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BOARD DIVERSITY

Board Diversity: Who Has a Seat at the Table?

By Cynthia M. Krus, Lisa A. Morgan and Terri Ginsberg

Diversity is a word that has become ingrained in the corporate governance lexicon in recent years. In 2010, the Alliance for Board Diversity found that, of the boards of directors of Fortune 100 companies, 72.9 percent of all corporate board seats were held by white men. Minorities and women shared the remainder, with very few seats occupied by Asian Pacific Islanders, Hispanics, or minority women in particular.[1] The report indicates that such levels have remained unchanged since 2004. In light of these statistics outlined in this report, it is no surprise that the focus on increasing diverse representation on corporate boards has gained steam in recent years. This article examines current trends with respect to board diversity in Europe and in the United States in light of quota systems put in place in Europe, support from federal regulators and pressure from institutional investors.

Continued on page 2

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CONTENTS

European Model

Unlike the United States, where diversity initiatives encompass a broader sense of the term diversity, gender diversity in the boardroom is a primary governance focus for European companies. A recent article in the *Financial Times* reported that the glass ceilings in Europe were beginning to crack for women as many European countries must now comply with quotas for women on corporate boards.[2] For example, Norway established a 40 percent quota in 2006 and reported to have achieved this target in 2008. Spain passed a law in 2007 recommending that companies fill 40 percent of their board seats with women by 2015. In the UK, the February 2011 Davies Report's review, "Women on Boards," recommended that FTSE 100 companies should aim for at least 25 percent female representation on boards by 2015, while also urging FTSE 350 companies to set similar targets. The European parliament has called for EU-wide legislation with a 40 percent quota by 2020.

The effort to promote gender diversity among European countries has not been entirely seamless. France, which was recently cited by Corporate Women Directors International as having improved from 7.2 percent to 20.1 percent female representation on the boards of France's largest 40 companies, has faced claims of "tokenism" and criticisms that diversity has not come quickly enough.[3] To challenge the perceived slow progress, a group of women wearing fake beards began storming annual meetings during the 2010 annual meeting season.[4] These so-called "bearded ladies" underscore the attention, and emotion, directed to the inclusion of women on European boards of directors.

SEC Disclosure Rules

While regulatory developments with respect to board diversity in Europe have focused on the inclusion of women on corporate boards through quotas, in the United States the regulatory focus has focused on public disclosure with respect to board diversity in a broader sense. In December 2009, the Securities and Exchange Commission (the "SEC") issued proxy disclosure rules that enhanced the disclosures required in a company's annual proxy statement. During the SEC's 2009 open meeting adopting the new rules, the SEC announced a new rule that was not previously released for comment. Under this rule, companies are required to disclose whether diversity is considered by the nominating committee in nominating directors, and if so, how it impacts the nomination process.

Additionally, if the nominating committee or the board has a policy with regard to the consideration of diversity in identifying director nominees, the rules require disclosure of how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy. The SEC declined to define the term "diversity," rather leaving it to the company to define diversity as broadly or narrowly as deemed appropriate.[5] In responses to proxy statements filed the first year after the rule was instated, the staff of the SEC (the "Staff") commented frequently that, if a company disclosed that diversity was a consideration in determining director nominees, it expected disclosure of the company's diversity policy and how it is implemented and monitored.

Recent remarks from SEC Commissioner Luis Aguilar highlight the Staff's continued interest in compliance with the diversity disclosure requirements.[6] Commissioner Aguilar stressed that diversity policies exist whether they are "formal" or "informal," clarifying that the diversity disclosure rule was instituted "because investors care about board diversity issues and it is an important factor when they make investment and voting decisions. Investors do not care if the diversity policy is formal or informal; they care about the substance of the policy and whether it is effective."[7] In addition, Commissioner Aguilar remarked that the Staff has focused on the completeness of disclosure with respect to how a company evaluates the diversity policy's efficacy and has asked for additional transparency with respect to diversity policies. Commissioner Aguilar also made clear that the Staff would continue to monitor diversity-related disclosure in the future to ensure transparency with respect to diversity policies.

Below is an example of disclosure wherein an issuer claims to have a diversity policy:

Board Diversity

Our policy on board diversity relates to the selection of nominees for the board. Our policy provides that while diversity and variety of experiences and viewpoints represented on the board should always be considered, a director nominee should not be chosen nor excluded solely or largely because of race, color, gender, national origin or sexual orientation or identity. In selecting a director nominee, the Governance and Nominating Committee focuses on skills, expertise or background that would complement the existing board, recognizing that the company's businesses and operations are diverse and global in nature. Reflecting the global nature of our business, our directors in 2010 were citizens of the United States, France, Germany, India and Mexico. We have three female directors, one African-American director and one Hispanic director out of a total of 11 directors, as of the date of this proxy statement. Our directors come from diverse backgrounds including industrial, non-profit and governmental.[8]

In contrast, below is an example of disclosure wherein an issuer considers diversity, but does not have a diversity policy in place:

The [Corporate Governance and Nominating] Committee also gives consideration to a candidate's judgment, competence, anticipated participation in Board activities, experience, geographic location and special talents or personal attributes. Although the Committee does not have a formal diversity policy, it believes that diversity is an important factor in determining the composition of the Board.[9]

An analysis by The Conference Board of proxy statements filed in 2010 of 27 companies (including all companies in the Dow Jones Industrial Average that filed proxy statements after the effectiveness of the diversity disclosure rule) revealed that, while all surveyed companies said they considered diversity in identifying nominees for director, only one company claimed to have a policy on board diversity. Of the companies surveyed, ten made an affirmative statement that, although the board considered diversity in making nominations, it did not have a diversity policy in place.[10] As a result, disclosure such as that provided by AT&T in the example above has proliferated throughout the 2010 and 2011 proxy seasons.

Dodd-Frank Changes

Regulatory reforms with respect to diversity in the United States have not stopped with SEC disclosure rules. Section 342 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires that all financial regulators undertake significant efforts to recruit and promote employees from all backgrounds. In particular, financial regulators are mandated under the Dodd-Frank Act to establish an Office of Minority and Women Inclusion. This office is responsible for diversity matters in management, employment and business activities. Despite the SEC's emphasis on diversity matters in disclosure, the agency only named a director to establish such an office at the SEC in early January 2012.[11] Ms. Gibbs, who takes over from interim director Alta G. Rodriguez, previously directed the Commodity Futures Trading Commission's Office of Diversity and Inclusion and is a former attorney with the U.S. Department of Labor.[12] At this early juncture in Ms. Gibbs' tenure, it is uncertain how the SEC will tackle the Dodd-Frank Act's mandate requiring federal agencies and the private companies that contract with them to achieve "fair inclusion and utilization" of women and minorities in their workforces.

Institutional Investors Weigh In

As has been the case with the majority of recent corporate governance initiatives, it has been institutional investors in the United States that have driven the movement towards corporate board diversity in recent years. Many institutional investors have developed diversity policies to guide investment and corporate governance decisions. Some institutional investors have gone further and have taken discrete actions to promote board diversity.

Both public and private institutional investors have adopted policies that explicitly promote board diversity. The California Public Employees' Retirement System (CalPERS) states in its Global Principles of Accountable Corporate Governance that corporate boards should establish and disclose nomination policies that "address historically underrepresented groups on the board, including women and minorities."[13] Similarly, in its Policy Statement on Corporate Governance, TIAA-CREF states that "the nominating committee should develop appropriate diversity criteria for director searches to ensure that candidates are drawn from the broadest possible talent pool."[14] The Policy Statement further notes that TIAA-CREF will generally support shareholder proposals that that would require disclosure of a board's diversity practices.[15] Among private investors, UBS, the investment bank, also has been vocal in calling for more diversity on corporate boards. Through its Head of Global Sector Research, UBS has publicly announced that "diversity must be recognized as an economic imperative."[16]

Institutional investors have also taken active steps to encourage corporations to foster more diverse corporate boards. For example, Pax World Mutual Funds recently launched the Pax World Global Women's Equality Fund. The fund invests in large cap companies that are leaders in promoting gender equality. One of the fund's primary investment criteria is women's inclusion on the board of directors and in senior management.[17]

In addition, institutional investors have begun to use shareholder proposals to promote board diversity. In 2011, the California State Teachers' Retirement System (CalSTRS), the largest public teachers pension fund in the United States, submitted shareholder proposals to eight companies to implement diversity policies for their boards.[18] Notably, CalSTRS withdrew all eight proposals after the targeted companies voluntarily implemented diversity policies in consultation with CalSTRS and other investors.[19] CalSTRS's experience with diversity-related shareholder proposals demonstrates the impact of institutional investor activism on corporate diversity policies.

Finally, institutional investors have begun to offer resources to assist companies in cultivating diverse boards. CalSTRS and CalPERS, in partnership, recently launched the Diverse Director Datasource (3D), which will be maintained by Governance Metrics International (GMI). 3D is a database of qualified woman and minority director candidates.[20] The idea behind the 3D database is that investors, nominating committees, and other interested parties will be able to use 3D to identify qualified woman and minority director candidates.[21] Shauna Morrison, GMI's Vice President of Data and Editorial Operations, noted that 3D is "about giving corporations access to new, qualified talent with diverse skill sets that can bring fresh thinking to a board."[22]

Previous sources for training identifying diverse directors have included, among others, Catalyst (focus on recruiting women), InterOrganization Network (ION composed of 12 regional organizations) (focus on recruiting women), Forum for Women Entrepreneurs & Executives (focus on recruiting women), The Executive Leadership Council (focus on recruiting AfricanAmericans), Hispanic Association on Corporate Responsibility (focus on recruiting Hispanics), New America Alliance (focus on recruiting Latinos and Latinas), and Director Diversity Initiative (focus on recruiting women, racial, and ethnic minorities).[23] Moreover, there are some executive search firms that also have a recognized expertise in diversity searches, such as The Prout Group, which has partnered with The Executive Leadership Council, the Hispanic Association on Corporate Responsibility, and Catalyst, which collectively form The Alliance for Board Diversity, to produce the survey on women and minorities on Fortune 100 boards.[24] However, the 3D is notable for encompassing both gender and racial diversity in its mix of potential directors.

Despite the increasing pressure many corporations have received from institutional investors to promote board diversity, it is unclear what action, if any, such investors will take against those corporations that consistently fail to promote board diversity.

Anecdote from the Front Lines of the Diversity Debate

In 2011, Calvert Asset Management, Inc. (Calvert), submitted shareholder proposals to five companies seeking a commitment to increase diversity in gender, ethnicity and race on the board of directors. Three of these proposals were withdrawn when companies agreed to add specific considerations of race, gender and ethnicity to the selection criteria for new board candidates. Two proposals went to a shareholder vote.[25]

One these two companies was the retail and wholesale business Urban Outfitters. Calvert and Connecticut Retirement Plans and Trust Funds submitted a proposal in Urban Outfitters' 2011 proxy statement that reads as follows:

BE IT RESOLVED: That the Board of Directors consistent with their fiduciary duties:

- Take every reasonable step to ensure that women and minority candidates are in the pool from which Board nominees are chosen;

- Publicly commit itself to a policy of Board inclusiveness to ensure that:

- Women and minority candidates are routinely sought as part of every Board search the company undertakes;

- The Board strives to obtain diverse candidates by expanding director searches to include nominees from both corporate positions beyond the executive suite and non-traditional environments such government, academia, and non-profit organizations; and

- Board composition is reviewed periodically to ensure that the Board reflects the knowledge, experience, skills, expertise, and diversity required for the Board to fulfill its duties.

- To report to shareholders, at reasonable expense and omitting proprietary information, its efforts to encourage diversified representation on the Board.

In the Company's response to the above proposal, it disclosed the following:

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The Board of Directors and the Nominating Committee seek qualified candidates for director, and consider diversity as a factor, but believe that Proposal 4 is unnecessarily restrictive and would not maintain the necessary flexibility in the nominating process to ensure that the most qualified available candidates are selected as directors in light of the Company's evolving needs and circumstances. In addition, the reporting obligations contemplated by Proposal 4 would be expensive and time consuming, without any corresponding benefit to our shareholders. The Board of Directors believes that the Company's existing nominating process, including the factors considered by the Nominating Committee in evaluating director candidates, is the best approach. The imposition on the nominating process of gender and minority requirements and affirmative search obligations would undermine the Company's holistic evaluation of candidates, unduly restrict the Nominating Committee in the performance of its duties and add administrative burdens and costs, without necessarily resulting in the selection of the best director candidates for the Company.[26]

In the end, only 22.5 percent of shareholders voted for the proposal at Urban Outfitters' Annual Meeting. Despite the fact that shareholders did not approve the proposal, Urban Outfitters faced a public backlash in the media with respect to the proposal and the company's perceived "diversity problem."[27] The experience of Urban Outfitters during the 2011 proxy season underscores the continued interest of institutional investors in board diversity.

Conclusion

Although a range of theories are offered in support of promoting board diversity, proponents of board diversity frequently point to improved corporate performance and other market- or economic-based rationales when defending the merits of their position.[28] Regardless of the theory that such proponents subscribe to, it is evident that the movement toward increased diversity on corporate boards of directors has become the corporate governance initiative *du jour* and is an issue corporations will have to contend with going forward. As a result, corporations may want to revisit their board diversity policies in connection with their annual director nomination processes and preparation of disclosure included in their proxy statements. Corporations that fail to take measures to diversify their boards of directors may be targeted by institutional investors.

Notes

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2. Liz Bolshaw, *Glass Ceilings Starting to Crack Across Europe*, Financial Times (Dec. 12, 2011).

3. *Id.*

4. Tara Patel, *Bearded Women Challenge French 'Boys Club' Boards in Paris*, Bloomberg (June 9, 2010).

5. Proxy Disclosure Enhancements, Securities Act Release No. 9,089, Exchange Act Release No. 61,175, Investment Company Act Release No. 29,092 (adopted December 16, 2009), available at http://www.sec.gov/rules/final/2009/33-9089.pdf

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7. *Id.*

8. Alcoa Inc., Proxy Statement (Schedule 14A), at 64 (Mar. 7, 2011).

9. AT&T Inc., Proxy Statement (Schedule 14A) at 4 (Mar. 10, 2011).

10. Louis Goldberg and Janice Brunner, Board Diversity and Director Qualifications, *Director Notes: The 2010 Proxy Season*, The Conference Board, available at http://www.conference-board.org/retrievefile.cfm?filename=DN-012-10.pdf&type=subsite (last accessed February 1, 2012).

11. SEC Names Pamela A. Gibbs as Director of the Office of Minority and Women Inclusion, SEC, available at http://www.sec.gov/news/press/2012/2012-1.htm.

12. Kevin Roose, *A New Diversity Monitor for the S.E.C.*, N.Y. Times, Jan. 4, 2012, *available at* http://dealbook.nytimes.com/2012/01/04/a-new-diversity-monitor-for-the-s-e-c/ (last accessed Feb. 1, 2012).

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15. *Id.* at 20.

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19. *Id.*

20. *Id.*

21. *Id.*

22. GMI, *GMI Launches Diverse Director Database*, available at: http://www.gmi3d.com/about/pr/GMI_PressRelease_3D_092111_Final.pdf (Sept. 26, 2011).

23. See Lisa Broome and Thomas Hazen, Proxy Disclosure and Solicitation Enhancements Comment, File Number S7-13-09, available at http://www.sec.gov/comments/s7-13-09/s71309-65.pdf (last accessed January 26, 2012).

24. *Id.*

25. Invision: A Newsletter for Calvert Investors, *Calvert's Shareholder Advocacy* at 3 (Fall 2011), http://www.calvert.com/NRC/literature/documents/NL10009.pdf?litID=NL10009 (last accessed Feb. 1, 2012).

26. Urban Outfitters, Inc., Proxy Statement (Schedule 14A), April 1, 2011.

27. See, e.g., Amy Odell, Urban Outfitters' All-White, All-Male Board of Directors Denies Having a 'Diversity Problem,' N.Y. Mag., Jun. 21, 2011, *available at* http://nymag.com/daily/fashion/2011/06/urban_outfitters_all-white_all.html.

28. Lissa Broome, John Conley and Kimberly Krawiec, Dangerous Categories: Narratives of Corporate Board Diversity, 89 N.C. L. Rev. 759 (2011).