019 guidelines encourage Russell 3000 companies to have at least one female director. Both BlackRock's and State Street's guidelines extend beyond gender diversity. BlackRock expects companies to consider personal diversity factors (for example, gender, ethnicity, and age) and professional characteristics (such as, industry, area of expertise, and geographic location) when selecting director nominees. BlackRock also states that it may vote against a company's nominating/corporate governance committee if there appears to be a lack of commitment to board diversity. (See BlackRock, Proxy Voting Guidelines for U.S. Securities (January 2019).) State Street has stated that beginning in 2020, State Street will vote against the entire nominating committee of a company that does not have at least one woman on its board, and has not engaged in successful dialogue on State Street's board diversity program for three consecutive years. (See State Street Global Advisors, Summary of Material Changes to SSGA's 2019 Proxy Voting and Engagement Principles and Market Specific Guidelines (March 18, 2019).) Similarly, although T. Rowe Price has not announced a specific gender diversity benchmark, its 2019 proxy voting guidelines call for boards to be diverse across gender, ethnic, or national lines, and state that it will oppose the re-election of governance committee members if it "can find no evidence of board diversity" (see T. Rowe Price, Proxy Voting Guidelines (2019)).

Other institutional shareholders are also focusing on board diversity, without committing to take action against companies that do not have diverse boards. For example The Vanguard Group's proxy voting guidelines state that boards should have "diversity of thought, background, and experience, as well as of personal characteristics (such as gender, race, and age)," but do not contain any requirements

to vote against the nominating committee (or any other directors) of a company that does not have a diverse board (see The Vanguard Group, Proxy Voting Guidelines for U.S. Portfolio Companies (April 1, 2019)).

### PROXY ADVISORY FIRMS

Recent announcements by the two primary proxy advisory firms, Glass Lewis and ISS, further reinforce the pressures that shareholders have brought to bear on the question of board diversity.

Glass Lewis has stated that, beginning in 2019, it will generally recommend voting “against” the nominating committee chair of a board with no female members. Depending on factors such as company size, industry, and governance profile, Glass Lewis may extend this “against” recommendation to other nominating committee members. In determining each recommendation, Glass Lewis will examine a company’s disclosure of its board diversity and other contextual factors. For smaller companies outside the Russell 3000 Index, it may refrain from making a recommendation against the nominating committee chair or nominating committee members on a case-by-case basis, such as if the board provides a timetable for improving board diversity. However, due to California’s new gender diversity law (see Legislative Pressure: California) during the 2019 proxy season, Glass Lewis will generally recommend voting against the nominating committee chair of a company headquartered in California unless the company has in place a clear plan for how it intends to comply with that law. (See Glass Lewis, 2019 Proxy Paper Guidelines: An Overview Of The Glass Lewis Approach to Proxy Advice.)

Similarly, ISS has published proxy voting guidelines for companies in the Russell 3000 or S&P 1500 indices with no female directors. For those companies, beginning with annual shareholder meetings held on or after February 1, 2020, ISS will recommend a vote “against” (or withhold from) the nominating committee chair, or other directors who are responsible for the board nomination process on a case-by-case basis. ISS noted that it will consider mitigating factors, such as a commitment to appoint at least one female to the board in the near term, or the presence of a female on the board at the preceding annual meeting. (See ISS, United States Proxy Voting Guidelines (December 6, 2018).)

### LEGISLATIVE PRESSURE

Lawmakers also are beginning to address the lack of diversity in corporate board rooms.

#### CALIFORNIA

In September 2018, the California General Corporation Law was amended to require female representation on the boards of publicly-held corporations based in California. The California law applies to publicly-held corporations (defined as corporations with shares listed on a major U.S. stock exchange) whose principal executive offices are located in California (according to the company’s annual report on Form 10-K). The law requires that these companies:

- By the close of 2019 have at least one female director on their board.
- By the close of 2021 have at least:
  - three female directors if the company has six or more directors;
  - two female directors if the company has five directors; and
  - one female director if the company has four or fewer directors.

The law imposes fines of \$100,000 for a company’s first violation and \$300,000 for any subsequent violation. (Cal. Corp. Code § 301.3.)

The California law is not without its critics, and there are questions as to its scope and implementation. Opponents of the law argue that it prioritizes gender diversity at the expense of a broader view of diversity, including ethnic minority representation on corporate boards. There are also possible state and federal constitutional challenges on equal protection grounds, as well as challenges based on the internal affairs doctrine, a choice-of-law principle that ensures only a corporation’s state of incorporation has the authority to regulate its internal affairs. For additional information on the internal affairs doctrine, see Practice Note, Shareholder Derivative Litigation: Choice of Law ([8-508-8277](#)).

California is the first, and so far the only, state with mandated board diversity laws. However, as described more fully below, other states and the federal government have passed or are considering legislation and/or have passed resolutions on the topic of board diversity.

### OTHER STATE BILLS

State legislatures in a number of states, including Massachusetts, Michigan, New Jersey, New York, Texas, and Washington, have introduced bills that are modeled after the California statute (see California). The proposed Massachusetts law (see S.B. 1879 (Mass. 2019)), New Jersey law (see S.B. 3469 (N.J. 2018)), Michigan law (see S.B. 115 (MI. 2019)), New York law (two slightly different bills—with the primary difference being the effective dates—have been proposed in New York, see S.B. 4011 (N.Y. 2019) and S.B. 4279 (N.Y. 2019)), Texas law (see S.B. 1197 (TX. 2019)), and Washington law (see S.B. 5142 (WA. 2019)) generally track the language of the California statute.

New York has two additional proposals currently being considered. The first commissions a study on the number of women currently on boards headquartered in New York (S.B. 4278 (N.Y. 2019).) The second proposal requires New York state contractors (for contracts in amounts greater than \$100,000) to disclose the percentage and number of their female board members and executives and their goals for inclusion of women in these positions as well as how they intend to achieve those goals (Assemb. B. 910 (N.Y. 2019)).

The Illinois legislature recently passed a bill (that is expected to be signed by the governor) that focuses on required disclosures of diversity statistics for public companies that have their principal executive offices in the state of Illinois. These companies must disclose:

- The specific qualifications that the board considers for its board of directors and nominees.
- The self-identified gender of each member of the board and whether each member of the board self identifies as a minority.
- The companies’ process for identifying nominees for the board and whether demographic diversity is considered.

(See H.B. 3394 (Ill. 2019).)

### STATE RESOLUTIONS

Other states have passed or are considering non-binding resolutions. For example, in 2017, Pennsylvania passed a resolution that encourages companies to have at least 30% female membership on

their boards by 2020. A similar resolution was introduced in the 2019 session that urges every publicly held corporation in Pennsylvania with nine or more directors to have at least three women on its board, with five to eight directors to have at least two women on its board, and those with fewer than five directors to have at least one woman director (H. Res. No. 114 (PA 2019)).

## FEDERAL

At the federal level, in March 2017, the Gender Diversity in Corporate Leadership Act was introduced that would have required the SEC to study the gender diversity of reporting companies and required those companies to disclose the gender composition of their board of directors (see H.R. 1611, 115th Cong.) The 2017 bill did not make it out of committee, but lawmakers are gearing up to try again, having introduced a similar bill earlier this year. The 2019 bill calls for annual disclosure of gender, race, ethnicity, and veteran status of board directors and nominees and executive officers, as well as, whether the company has a policy or strategy to promote racial, ethnic, and gender diversity among these persons (see Improving Corporate Governance Through Diversity Act of 2019, H.R. 1018, 116th Cong.; see also U.S. Representative Gregory W. Meeks, Rep. Meeks and Sen. Menendez Introduce Corporate Diversity Bill (February 6, 2019)).

## REGULATORY PRESSURE

### SEC DISCLOSURE PRESSURE

Change can often result from shining a light on the facts. Since 2009, SEC regulations have required a reporting company to disclose information regarding its diversity policies, if any, in its annual proxy statement (see Background). In February of 2019, the SEC released two Compliance and Disclosure Interpretations (C&DIs) relating to Item 401(e) of Regulation S-K (17 C.F.R. § 229.401(e)) and Item 407(c)(2)(vi) (17 C.F.R. § 229.407(c)(2)(vi)) that some believe signal the SEC's desire to see more meaningful disclosures on the question of board diversity. The C&DIs do not change the existing proxy disclosure rules, but they do clarify the SEC's view that the existing rules require disclosure of self-identified diversity characteristics (such as race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) if the board or nominating committee takes any of those characteristics into consideration and the individual nominated has consented to the company's disclosure of those characteristics. The C&DIs also make clear that if the corporation considers diversity

characteristics of any kind when assessing candidates for directors, or if the company has a diversity policy, the characteristics considered and the policy itself must be disclosed in its proxy statement. (See C&DIs on Regulation S-K, Questions 116.11 and 133.13.)

## CHARTING THE WAY FORWARD: SEVEN "C"'S

In light of these shareholder, legislative, and regulatory pressures steering towards more diversity in the boardroom, now is the time for companies to consider and improve their approach to board diversity, including by focusing on:

- **Current developments.** Keep your board informed about the latest developments in the push for board diversity by regulators, legislators, shareholders, and proxy advisory services.
- **Corporate performance.** Facilitate a board discussion about the effect of diversity on corporate performance and the business case for diversity.
- **Consensus approach.** Encourage your board to consider reaching a consensus on the definition of diversity, and/or a board policy on diversity, that is consistent with the company's business strategy and that can be used by the nominating committee when assembling a slate of board candidates.
- **Compliance with practice/laws.** Review your proxy disclosure and discuss it with the board to be sure it is reflective of the board's current practice, complies with legal requirements, and is current relative to peer company disclosure practices.
- **Consistent disclosure.** Review your director and officer questionnaire to determine if it needs updating to ensure accurate disclosure that is consistent with your board's mandate on diversity.
- **Cognizance of shareholders.** Assess your board diversity policies and practices against the voting guidelines and policy statements issued by your major institutional shareholders to ensure alignment or identify areas that need discussion or review.
- **Comprehensive strategy.** Consider if your board diversity initiatives are aligned with company-wide diversity and inclusion efforts and adjust as necessary to ensure a comprehensive strategy.

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