



KIRKLAND & ELLIS

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# Diversity in Corporate Boardrooms

## Recent Developments

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# Growing Focus on Racial Diversity in Boardrooms

After significant recent advances in gender diversity in boardrooms, focus has turned to racial/ethnic diversity

## **Gender diversity increased substantially between 2016 and 2019**

In 2017, State Street announced it would vote against board nominees where a board lacked sufficient female representation, and other institutional investors (including NY, MA and CA state pension funds) announced similar voting plans

- ▶ In 2019, 92% of S&P 500 boards had two or more women directors, up from 77% in 2016
- ▶ In July 2019, the only remaining all-male board in the S&P 500 appointed a woman director

## **Racial/ethnic diversity progressed more slowly, but now picking up**

- ▶ As of September 2020, 1,260 of the Russell 3000 companies did not have any racial/ethnic minority board representation
- ▶ In 2019, 45% of new Russell 3000 board vacancies were filled by women, whereas only 15% were filled by racial/ethnic minorities
- ▶ In the five months following George Floyd's death in May 2020, Russell 3000 companies appointed 130 Black directors, compared with 38 Black directors appointed in the preceding five months

## **New efforts underway to increase racial diversity in corporate boards**

In light of more widespread societal focus on racial justice matters, we are seeing increasing focus on racial/ethnic diversity in corporate boardrooms and C-suites from a variety of stakeholders, including:

- ▶ Public company leaders
- ▶ Institutional investors
- ▶ Proxy advisory firms
- ▶ Private equity firms and financial institutions
- ▶ Governments, regulators and a major stock exchange


# The Business Case for Diversity, Equity & Inclusion

## Major institutional investors and business groups have been championing the idea of diversity for boards

- ▶ **State Street:** “Companies with greater levels of diversity have stronger financial performance as well as fewer governance-related issues such as bribery, corruption, shareholder battles and fraud.”
- ▶ **BlackRock:** “Diverse boards, including but not limited to diversity of expertise, experience, age, race and gender, make better decisions.”
- ▶ **New York City Comptroller:** “Diversity isn’t a box to be checked - it’s a strategy for economic success.”
- ▶ **The Business Roundtable:** “Diverse backgrounds and experiences on corporate boards strengthen board performance and, in turn, help drive long-term economic value.”

## Many recent studies have found that diversity is associated with improved governance and financial performance

- ▶ **McKinsey (2015, 2018, and 2020):** companies with greater gender and ethnic diversity in executive leadership are more likely to financially outperform peers
- ▶ **Accenture (2020):** estimated US companies lost >\$1 trillion in profits in 2019 due to gaps in perception between employees and managers relating to workplace culture and inclusion
- ▶ **Journal of Empirical Finance (2019):** male CEOs are less likely to exhibit overconfidence where there is female board representation
- ▶ **Journal of Business Ethics (2018):** boards with gender-diverse boards commit fewer financial reporting mistakes and engage in less fraud



“Because companies are the sources of so many of the world’s jobs, companies have great opportunities to turn today’s unrest into tomorrow’s enhanced fairness and opportunities.”

SANDRA LEUNG  
GENERAL COUNSEL, BRISTOL MYERS SQUIBB

“We want to invest in 21st century companies ... If their management teams, their boards, look like 1940s companies, we can’t invest in those types of companies. It means they’re backward-looking, not forward-thinkers.”

JOHN ROGERS  
CHAIRMAN, CEO AND CIO, ARIEL INVESTMENTS

# SEC Requires Diversity Disclosure in Limited Circumstances

## No “bright line” requirement to disclose board diversity...

SEC rules require public companies to disclose in their proxy statements both:

- ▶ the experience, qualifications, attributes or skills of an individual being nominated to serve as director, and
- ▶ how the board implements policies regarding the consideration of diversity in identifying director nominees

But SEC rules do not generally require companies to disclose the race, ethnicity or gender of directors or executives

## ... but in 2019, the SEC released guidance calling for disclosure regarding diversity characteristics of directors under certain circumstances

Under the SEC’s 2019 guidance, if a board considers an individual nominee’s self-identified diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background), the SEC now expects proxy disclosures to identify such characteristics and how they were considered

- ▶ However, this disclosure is only required if the nominee consents to the disclosure of such diversity characteristics



## Self-Identification

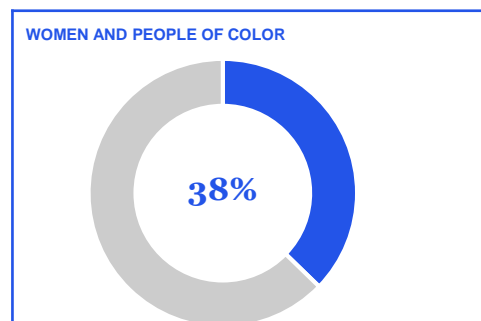
Racial/ethnic diversity disclosures are only possible to the extent the director (or nominee) is willing to self-identify, and as a result, some directors may opt out for personal reasons

# Diversity Disclosure Growing at Large Companies but Still Rare

- ▶ In 2020, 50% of Fortune 100 companies specifically disclosed the racial/ethnic diversity of their board, while 40% disclosed the level of board diversity only on an aggregate basis (combining gender, race, ethnicity, etc.) — each up from 24% in 2017\*
- ▶ However, the number of companies outside of the Fortune 100 that disclose board diversity data remains extremely low

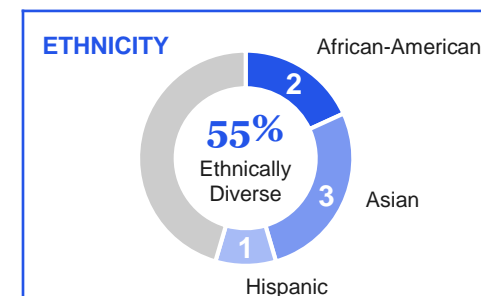
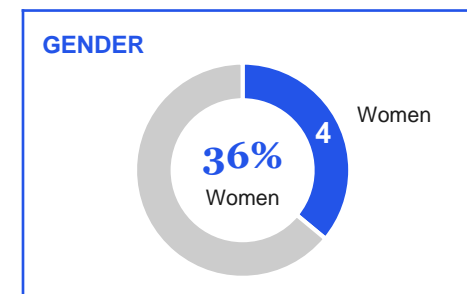
## Sample Disclosure of Racial and Gender Diversity on an Aggregate Basis:

### United Technologies 2020 Proxy\*\*



## Sample Disclosure Breaking Out Racial Diversity Specifically:

### Accenture 2019 Proxy\*\*



\* EY Center for Board Matters

\*\* Data taken from proxies has been reformatted for this presentation

# State Street Pushes for Board and Workplace Racial Diversity

State Street expects companies to disclose board diversity data and to have at least one diverse director by 2022

On January 11, 2021, State Street announced a new policy on racial and ethnic diversity

## Board Racial Diversity Disclosure

- ▶ Starting in 2021, State Street will vote against NomGov chairs at S&P 500 companies that do not disclose the racial/ethnic composition of the board
  - Aggregate diversity disclosure will be sufficient (individual, director-level disclosure not required)
  - Notwithstanding 2019 SEC guidance, most companies do not provide disclosure of race/ethnicity of directors or NEOs in proxy statements


## Board Racial Diversity Requirement

- ▶ Starting in 2022, State Street will vote against S&P 500 NomGov chairs if the company does not have at least one director from an underrepresented group
  - State Street has not defined “underrepresented group”

## Workplace Diversity Disclosure

- ▶ Starting in 2022, State Street will vote against S&P 500 compensation committee chairs if the company hasn’t yet disclosed its EEO-1 workplace diversity data
  - According to a recent study, only 4% of Russell 1000 companies publicly disclose their EEO-1 report

- ▶ While these policies apply only to S&P 500 companies, State Street also makes clear that it expects all of its investee companies to be prepared to engage on these topics and suggests that State Street will likely be receptive to shareholder proposals on these topics



“The ongoing issue of racial equity has caused us to focus more closely on the ways in which racial and ethnic diversity impacts us as investors...we are convinced that the lack of racial and ethnic diversity and inclusion poses risks to companies that senior managements and boards should understand and manage.”

RICHARD F. LACAILLE

GLOBAL CHIEF INVESTMENT OFFICER, STATE STREET GLOBAL ADVISORS

“We continue to promote gender diversity — there is still progress to be made — but our research and experience with corporate boards tell us that gender diversity is not enough. The effective boards of today and tomorrow should reflect all facets of diversity, and we are calling for greater progress on this front.”

VANGUARD INVESTMENT STEWARDSHIP PERSPECTIVES: BOARD DIVERSITY



# NYC Comptroller Presses for Rooney Rule and Workplace Data

## Rooney Rule

On October 11, 2019, NYC Comptroller Stringer called on companies to adopt policies requiring the consideration of both women and people of color for every open board seat and CEO vacancy, channeling the “Rooney Rule” pioneered by the NFL

- ▶ Launched by sending letters urging 56 S&P 500 companies to adopt the Rooney Rule
- ▶ Marks third phase of the Comptroller’s Boardroom Accountability Project
  - First phase led to widespread adoption of proxy access
  - Second phase increased adoption of “board matrix” proxy disclosure
- ▶ During 2020 proxy season, the Comptroller’s Office submitted shareholder proposals to 17 companies identified as lacking apparent racial diversity at the highest levels and requesting that they adopt the Rooney Rule
  - As of April 14, 2020, the Comptroller’s Office reached settlements with 13 of such companies
  - Settlements involved companies approving and publicly disclosing policies requiring consideration of diverse candidates for director and external CEO searches

## Workplace Diversity Data

On July 1, 2020, NYC Comptroller Stringer sent letters to 67 of the S&P 100 companies who issued recent public statements condemning racism, asking them to “walk the walk” and publicly disclose data regarding workplace demographics or face potential shareholder proposals at the company’s next annual meeting

- ▶ Specific requests include:
  - Public disclosure of each company’s EEO-1 report documenting the race, ethnicity and gender of its employees by employment category (including senior leadership)
  - Public commitment to release this data by August 30
- ▶ The letter also indicates that this data would be used to “**monitor, assess and benchmark** the company’s performance in **hiring, retaining and promoting** black employees, other employees of color and women in the U.S.”
- ▶ On September 28, 2020, the Comptroller announced that 34 of the 67 companies had agreed to publicly disclose EEO-1 reports

# ISS (and others) Seeking Data on Racial Diversity of Boards...

## In July 2020, ISS began sending letters to each of the 4,500+ US public companies requesting data on racial and ethnic diversity of directors and executives

- ▶ Requests self-identified race/ethnicity of each board member and named executive officer
- ▶ ISS plans to use the data to provide its clients *“with a more holistic picture of board and leadership diversity across their investment portfolios and, more broadly, to help ensure that all stakeholders have accurate and complete information as they consider the wider debate concerning the state of corporate diversity beyond gender”*
- ▶ Letter comes from ESG division of ISS (not the primary policy-making group at ISS)

## Considerations for issuers

- ▶ Response to ISS data request is voluntary
- ▶ ISS will not keep data confidential and may use in its discretion
- ▶ ISS has adopted new voting policy tied to racial / ethnic diversity of boards (see next page)

## BlackRock 2021 Stewardship Expectations

- ▶ Starting in 2021, BlackRock expects companies to disclose (1) workplace demographics, including gender, race and ethnicity in line with the EEO-1 format and (2) actions to advance diversity, equity and inclusion
- ▶ BlackRock may vote against directors or support shareholder proposals where disclosures or practices fall short relative to market or peers

## Russell 3000 Board Diversity Disclosure Initiative

- ▶ On Oct. 28, 2020, the Illinois treasurer sent a letter on behalf of investors representing \$3 trillion in AUM (including NYC Comptroller) to Russell 3000 companies calling for board diversity disclosure
- ▶ Asks each Russell 3000 company to consider publicly reporting the racial/ethnic and gender composition of its board in its 2021 proxy statement

# ...and New ISS Policy Will Mandate Minimum Racial Diversity

On November 12, 2020, ISS adopted a new policy relating to racial/ethnic diversity

- ▶ **Starting in 2021:** ISS will highlight boards that lack racial and ethnic diversity (or lack disclosure of such)
- ▶ **Starting in 2022:** ISS will recommend voting against nominating committee chair (or other directors on a case-by-case basis) at companies where board has no apparent racially or ethnically diverse members
  - ISS does not define racial or ethnic diversity
  - Aggregate diversity statistics will only be considered if they are specific as to racial or ethnic diversity
  - Exception if racial/ethnic diversity present at last annual meeting and board commits to appoint at least one racially/ethnically diverse member within a year

## ISS Investor Survey Data

- ▶ 61% of investors indicated that boards should aim to reflect the company's customer base and the broader societies in which they operate by including directors drawn from racial and ethnic minority groups
- ▶ 56% of investors responded that they would also consider voting against members of the nominating committee (or other directors) where board racial and ethnic diversity is lacking
- ▶ When asked about actions considered appropriate to increase the racial and ethnic make-up of boards, 85% of investor respondents and 92% of non-investor respondents indicated that shareholder engagement with the company would be appropriate to encourage increased racial and ethnically diverse directors

# Select Investor Voting Policies on Board Diversity

| ORGANIZATION  | MINIMUM FEMALE DIRECTORS | MINIMUM MINORITY DIRECTORS |
|---|--------------------------|----------------------------|
|    | 1                        | 1 (starting in 2022)       |
|    | 1 (2 starting in 2022)   | No Minimum Specified       |
| <b>BLACKROCK</b>  | 2                        | No Minimum Specified       |
|   | No Minimum Specified     | No Minimum Specified       |
| <b>STATE STREET<br/>GLOBAL ADVISORS.</b>  | 1                        | 1 (starting in 2022)       |
|  | No Minimum Specified     | No Minimum Specified       |

# Nasdaq Proposes to Mandate Diversity Through Listing Rules

On Dec. 1, 2020, Nasdaq proposed new rules that (if approved by SEC) would require the 3,000+ companies listed on its U.S. exchanges to:

- ▶ publicly disclose board-level diversity data in a uniform statistical format
- ▶ have, or explain why they do not have, at least one female director and one director self-identifying as either an underrepresented minority or LGBTQ+
  - underrepresented minority defined as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities

Rules would take effect in phases if approved by SEC:

- ▶ **One year after rules approved:** listed companies must begin disclosing board-level diversity data
- ▶ **Two years after rules approved:** listed companies must have, or publicly explain why they do not have, at least **one** diverse director (female, underrepresented minority or LGBTQ+)
- ▶ **Four years after rule approved (or five years for smaller companies):** listed companies must have, or publicly explain why they do not have, at least **two** diverse directors (including one female and one underrepresented minority or LGBTQ+)

## Considerations

- ▶ Nasdaq believes 75%+ of its listed companies would not meet these standards today (80-90% have at least one female director, but only about 25% have a second diverse director)
- ▶ Companies that fail to comply with new rules could face potential delisting
- ▶ Rules not yet effective, will be subject to public comment period and SEC approval, and could be changed or shelved

“It’s not like we’re saying this is an optimal composition of a board, but it’s a minimum level of diversity that we think every board should have.”

ADENA FRIEDMAN  
CEO, NASDAQ

# State Legislatures Remain Focused on Gender Diversity

## Several states have passed laws requiring gender diversity quotas or disclosure

- ▶ In September 2018, **California** became the first state to mandate minimum gender diversity on corporate boards
  - California’s law applies to public companies headquartered in California (including those incorporated in Delaware and other states)
  - The law requires each company to have at least one woman on the board by the end of 2019 (increasing in some cases to two or three women by the end of 2021, depending on board size)
- ▶ In March 2020, **Washington State** enacted a law requiring most public companies incorporated in Washington to, by January 1, 2022:
  - have at least 25% women on the board, or
  - disclose to shareholders the company’s approach to developing and maintaining board diversity
- ▶ A number of other states now require **disclosure** of the number of women on corporate boards, including **New York**, **Illinois** and **Maryland**
- ▶ Other state legislatures, including those in **Colorado**, **Massachusetts** and **Pennsylvania**, have also passed **non-binding resolutions** urging companies to meet minimum gender diversity requirements



## Racial Diversity Laws on the Horizon?

- ▶ On September 30, 2020, **California’s** governor signed a bill into law that will require a minimum number of directors who self-identify as racial/ethnic minorities or as gay, lesbian, bisexual, or transgender
- ▶ **Illinois** law currently requires public companies to disclose board racial diversity

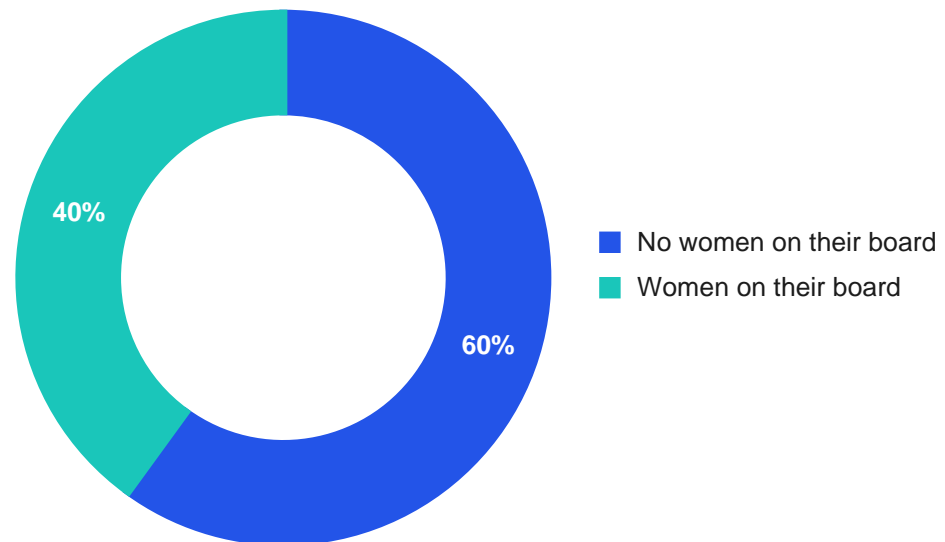
# Goldman Requiring Board Diversity from Its IPO Clients

“Look, we might miss some business, but in the long run, this I think is the best advice for companies that want to drive premium returns for their shareholders over time.”

**DAVID SOLOMON**  
CEO, GOLDMAN SACHS

- ▶ At the 2020 World Economic Forum in Davos, Goldman Sachs announced a new policy for taking companies public as part of their corporate commitment to board diversity
- ▶ Effective July 1, 2020, Goldman will only underwrite IPOs in the U.S. and Europe for companies that have at least one diverse (with respect to race/ethnicity or gender) board member
- ▶ Starting 2021, Goldman will raise the target to two diverse candidates for each of its IPO clients

**Proportion of Private Company Boards with Women in 2019**



Source: Crunchbase study of 200 companies with \$100M+ raised capital or valuation >\$500M

# Growing Commitment to Board Diversity from Private Equity

## Private equity firms have recently launched diversity initiatives


- ▶ Ten private equity firms partnered with Diligent to support the Modern Leadership initiative
  - Each firm pledged to create and post 5 new board seats at portfolio companies that will be made available to minority and women candidates, creating a total of 50 new board roles for diverse candidates
- ▶ Carlyle is implementing a version of the Rooney Rule
  - Two diverse candidates to be interviewed for each open role
  - Committed to ensuring that 30% of portfolio company directors are diverse by 2023
- ▶ Each of KKR's controlled US portfolio companies now has at least two diverse directors
- ▶ Several other large private equity sponsors are actively developing diversity initiatives

## Benefits of Diverse Portfolio Company Boards

- ▶ Carlyle Group portfolio companies with two or more diverse board members had average earnings growth of nearly 12% per year greater than those lacking board diversity
- ▶ Carlyle portfolio companies with diverse boards generated earnings growth 5X faster, on average, with each diverse board member associated with a 5% increase in annualized earnings growth

*Source: The Carlyle Group, Global Insights: From Impact Investing to Investing for Impact (Feb. 2020)*





“In order to address social and economic justice, we need scalable solutions that speak to both Main Street and the boardroom.”

ROBERT F. SMITH  
FOUNDER, CHAIRMAN AND CEO, VISTA EQUITY PARTNERS

“We are in the judgment business. We want to have the best diverse and the most experienced viewpoints around the table when we have to tackle these complicated issues.”

KEWSONG LEE  
CO-CEO, CARLYLE GROUP

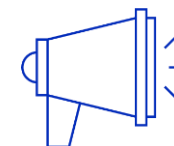
“Portfolio company diversity starts at the top ... Diverse boards make better decisions and it's also going to set the right tone and drive diversity into the organizations.”

PETE STAVROS  
CO-HEAD, KKR'S AMERICAS PRIVATE EQUITY

# Recent Suits Draw Attention to Lack of Diversity

Since July 2020, at least eight derivative lawsuits have been filed against large companies alleging lack of board and C-suite diversity

- ▶ Lawsuits generally allege that directors failed to create board or C-suite diversity despite public commitments to diversity and inclusion
- ▶ Claims include:
  - Alleged breaches of fiduciary duties, including *Caremark* oversight duties, for failure to add diverse directors and failure to monitor compliance with anti-discrimination laws
  - Alleged violations of SEC rules for misleading proxy disclosure regarding commitments to diversity
- ▶ Demands include:
  - Replacement of one to three directors with minority directors
  - Return of all 2020 director compensation and donation of such proceeds to diversity-focused charities
  - Publication of annual diversity report and conducting annual diversity training for directors and officers
  - Establishment of fund (~\$500M to \$1B) dedicated to hiring and promoting minority employees or making similar sized investments in minority communities
  - Setting specific minority-hiring goals and tying 30% of executive compensation to achieving such goals
- ▶ Lawsuits have been filed by two plaintiffs firms



## Complaints Designed to Attract Media

- ▶ Most contains photos of individual directors
- ▶ Some reference CEO pay ratio and attempt to tie perceived issues of executive compensation to diversity-related issues
- ▶ Media outlets picked up on salacious quotes in complaints

# Select Organizations Focused on Board Diversity Pipelines

