Governance & Securities
Alert

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Heads-Up for the 2021 Proxy Season: Focus on Diversity Disclosure

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In 2021, public companies will need to focus more than ever on addressing diversity, equity and inclusion (DEI) organization-wide. Companies are facing pressure from state legislatures, institutional investors and other stakeholders to enhance their DEI efforts and corporate leaders are making public commitment to advance such efforts. As companies focus on their proxy statements for their 2021 annual meetings, it is important to understand the lens through which their various constituencies will scrutinize board and workforce diversity disclosure and prepare disclosure that provides a meaningful picture of the company's board diversity and DEI initiatives.

In this Alert, with a focus on DEI, we provide an overview of:

- Expectations of key institutional investors
- ISS and Glass Lewis voting policies for 2021 and beyond
- Nasdaq's proposed listing rule on board diversity
- Shareholder proposals: DEI, "Rooney Rule" and EEO-1 workforce data
- State legislative initiatives
- Recent shareholder litigation
- Where the SEC stands
- Expected Biden administration and Congressional initiatives

We also offer a checklist for proxy statement disclosure considerations. The Annex provides a summary of key investor policies on board and workforce diversity.

Board Diversity: Key Institutional Investor Views

The momentum of boardroom diversity began to build meaningfully in 2020, and we expect to see significant progress in 2021 as institutional investors expand their focus beyond gender diversity to address racial and ethnic diversity on the board. Investors such as BlackRock, State Street and Vanguard have made it clear that they intend to engage companies on DEI during the 2021 proxy season and will consider voting against certain directors where boards have not taken sufficient action or made a commitment to increase diversity.

BlackRock, for example, voted against over 1,500 directors in 2020 due to lack of gender board diversity, and has indicated that it will take a critical look at board diversity more broadly in 2021. Beginning in 2021, State Street will vote against nominating and governance committee chairs of S&P 500 and FTSE 100 companies that do not disclose the racial and ethnic composition of their boards and, beginning in 2022, will vote against nominating and governance committee chairs at companies that do not have at least one director from an underrepresented community on the board. Vanguard may vote against directors at companies where there has not been "sufficient progress" (in its view) made in relation to board diversity. We summarize key investors' policies on board diversity in the Annex of this Alert.

ISS and Glass Lewis Voting Policies on Diversity

For 2021, proxy advisory firms, Institutional Investor Services (ISS) and Glass Lewis, have updated their proxy voting guidelines, available here and here, to address board gender, racial and ethnic diversity, and may recommend against the election of directors at boards that have not disclosed board diversity characteristics consistent with their respective guidelines.

ISS Policy

Since 2020, it has been ISS's policy to generally recommend against the nominating committee chair if the board does not include at least one woman and note a concern if there are fewer than two women directors. Beginning in 2022, ISS will generally recommend voting against the nominating committee chair of a board with fewer than two women directors (unless there are six or fewer board members, in which case one woman member will be required).

Beginning with meetings held on or after February 1, 2021, ISS will indicate in its voting recommendation report if there is no apparent racial and/or ethnic board diversity at any Russell 3000 or S&P 1500 company, and in 2022, will generally recommend against the chair of the nominating committee at any Russell 3000 or S&P 1500 company that has no apparent racial and/or ethnic board diversity.

In each case, ISS will consider exceptions if there was a gender or racial and/or ethnic diverse member in the preceding annual meeting and the board makes a firm commitment to appoint a diverse director within one year.

Glass Lewis Policy

Starting for meetings held on or after January 1, 2021, Glass Lewis voting recommendation reports for S&P 500 companies will include an assessment of proxy statement disclosure relating to board diversity, skills and the company's director nomination process, which will analyze: (i) the board's current percentage of racial/ethnic diversity; (ii) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity; (iii) whether the board has adopted a "Rooney Rule" policy (discussed further below); and (iv) board skills disclosure. Glass Lewis will not make voting recommendations solely on the basis of this assessment in 2021; rather, the assessment may be a contributing factor in recommendations when other board-related concerns have been identified. Glass Lewis will generally align its recommendations on board diversity with applicable state laws (discussed further below), though may refrain from making negative recommendations at companies outside of the Russell 3000 index or if there is sufficient disclosure of a rationale or a plan to improve diversity.

Nasdaq's Game-Changing Move

In a game-changing move, Nasdaq has proposed an amendment to its listing rules that would require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors – one self-identified as female and one self-identified as being from an underrepresented racial or ethnic group or as LGBTQ+. Boards of five or fewer directors need only have one diverse director to satisfy the requirement, rather than two. The proposal provides a one-year grace period for companies that no longer meet the diversity objective as a result of a vacancy on the board of directors. Newly-listed companies would have an initial phase-in period of two years to meet the diverse director objective.

Shareholder Proposals: DEI, “Rooney Rule” and EEO-1 Workforce Data

For the 2021 proxy season thus far, shareholder proponents have submitted more than 60 proposals on diversity, racial justice and human capital issues more broadly, including proposals asking companies to prepare a diversity and inclusion report and requesting that companies conduct a “civil rights” audit.

We also anticipate that companies will continue to adopt a “Rooney Rule” policy, requiring that diverse individuals based on gender, race and ethnicity be included in formal searches for new directors and, in some cases, in a CEO search. During the 2020 proxy season, as part of its Boardroom Accountability Project 3.0, the Office of the New York City Comptroller (NYC Comptroller) submitted shareholder proposals to 18 companies following its 2019 letter writing campaign to 56 S&P 500 companies, requesting the adoption of a “Rooney Rule” policy. Of those 18 companies, 14 adopted the policy and the proposal was withdrawn. The proposal went to vote at three companies receiving 53%, 24% and 12% support from shareholders, respectively. Of note is that one company adopted a policy governing director searches but not CEO searches, which the NYC Comptroller considered insufficient to withdraw its proposal.

Disclosure of Consolidated EEO-1 Reports is becoming the “gold standard” for investors. These annual reports provided to the US Equal Employment Opportunity Commission include the race, gender and ethnicity of the employees filling various job categories, including senior management. The NYC Comptroller has announced commitments from 34 of the 67 S&P 100 companies it contacted during the summer of 2020 to adopt a policy to publicly disclose their Consolidated EEO-1 Reports. Similarly, among other institutional investors, State Street has called on the board chairs of public companies in its investment portfolio to disclose measures of workforce diversity using the EEO-1 Report framework and has stated that, beginning in 2022, it would vote against the chair of the compensation committee at S&P 500 companies that do not disclose their EEO-1 survey responses.

During the 2020 proxy season, four of eight shareholder proposals seeking reports on the diversity of the respective company’s workforce based on gender and the EEO-1 racial and ethnic categories as well as the policies and procedures related to workforce DEI and the effectiveness of such programs received majority support. We expect that shareholder support for such proposals will continue to gain momentum in the 2021 proxy season. ISS generally recommends voting for shareholder proposals that request a company to disclose its diversity policies or initiatives, or proposals that request disclosure of a company’s comprehensive workforce diversity data, including requests for EEO-1 data, unless the company (i) publicly discloses equal opportunity policies and initiatives in a comprehensive manner, (ii) already publicly discloses comprehensive workforce diversity data, and (iii) has no recent significant EEO-related violations or litigation.

State Legislative Initiatives

There is a growing movement by state legislatures for action on board diversity. California has led the way on board diversity with laws that require public companies with principal executive offices located in the state to have had at least one female director by the end of 2019, and at least two or three female directors, depending on board size, by the end of 2021. Additionally, such California companies also must have at least one director from an “underrepresented community” (defined in terms of race, ethnicity or sexual orientation) by the end of 2021 and at least two or three such directors, depending on board size, by the end of 2022. (See California Senate Bill 826 and Assembly Bill 979). Washington State recently required companies incorporated in that state to meet certain gender diversity targets by January 1, 2022 or disclose in their proxy statements or on their websites, a “board diversity discussion and analysis” that includes information regarding the company’s approach to developing and maintaining board diversity. A number of other states, such as New York, Maryland, Illinois, Hawaii, Massachusetts, Michigan, New Jersey, Colorado and Pennsylvania, have either enacted or are currently considering mandatory board diversity legislation. As discussed above, Glass Lewis will look to applicable state laws when making its voting recommendations in director elections.

Wave of Shareholder Litigation

Companies and their boards should take care to ensure that public statements regarding commitments to DEI are not embellished, but rather match the company's actions. Since the summer of 2020, several shareholder derivative lawsuits have been filed alleging that the company's commitments to diversity appearing in proxy statements and other disclosures were materially false and misleading. These shareholder actions also allege that directors violated their fiduciary duties for failing to have diverse boards, failing to take action on DEI issues and tolerating racially discriminatory practices at their companies. Relief sought by the plaintiffs includes damages, significant changes to the composition of the board to include black candidates, tying executive compensation to achievement of diversity goals, diversity training and concrete workforce diversity goals, among other actions. The initial wave of these lawsuits was brought against technology companies headquartered in California by the same California-based plaintiff's law firm. More recently, plaintiffs have filed similar actions against corporations headquartered outside of California and outside of the technology industry. The number of plaintiff's law firms that are initiating these actions is also broadening, indicating that more companies with a lack of board and/or workforce diversity could face similar challenges absent concrete changes in their board and workforce composition and related public disclosure. While it remains to be seen how these lawsuits will fare, shareholders are likely to continue to use litigation as another means to press for greater board and workforce diversity.

Where the SEC Stands

The SEC does not currently explicitly require companies to disclose the diversity composition of their boards. Historically, the SEC has largely declined to require diversity-related disclosure, opting instead for a principles-based materiality regime regarding diversity, whereby companies determine whether information concerning diversity is material, and, if so, what specifically to disclose. Since 2009, the SEC has required companies to disclose if and how diversity is considered as a factor in the process for considering candidates for board positions. In 2018, the SEC issued guidance encouraging the disclosure of self-identified characteristics of board candidates. And in 2019, the SEC's Division of Corporation Finance issued two identical CD&Is (Regulation S-K, Question 116.11 and Question 133.13) providing that to the extent a board or nominating committee, in determining the specific experience, qualifications, attributes, or skills of an individual for board membership, has considered the self-identified diversity characteristics of an individual who has consented to the company's disclosure of those characteristics, the SEC Staff would expect that the company's disclosure would include identifying those characteristics and how they were considered.

In recent months, the Democratic SEC Commissioners have been vocal in their calls for the SEC to do more to promote diversity through disclosure. Commissioner Allison Lee suggested that the SEC should strengthen its 2018 guidance on board nominee diversity disclosure, and has called on the SEC to revisit its 2020 amendments to Regulation S-K to require disclosure of workforce diversity data at all levels of seniority. Commissioner Lee has further stated her belief that the current principles-based materiality regime covering diversity disclosure does not go far enough "to get investors the diversity information they need to allocate capital wisely." These recent statements signal that a Democratic-led SEC may move away from a principles-based approach to diversity disclosure and towards requiring specific disclosures regarding the diversity composition of public company boards and nominees, measured by specified metrics.

Biden Administration and Democratic Congress Set to Ramp up Efforts

We expect efforts to enhance diversity disclosure at the board and senior executive level to intensify further under the Biden administration with a Democratic-controlled House, Senate (tiebreaker) and SEC. Congressional Democratic efforts introduced in recent years and expected to be revived under a Democratic-controlled Congress include: requiring public companies to disclose in their proxy materials data on the racial, ethnic and gender composition, as well as veteran status, of their board, board nominees and executive officers (an initiative that previously garnered support from the Council of Institutional Investors (CII) and the U.S. Chamber of Commerce); requiring disclosure regarding the adoption of any board policy, plan or strategy to promote racial, ethnic and gender diversity; and calling on the SEC to review its proxy disclosure rules covering the diversity of board nominees. Notably, while the spotlight on many of the diversity initiatives noted above have mostly focused on the board, Congressional efforts have often gone a step further to cover diversity among executive officers.

What to Do Now?: Proxy Statement Checklist

- **Objectively review diversity composition disclosure and plans.** Review and consider whether disclosure of the board's composition and the director nomination process clearly communicates the board's diversity composition, and any plans to improve, refresh and strengthen the board's composition and functioning, without overstating. Companies should be mindful that plaintiff law firms are actively scrutinizing disclosures.

- **Consider a skills matrix or other visual depiction of the board's diversity characteristics.** Consider a matrix summarizing the skills, qualifications, attributes and diversity of directors. Many companies are further disaggregating their diversity disclosure to provide greater transparency on gender, racial and ethnic diversity by disclosing individual director's diversity characteristics, either narratively or graphically.

- **Consider how to describe board ethnic and racial diversity.** While some companies generically indicate whether directors have "ethnic" or "racial" diversity characteristics, many others are moving towards more specific identifications – e.g., Asian, Black/African American, Hispanic/Latino, Native Hawaiian/Pacific Islander, American Indian/Alaskan Native/Native American, White/Caucasian, non-U.S. citizen, etc.

- **Tackle a lack of board diversity head on.** Companies that lack board diversity should describe the board's plan to increase diversity and the proposed timing.

- **Clearly articulate board diversity policies**. Describe any policies on whether, and if so how, the board or the nominating committee considers diversity in identifying director nominees. If the company has adopted a "Rooney Rule" or other policy, the company should describe such policy and how it applies.

- **Engage with investors**. Engage with investors to understand their diversity policies and their views on how to enhance the board's composition.

- **Consider "self-identification" methodology.** As many of the initiatives noted herein rely on self-identification of diverse characteristics, determine the best way to gather directors' self-identified diversity information and consents to disclosure such information. Some companies have provided directors with the opportunity to self-identify in their annual D&O questionnaires, in which the company can also obtain consent to disclose such information. Preparers of the proxy statement disclosure should discuss with directors expectations surrounding self-identification and how diversity information will be disclosed.

- **Monitor the status of the proposed State, Congressional, SEC and Nasdaq rules and related developments.** Track the status of board diversity legislation and other rules and requirements applicable to the company, and plan ahead for related implications.

- **Consider disclosure of important workforce diversity data points.** Review and evaluate the workforce diversity data that is used by management and ensure that the most relevant data points are disclosed and clearly explained and how such data could meaningfully supplement the company's EEO-1.

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Annex
Summary of Institutional Investor Diversity Policies

<table>
<tr><th>Board Diversity</th><th>Workforce Diversity</th></tr>
<tr><td colspan="2">BlackRock[1]</td></tr>
<tr><td>
Voting Guidelines

May vote against members of the nominating/governance committee for an apparent lack of commitment to board effectiveness if a company has not adequately accounted for diversity in its board composition within a reasonable timeframe.
If company’s disclosures or practices fall short relative to the market or peers, or BlackRock is unable to ascertain the board and management’s effectiveness in overseeing related risks and opportunities, BlackRock may vote against members of the appropriate committee or support relevant shareholder proposals.
Boards should take into consideration the full breadth of diversity, including personal factors, such as gender, ethnicity, race and age, as well as professional characteristics, such as a director’s industry, area of expertise and geographic location.

Composition

Encourages companies to have at least two women directors on their board, in addition to other elements of diversity.

Disclosure

Encourages disclosure of, among other things, the demographics related to board diversity, including, but not limited to, gender, ethnicity, race, age and geographic location, in addition to measurable milestones to achieve a boardroom reflective of multi-faceted racial, ethnic and gender representation.
Considers a company’s commitment to increase board diversity within the next 12-18 months, the addition of a diverse director within the previous year, board tenure and public statements that focus on diverse recruiting efforts.

</td><td>
Talent Pipeline

Seeks to understand company’s philosophy, policies and performance on diversity at the board level, and by extension, within senior management and the “talent pipeline.”
Expects companies to disclose workforce demographics, such as gender, race and ethnicity in line with the US Equal Employment Opportunity Commission’s EEO-1 Survey, alongside the steps they are taking to advance diversity, equity and inclusion.

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[1] BlackRock, Our 2021 Stewardship Expectations: Global Principles and Market-level Voting Guidelines, available here; BlackRock Investment Stewardship: Proxy voting guidelines for U.S. Securities, available here; BlackRock, Commentary: Investment Stewardship’s approach to engagement on board diversity, available here.

<table>
<tr><th>Board Diversity</th><th>Workforce Diversity</th></tr>
<tr><td colspan="2">State Street[2]</td></tr>
<tr><td>Voting Guidelines
• In 2021: Will vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not disclose the racial and ethnic composition of their boards.
• In 2022: Will vote against the Chair of the Nominating & Governance Committee at companies in the S&P 500 and FTSE 100 that do not have at least 1 director from an underrepresented community on their boards.</td><td>Voting Guidelines
• In 2022: Will vote against the Chair of the Compensation Committee at companies in the S&P 500 that do not disclose their EEO-1 Survey responses.</td></tr>
<tr><td colspan="2">Vanguard[3]</td></tr>
<tr><td>Voting Guidelines
• In 2021: May vote against directors (nominating committee chairs or other relevant directors) at companies where progress on board diversity falls behind market norms and expectations.
Disclosure
• Expects boards to publish their perspectives on board diversity and disclose board diversity measures, in terms of gender, race and ethnicity.
Recruitment
• Expects boards to interview diverse pools of director candidates and reflect a range of diversity with tangible outcomes such as formerly homogenous boards becoming increasingly diverse.</td><td>Disclosure
• Looks for companies to publish policies on employee recruitment, retention and inclusion, and expects them to outline the steps the board is taking to ensure that employees feel they can succeed.
• Encourages disclosure of workforce diversity measures (gender, race and ethnicity) at the executive, nonexecutive and overall workforce levels.
• The Sustainability Accounting Standards Board and EEO-1 reports are identified as helpful starting points for such disclosure.</td></tr>
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[2] State Street, CEO's Letter on Our 2021 Voting Agenda (January 11, 2021), available here; State Street, Guidance on Enhancing Racial & Ethnic Diversity Disclosures (January 2021), available here.

[3] Vanguard Investment Stewardship Insights: A continued call for boardroom diversity (December 2020), available here; Vanguard Investment Stewardship Insights: Diversity in the workplace (December 2020), available here.

Board Diversity	Workforce Diversity
NYC Comptroller [4]	
Voting Guidelines • Will vote against directors on the nominating committee of any board that lacks adequate gender and racial/ethnic diversity. **Board Recruitment** • Encourages companies to adopt policies requiring the initial list of board candidates include qualified female and racial/ethnically diverse individuals (also known as the "Rooney Rule"). (Boardroom Accountability 3.0) **Disclosure** • Supports the Nasdaq proposal and advocates for expanding the proposed matrix to describe not only each director's self-identified gender and race/ethnicity, but also their skills, experience and attributes that are most relevant to the company's overall business, long-term strategy and risks.	**Disclosure** • Calling on companies (through letter writing and submitting proposals) to publish annual EEO-1 Report data, including the race, ethnicity and gender of their employees. **Senior Executive Recruitment** • Encourages companies to adopt policies requiring recruitment lists of senior executives to include qualified female and racially/ethnically diverse candidates. (Boardroom Accountability 3.0)

[4] Office of the New York City Comptroller, Corporate Governance Principles and Proxy Voting Guidelines, available here; Comptroller Stringer, Nasdaq's Proposed Board Diversity Rule Would Help Expand Racial, Gender and LGBTQ+ Diversity in Corporate America (January 4, 2021), available here.