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Corporate Governance Update: Gender Diversity on Boards:
The Future Is Almost Here

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> *A board composed of directors representing a range of perspectives leads to an environment of collaborative tension that is the essence of good governance.* In a room where everyone has different points of view and there is a greater opportunity for cross-pollination of ideas, there are fewer unspoken assumptions, less "group think" and a greater likelihood of innovation. This allows the board to ask the probing questions and tackle the challenging issues, such as risk management and succession planning, which are at the center of good corporate governance. [1]

Gender diversity on public company boards—and meaningful participation by women directors in the boardroom—is steadily increasing. Although the number of women on boards in the United States is growing more slowly than in some other countries, there has never been such consensus and collective effort toward gender diversity at the upper echelons of corporate America. A combination of regulatory, legislative, and investor-driven efforts is likely to accelerate the progress that has been made to date toward greater gender diversity and perhaps, one day, gender parity.

Progress to Date

The latest data shows that the number of women on U.S. public company boards continues to grow slowly and steadily. According to the 2020 Gender Diversity Index, women represented 17.9 percent of Fortune 1000 company directors, 19.7 percent of Fortune 500 company directors, and 22.3 percent of Fortune 100 company directors in 2015.[2] Larger companies tend to have greater diversity as well as larger boards. Representation of women on

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[1] Russell Reynolds Associates, "Different is Better—Why Diversity Matters in the Boardroom," 2009, at 11 (emphasis in original), available at http://www.russellreynolds.com/insights/thought-leadership/Documents/different-is-better_0.pdf

[2] 2020 Women on Boards, 2020 Gender Diversity Index, 2015 Key Findings, available at https://www.2020wob.com/companies/2020-gender-diversity-index

key board committees (audit, compensation, and nominating) roughly tracks their representation on boards generally.[3]

As women gain public company board positions, target goal representation levels that once seemed overly optimistic are beginning to seem realistic. Targets set by various groups range from 20 percent[4] to 40 percent,[5] and they are being achieved in a number of countries around the world. Some countries have used quotas to achieve their goals; mandatory percentages of female participation on boards have been implemented to date in Iceland (40 percent), Israel and India (at least one woman on each board), Italy (33 percent), and Norway (40 percent or higher, depending on the size of the board). By the end of 2016, several other nations will have fully phased in their mandatory quotas, such as France (40 percent), Germany (30 percent), and Malaysia (30 percent for new appointments).[6] Moreover, many countries have mandatory requirements for the boards of state-owned companies, all in the range of 30 percent to 50 percent female participation.[7] The question for these countries is how well these quotas work in practice and whether they are indeed forces for positive change at the individual, board, corporate, and societal levels. Recent research indicates that quotas are less effective than other elements—such as a corporate governance code that mentions diversity—in producing long-term female board representation.[8] One study of Norwegian boards, which have been integrated by mandatory quota since 2008—longer than those in any other country—found that, after a difficult adjustment period, support for the requirement has increased over time, as participants in the corporate culture experienced many positive effects of the law.[9]

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[3] *See* EY Center for Board Matters, "Women on US Boards: What Are We Seeing?" March 4, 2015, available at https://corpgov.law.harvard.edu/2015/03/04/women-on-us-boards-what-are-we-seeing/.

[4] *See, e.g.*, 2020 Women on Boards ("A national campaign to increase the representation of women on boards to 20 percent or greater by the year 2020."), https://www.2020wob.com/about

[5] *See, e.g.*, EU Justice Commissioner Viviane Reding, "Women on the Board Pledge for Europe" (a pledge representing a voluntary commitment by publicly listed companies to increase women's presence on corporate boards to 30 percent by 2015 and to 40 percent by 2020), Memo/11/124, March 1, 2011, available at http://europa.eu/rapid/press-release_MEMO-11-124_en.htm; 30 percent Club (a group "launched in the United Kingdom in 2010 with a goal of achieving a minimum of 30 percent women on FTSE-100 boards"), http://30percentclub.org/.

[6] *See* Linda-Eling Lee et al., "Women on Boards: Global Trends in Gender Diversity on Corporate Boards," MSCI, Nov. 2015 (MSCI Report), Appendix III: Global Mandates Summary, available at https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b.

[7] *See id.*

[8] *See* Jenny Anderson, "Quotas Not the Best Way To Add and Retain Women for Corporate Boards, Study Finds," New York Times Dealbook, April 8, 2015, available at http://www.nytimes.com/2015/04/09/business/dealbook/quotas-not-the-best-way-to-add-and-retain-women-for-corporate-boards-study-finds.html?_r=0.

[9] *See* Aaron A. Dhir, "Corporate Governance and Diversity," Aug. 19, 2015, available at https://corpgov.law.harvard.edu/2015/08/19/corporate-governance-and-diversity/.

While quotas are prevalent around the world, they remain unpopular in the United States and Commonwealth countries, including Australia and Canada. Fortunately, quotas are not necessary to produce meaningful change. The United Kingdom is an excellent example of change achieved through voluntary participation. Several years ago, Lord Mervyn Davies began an inquiry, on behalf of the U.K. government, into gender diversity on public boards. His initial paper, published in February 2011, found that only 12.5 percent of the FTSE 100 directors were women and suggested that at the rate of change in effect at that time, it would take many decades to achieve "gender-balanced" boardrooms.[10] The paper did not recommend quotas but instead encouraged companies to set their own goals and work to reach them. The aspirational goal set forth in the paper itself was for FTSE 100 companies to have 25 percent female board members by 2015. The follow-up paper, published in October 2015, reported that in the five years since the initial inquiry, self-directed efforts by U.K. companies had surpassed this goal, resulting in 26.1 percent women directors in the FTSE 100 and 19.6 percent in the FTSE 250.[11] Notably, the number of all-male boards declined during this time frame from 152 in the FTSE 350 to none in the FTSE 100 and only 15 in the FTSE 250. Lord Davies described these developments as a "near revolution that has taken place in the boardroom and profound culture change at the heart of British business."[12] His 2015 paper calls for FTSE 350 companies to achieve 33 percent female board representation by 2020, a goal which would entail adding roughly 350 women directors.

Legislative and Regulatory Actions

In a 2015 speech at the Women's Forum of New York, SEC Chair Mary Jo White fully endorsed that organization's goal of 40 percent female representation on boards of all Fortune 1000 and S&P 500 companies by 2025, emphasizing that there is no shortage of highly qualified candidates and stating her view that the 40 percent target is not only "attainable," but "also a business and moral imperative."[13] More recently, in January 2016, Chair White stated

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[10] Lord Davies of Abersoch, CBE, et al., "Women on Boards," February 2011, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf.

[11] Lord Davies of Abersoch, CBE, et al., "Women on Boards Davies Report," October 2015, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482059/BIS-15-585-women-on-boards-davies-review-5-year-summary-october-2015.pdf.

[12] *Id.*

[13] SEC Chair Mary Jo White, Keynote Remarks at the Women's Forum of New York Breakfast of Corporate Champions, "The Pursuit of Gender Parity in the American Boardroom," Nov. 19, 2015, available at http://www.sec.gov/news/speech/gender-parity-in-the-american-boardroom.html.

that SEC staff is currently reviewing the disclosures regarding board diversity and considering whether additional guidance or rulemaking would be appropriate.[14]

Nevertheless, Chair White has been criticized for moving too slowly to amend the disclosure requirements regarding board diversity. Ten Democratic lawmakers, led by Sen. Sherrod Brown, D-Ohio, and Rep. Maxine Waters, D-Calif., released a letter earlier this month expressing "disappointment" that the SEC had not taken action on this issue in the past year.[15] The letter references a prior request by Rep. Carolyn Maloney, D-N.Y. asking the SEC to expand proxy disclosure requirements to include information about director candidates' gender, race, and ethnicity. Rep. Maloney's January 2016 letter to Chair White highlights a contemporaneously released report from the Government Accountability Office (GAO) that addresses gender diversity on boards.[16] The GAO report found that women held about 16 percent of board seats in the S&P 500 in 2014, an increase from eight percent in 1997.[17] The GAO report estimated that it will be decades before women's board participation equals men's.

The GAO report identified several potential strategies that could help boards increase their gender diversity, including requiring diverse slates of candidates (including at least one woman), setting voluntary targets, expanding board searches, expanding board size, and increasing seat turnover by adopting term or age limits and conducting board performance evaluations. The report noted that the stakeholders interviewed generally expressed a strong preference for voluntary efforts over government mandates such as quotas.

The Democratic lawmakers' letters reiterate a proposal made in March 2015 by nine large pension funds to enhance federal disclosure requirements as a means to increasing the diversity of director candidates.[18] The pension funds' petition to the SEC called for candidates' gender, race, and ethnicity to be presented in a chart or matrix form. While companies currently

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[14] SEC Chair Mary Jo White, Speech, "A Conversation with Mary Jo White," Keynote Session, 43rd Annual Securities Regulation Institute, San Diego, CA, Jan. 26, 2016, available at http://www.sec.gov/news/speech/securities-regulation-institute-keynote-white.html.

[15] Sen. Sherrod Brown et al., Letter to the Hon. Mary Jo White, Chair, SEC, March 2, 2016, available at http://democrats.financialservices.house.gov/uploadedfiles/3.2.2016_letter_to_sec_board_diversity_final_executed.pdf.

[16] Rep. Carolyn B. Maloney, Letter to the Honorable Mary Jo White, Chair, SEC, Jan. 4, 2016, available at http://maloney.house.gov/media-center/press-releases/maloney-unveils-new-gao-report-showing-rampant-disparities-against-women.

[17] U.S. Government Accountability Office, "Corporate Boards," Report to the Ranking Member Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, House of Representatives, December 2015, available at http://www.gao.gov/assets/680/674008.pdf.

[18] Denise L. Nappier et al., Petition for Amendment of Proxy Rule Regarding Board Nominee Disclosure - Chart/Matrix Approach, March 31, 2015, available at http://www.sec.gov/rules/petitions/2015/petn4-682.pdf.

are required to discuss board diversity in their proxy statements, the SEC does not define "diversity," thus allowing companies wide latitude in their disclosures. The petition argues that under the current disclosure requirements, it is difficult for investors to ascertain the gender, racial, and ethnic diversity of directors, particularly if pictures and first names or pronouns are not used in the proxy materials. According to the GAO report, the SEC has indicated that it intends to consider the requested change as part of its Disclosure Effectiveness Initiative, an ongoing, broad-based review of disclosure requirements.

One analysis of the proxy statements of the S&P 100 companies found that companies "most frequently define diversity with reference to a director's prior experience or other non-identity-based factors rather than his or her socio-demographic characteristics."[19] The author found that more than 80 percent of the companies consistently cited background and experience as sources of diversity, while about half described diversity in terms of gender, race, or ethnicity. Indeed, many types of diversity are valuable to boards, and the range of experience and variety of backgrounds among directors is valuable information for shareholders. That said, demographic diversity is also highly relevant to investors and easily can be disclosed along with other elements of diversity.

In addition to SEC action, there have been state-level initiatives of a precatory nature. In May 2015, the Illinois state legislature—citing studies showing the business benefits to companies of having women directors—passed a non-binding resolution urging public companies to have at least three women directors on boards of nine or more members, at least two on boards of five to nine members, and at least one on boards with fewer than five members, by 2018.[20] In substance, the Illinois resolution was modeled on a California resolution adopted in 2013.[21] A similar resolution was passed in Massachusetts in 2015.[22]

<u>Investor-Driven Efforts</u>

Institutional investors have become increasingly focused on environmental, social, and governance (ESG) practices in recent years. This is driven by a growing sense among

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[19] *See* Elizabeth Olson, "New Paper Finds Fuzzy Definitions for Board Diversity," N.Y. Times Dealbook, Oct. 20, 2014 (quoting Prof. Aaron A. Dhir), available at http://dealbook.nytimes.com/2014/10/20/new-paper-finds-fuzzy-definitions-for-board-diversity/?_r=0.

[20] Illinois Gen. Assembly, HR0439, Adopted May 30, 2015, available at http://www.ilga.gov/legislation/fulltext.asp?DocName=&SessionId=88&GA=99&DocTypeId=HR&DocNum=0439&GAID=13&LegID=&SpecSess=&Session=.

[21] California State Concurrent Resolution 62, Adopted Sept. 12, 2013, available at http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_0051-0100/scr_62_bill_20130920_chaptered.html.

[22] Massachusetts State Senate Resolution 1007, Adopted Oct. 21, 2015, available at https://malegislature.gov/Bills/189/Senate/S1007.

these investors that corporate investment in ESG enhances a company's performance and reputation, fosters revenue growth, and represents an avenue for shareholder engagement.[23] In particular, institutional investors have prioritized corporate governance matters, and, as Martin Lipton has observed, "not as an afterthought in the shadow of business and financial matters addressed by their portfolio managers, but rather as a standalone priority in its own right. Corporate governance is not just a means-to-an-end administrative or procedural framework; it is about the basic rules of the game and can be an overarching value driver."[24] Gender diversity on boards is an issue that touches various elements of ESG practices, and—as the efforts of the nine pensions funds described above indicate—investors have begun to prioritize it accordingly.[25]

One prominent investor-led effort is the Thirty Percent Coalition, an organization founded in 2011 with a goal of attaining 30 percent female representation on U.S. public company boards.[26] Its diverse membership of corporate leaders includes companies, foundations, individuals, funds, and major institutional investors such as CalPERS and CalSTRS. The Coalition pursues a three-pronged strategy for achieving its goal. First, its "Institutional Investors Committee" works with companies directly to amend their corporate governance standards and enhance their recruitment efforts for female directors. Second, its "Public Sector Initiatives Committee" supports legislative efforts at all levels of government and seeks improved disclosure requirements through the SEC to encourage gender diversity. Third, its "Corporate Leaders Committee" mobilizes executives to publicly and privately advocate for gender diversity on boards. These three avenues cover the waterfront in terms of activism on this issue, and the organization has seen some success to date, though its ultimate goal has not yet been achieved. According to the Coalition, its efforts in targeting companies through direct shareholder contact produced the election of a female director at 62 companies with previously all-male boards.

In Australia, the Australian Council of Superannuation Investors (ACSI), a collaboration of funds and asset owners, launched an initiative in early 2015 to achieve 30 percent female representation on ASX 200 boards by 2017.[27] The ACSI indicated that its

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[23] *See, e.g.*, Matteo Tonello & Thomas Singer, "Corporate Investment in ESG Practices," Aug. 5, 2015, available at https://corpgov.law.harvard.edu/2015/08/05/corporate-investment-in-esg-practices/.

[24] Martin Lipton et al., "Some Thoughts for Boards of Directors in 2016," Dec. 9, 2016, available at http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25006.15.pdf.

[25] One prominent female public relations executive has noted that activists tend to target boards of directors that are "pale, stale and male," as a way of noting that many corporate boards have long tenured directors and lack gender and racial diversity. She has advised clients that one way to get ahead of activists is to have an ongoing board refreshment process so that progress can be made on both the diversity and the tenure fronts.

[26] Thirty Percent Coalition, http://www.30percentcoalition.org/who-we-are#faqnoanchor.

[27] ASCI Press Release, "ASCI Sets 2017 Goal for 30 percent Women on Boards," Feb. 5, 2015, available at http://acsi.org.au/images/stories/ACSIDocuments/MediaReleases/05.02.15.Media_Release.WoB_Policy.pdf.

investors—representing AU$1.6 trillion in investments and owning roughly 10 percent of the ASX 200—had provided a "strong mandate" for this initiative and that the issue would be a "key priority of ACSI's engagement." The ACSI indicated that it would target companies with all-male boards, that it would begin with private meetings with company representatives, and that, if necessary, it would recommend that its members vote against the re-election of directors at companies with limited gender diversity on the board. The chairman of the ACSI stated that the initiative "is based on the belief that skilled and suitably diverse boards make for better-governed companies and, as such, higher value investments in the long term."[28] Earlier this month, the ACSI issued a press release highlighting the fact that women represented more than 50 percent of all board appointments for ASX 200 companies in 2016 and that female board membership in that category had grown from 19 percent to 22 percent in one year.[29] As in the United Kingdom and the United States, Australian efforts toward gender diversity on boards have sought to forestall rather than require the implementation of mandatory quotas.

Another investor-driven initiative to increase gender diversity in corporate leadership is the establishment of impact-investment funds. Earlier this month, State Street Global Advisors opened the SPDR SSGA Gender Diversity Index ETF, an exchange-traded fund with the ticker symbol: SHE. The fund invests in U.S. companies with the highest levels of gender diversity in their sectors. SHE reportedly is receiving a $250 million investment from CalSTRS, which reportedly may double its investment in the near future.[30] While similar funds have been created in recent years, they are much smaller; the target for SHE is to accrue $1.5 to $2 billion in assets in the first year.[31] The size and prominence of State Street's latest effort illustrates institutional investors' significant interest, and confidence, in the performance-related benefits of gender diversity in corporate America.

By contrast to the institutional investors, activist funds have almost completely disregarded women as director nominees in their campaigns. According to one recent article, five of the largest U.S. activist funds have nominated 174 directors since 2011, yet only seven were women; of the 108 candidates to win seats on the target boards, only five—less than five percent—were women.[32] Likewise, Carl Icahn's Icahn Associates Holding nominated 42

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[28] *Id.*

[29] ACSI Press Release, "Diversity Gathering Pace in Australian Boardrooms," March 7, 2016, available at http://www.acsi.org.au/images/stories/ACSIDocuments/MediaReleases/07.03.16_ACSI_media_release_-_Diversity_gathering_pace_in_Australian_boardrooms.pdf.

[30] *See* Paul Sullivan, "In Fledgling Exchange-Traded Fund, Striking a Blow for Women," New York Times, March 4, 2016, available at http://www.nytimes.com/2016/03/05/your-money/in-fledgling-exchange-traded-fund-striking-a-blow-for-women.html?_r=0.

[31] *See id.*

[32] *See* Carol Hymowitz et al., "Icahn, Loeb and Other Activists Overlook Women for Board Seats," BloombergBusiness, Mar. 8, 2016, available at http://www.bloomberg.com/news/articles/2016-03-08/activists-from-icahn-to-loeb-overlook-women-for-board-positions?nl=?nl=dlbk&emc=dlbkpm&emc=edit_dlbkpm_20160308.

director candidates during that time frame, none of whom were women. By contrast, the S&P companies filled 26 percent of open board seats with female directors over that period.[33] As diversity on boards is associated with positive long-term performance, one must question why activist investors appear to have scant interest in nominating women as director candidates for an activist slate.

Consensus Around Gender Diversity

In the United States, the United Kingdom, Europe, and many other countries, there is now broad agreement as to the desirability of gender diversity, and ultimately gender parity, in boardrooms. The evidence has begun to speak for itself, as various studies in recent years have shown that companies with women in top management and board positions outperform their peers.[34] A 2015 MSCI report, for example, indicated that companies in the MSCI World Index with strong female leadership generated a return on equity of 10.1 percent per year, as opposed to 7.4 percent for those without such leadership.[35] Earlier this month, the International Monetary Fund presented new research on women in management that included the finding that adding one more woman in senior management or on the board of directors, while keeping the size of the board unchanged, is associated with three percent to eight percent higher return on assets.[36]

Progress on diversification of public company boards in the United States has been slower than elsewhere, partially due to the absence of mandatory quotas, but also perhaps in part due to a distaste for perceived micromanaging of board composition by outside forces, or to a resistance to target numbers even of an informal variety, or to lagging recognition that qualified female director candidates exist in abundance. All three of these latter factors are diminishing in

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[33] *See id.* (citing Spencer Stuart data).

[34] eBay is an excellent example of a public company that has focused on the gender issue:

> This isn't just a journey for women. Academic research shows that everyone has gender biases and expectations. Women and men acquire these attitudes, many of them unconscious, early in life. Starting with the children we raise, we must rewrite the norms that limit both genders, and this will take time. "Meeting everybody where they're at in the journey" is hard while establishing trust and sustaining momentum for change, but it's a worthy effort. In the future, winning companies will be those that learn to deploy the entire workforce productively and inclusively.

McKinsey & Company, "Realizing the Power of Talented Women," McKinsey Quarterly, Sept. 2015 (discussing eBay's efforts to bring more women into its top ranks), available at http://www.mckinsey.com/business-functions/organization/our-insights/realizing-the-power-of-talented-women.

[35] MSCI Report at 20 (MSCI designates a company as having "strong female leadership" if its board has three or more women, or if the percentage of women directors is higher than the average in that country, or if it has both a female CEO and at least one woman director.).

[36] *See* Paul Hannon, "European Businesses With Higher Share of Women in Management More Profitable," WSJ, March 7, 2016, available at http://www.wsj.com/articles/european-businesses-with-higher-share-of-women-in-management-more-profitable-1457364600.

public perception and U.S. corporate culture. Nominating committees have the authority and the duty to include diversity considerations into their board compositions, as well as to ensure that the company's proxy disclosures are appropriately descriptive of board diversity. It will be interesting to see if the progress made with gender diversity can be extended to other types of diversity on corporate boards.

Investors are eager to reap the established benefits of improved performance and governance that gender diversity can produce, while regulators and legislators are pressing for gender balance on public company boards. Fortunately, there has been general consensus in the U.S. corporate community that quotas are not a desirable means to achieving gender diversity on boards. While each company should set and pursue its own goal in light of its particular circumstances, progress to date and the cultural context are highly encouraging. Meaningful participation by women in the boardroom is a reality, and each year brings U.S. public companies closer to gender parity and its many attendant benefits.