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Diversity Poised To Take Center Stage In 2018 Proxy Season

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From Hollywood movie sets and Silicon Valley tech campuses to Wall Street banks and the U.S. Congress, calls for increased diversity have amplified in recent years. The boardrooms of corporate America are no exception. While diversity on corporate boards has been a matter of interest among U.S. investors for years, 2017 marked a turning point, and we expect the topic of boardroom diversity, particularly gender diversity, to take center stage in the 2018 annual meeting season.

Institutional Investors Step Up Scrutiny on Board Diversity


Gillian Hobson

The 2017 annual meeting season marked a transformation in how major institutional investors evaluate and influence diversity in the boardroom. Following the launch of its Gender Diversity Index in March 2016, State Street issued in March 2017 its “Guidance on Enhancing Gender Diversity on Boards,” noting that while State Street’s “preferred approach is to drive greater board diversity through an active dialogue and engagement with company and board leadership,” where companies fall short of State Street’s expectations for improving gender diversity, State Street would use its proxy voting power to vote against the chair of the nominating and governance committee. And in one of the most noteworthy corporate governance developments of the 2017 annual meeting season, State Street indeed followed through on this threat, voting against the re-election of directors at approximately 400 companies — over 10 percent of all U.S. public companies.


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The two other largest U.S. institutional investors, BlackRock and Vanguard, also have signaled their intent to make board diversity a major priority. In March 2017, BlackRock indicated in its top engagement priorities that it plans to look at how companies are working to increase boardroom diversity and promised to “hold nominating and/or governance committees accountable” for failure to make progress in this regard. In August 2017, Vanguard issued its Investment Stewardship 2017 Annual Report. In addition to discussing the investment firm’s views on climate change-related disclosures and proposals, Vanguard focuses on gender diversity on boards and indicates that the firm will consider whether companies are making meaningful progress in this area in its future voting decisions.

The California Public Employees' Retirement System, a longtime supporter of boardroom diversity, submitted over 500 letters to companies in August 2017 regarding this topic, focusing specifically on gender diversity. The form CalPERS letter notes that a company's board lacks gender diversity, and it encourages the company receiving the letter to develop and disclose the company's policy for considering board diversity. The letter further urges the company to disclose a board diversity implementation plan in its proxy statement and governance documents. This latest campaign is similar to a series of letters relating to board diversity that CalPERS, together with The Thirty Percent Coalition, submitted to over 100 companies in 2014; subsequently, nearly 20 of those companies appointed women to their boards. Based on publicly available information, among the companies that failed to adequately respond to CalPERS 2014 board diversity letter, over a dozen received Rule 14a-8 shareholder proposals regarding board diversity for the subsequent year's annual meetings.

On Sept. 8, 2017, New York City Comptroller Scott M. Stringer and the New York City Pension Funds announced the launch of the "Boardroom Accountability Project 2.0." According to the press release, this next phase of the comptroller's campaign "will ratchet up the pressure on some of the biggest companies in the world to make their boards more diverse, independent, and climate-competent." The release focuses on board diversity, and indicates that the comptroller has sent letters to the boards of 151 companies "calling on them to publicly disclose the skills, race and gender of board members and to discuss their process for adding and replacing board members." The comptroller referenced its 2014-2015 success in making proxy access common among the S&P 500, stating that when it launched its Boardroom Accountability Project back in 2014, the comptroller "set out to give investors a true voice in who sits on corporate boards," and that "[n]ow that ... [it has] that power," it is time for the comptroller to "demand change at some of the biggest companies in the world."

The comptroller's vision for disclosure regarding board diversity would involve a board matrix that would identify director skills and experience as well as board tenure, sexual orientation, gender, age and race/ethnicity. Based on the comptroller's release, it appears that the office is attempting to make this type of disclosure more routine for S&P 500 companies, similar to the impact of the comptroller's prior efforts with respect to proxy access, an outcome that, if realized, would likely lead to small and mid-cap companies also experiencing pressure to adopt a similar disclosure approach. While this type of matrix could be simple enough for some companies, it could present significant challenges and risks for companies where not all directors are willing to voluntarily identify across every measure of diversity, and where activist investors wait in the shadows to take advantage of so-called governance failures.

Evolving Principles and Voting Policies at Proxy Advisory Firms

The two leading U.S. proxy advisory firms, Institutional Shareholder Services and Glass Lewis, have also enhanced their focus on boardroom diversity in 2017.

In September 2017, ISS released the results of its annual survey for 2018 policy updates, noting that among the 602 investor respondents, 69 percent indicated that they believe it is problematic if there are no female directors on a public company board. While ISS has not proposed a U.S. policy regarding board diversity, its U.S. policy changes for 2018 include a new policy regarding shareholder proposals requesting a report on a company's pay data by gender or on a company's policies and goals to reduce any gender pay gap. Under the policy, ISS will recommend votes for such proposals on a case-by-case basis, taking into account certain enumerated factors. Notably, ISS also added the following statement to its fundamental principles: "[b]oards should be sufficiently diverse to ensure consideration of a wide range of perspectives."

ISS has also proposed a Canadian policy under which ISS will generally recommend voting "withhold" for the chair of the nominating (or similar) committee, or the chair of the board if no such committee has been established, if the board has not adopted a written gender diversity policy and has no female directors. While this policy will not affect U.S. companies in the upcoming annual meeting season, it is possible that it foreshadows ISS' thinking with respect to U.S. boardroom diversity.

On Nov. 22, 2017, Glass Lewis released updates to its proxy voting policies for the U.S. and Canada applicable to the 2018 proxy season. Glass Lewis' changes include a discussion of how it considers gender diversity on boards of directors. In addition, the advisory firm is adopting a new policy on board gender diversity. Specifically, beginning with 2018 meetings, Glass Lewis will consider board gender diversity when evaluating companies' oversight structures. Beginning with 2019 meetings, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members, and may extend this negative recommendation to other nominating committee members depending on other factors, including the size of the company, and its industry and governance profile.

Diversity-Related Shareholder Proposals

Diversity was also a matter of significant interest among Rule 14a-8 shareholder proponents during the 2017 annual meeting season, with shareholder proposals relating to board diversity, as well as discrimination and other diversity-related matters reaching their highest recorded numbers. Shareholder proposals regarding senior-level diversity were of two primary types: (1) proposals requesting that the board adopt a policy to improve boardroom or senior management diversity; and (2) proposals requesting a report on the company's plans for increasing boardroom or senior management diversity. Shareholder proposals regarding discrimination and other diversity-related matters were of four primary types: (1) proposals requesting that the company prepare a diversity report or report on its diversity policies; (2) proposals requesting that the company amend its policies on discrimination to prohibit discrimination based on sexual orientation or gender identity; (3) proposals requesting a report on gender, or race/ethnicity pay gaps; and (4) proposals requesting a report on the company's nondiscrimination policies.

The most prolific proponents were Arjuna Capital, Northstar Asset Management, Trillium Asset Management and UAW Retirees Medical Benefits Trust (and affiliated entities). Proposals were submitted to large and small companies alike and across a myriad of industries. Companies receiving proposals included Apple, Bank of America, BlackRock, Chevron, Coca-Cola, Colgate-Palmolive, Continental Resources, Dominion Energy, EOG Resources, Exxon Mobil, Facebook, General Electric, Johnson & Johnson, Procter & Gamble and Wal-Mart Stores.

Note that while it has traditionally proved challenging for companies to exclude shareholder proposals pertaining to diversity matters, the recently issued guidance on Rule 14a-8 shareholder proposals from the staff of the U.S. Securities and Exchange Commission's Division of Corporation Finance may offer new avenues for influencing the staff's decisions.

Shareholder Activism and Board Diversity

Despite the growing push for boardroom diversity from the broader investor community, activist investors have so far curiously remained on the sidelines. In fact, according to a recent study from ISS, activism appears to reduce gender and ethnic diversity, as the rate at which activists selected women or ethnically diverse directors or nominees has been significantly lower than the rate at which S&P 1500 companies appointed or nominated women or ethnically diverse candidates for new directorships during the same period.

However, as activist investors are generally creatures of opportunity, corporate boards should be prepared to see activist investors take advantage of the recent and growing investor pressure regarding board diversity. In addition to joining in the chorus of investor criticism of boards lacking in diversity, we expect that opportunistic activists, despite their abysmal track record to date, will also begin to nominate more women and ethnically diverse nominees in proxy contests as a means for drawing higher institutional investor support in proxy contests.

The Business Case for Diversity

Underlying the recent push for boardroom diversity is the increasingly well-accepted belief among major institutional investors, proxy advisory firms and other influential groups that diverse boards make better decisions. Citing the 2015 McKinsey & Co. report, "Why Diversity Matters," among other studies, State Street's March 2017 gender diversity report notes that "companies with greater levels of gender diversity have stronger financial performance as well as fewer governance-related issues such as bribery, corruption, shareholder battles and fraud." BlackRock noted in its engagement priorities that "[d]iverse boards, including but not limited to diversity of expertise, experience, age, race and gender, make better decisions." Vanguard's position is that "diversity among directors — along dimensions such as gender, experience, race, background, age, and tenure — can strengthen a board's range of perspectives and its capacity to make complex, fully considered decisions." And the New York City comptroller has indicated that "[d]iversity isn't a box to be checked — it's a strategy for economic success."

The belief in the business case for diversity is not limited to academics, consultants and investor groups. For example, in connection with its 2016 Principles of Corporate Governance, the Business Roundtable stated its belief that "[d]iverse backgrounds and experiences on corporate boards strengthen board performance and, in turn, help drive long-term economic value." It was a noteworthy shift in tone from an organization that has long emphasized that there is no one-size-fits-all approach when it comes to corporate governance matters.

While many companies have cited the difficulty of identifying qualified diverse candidates as a primary issue in expanding boardroom diversity, the increasingly well-accepted belief is that diversity improves board effectiveness and pressure on companies to diversify their boards has created a business opportunity for organizations that possess a deep network and knowledge of the diverse candidate pipeline. In response to this pressure, organizations like WomenCorporateDirectors, the Directors Academy and the Executive Leadership Council are taking a targeted approach to creating a rich pipeline of diverse board candidates.

Looking Ahead to 2018

The 2017 annual meeting season represented a significant shift in investor perception and scrutiny in respect of boardroom diversity, and companies appear to be taking note: According to a Spencer Stuart report, 2017 marked the first year that women and minorities filled a majority (just over 50 percent) of open S&P 500 independent board seats, up from 42 percent in 2016. We expect this trend to continue and for board diversity to be a central issue in the 2018 annual meeting season. We also expect to see growing support of shareholder proposals related to board diversity, discrimination and other diversity-related matters.

In light of the foregoing developments, we recommend that public companies proactively consult experienced governance counsel to assess the potential risk of investor pressure to improve board diversity during the 2018 annual meeting season. Investor engagement, director recruitment, board refreshment, disclosure and other corporate governance issues can be highly complex and present significant but avoidable pitfalls, and there is no one-size-fits-all approach to these or other corporate governance issues.

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