GLASS LEWIS

Racial & Ethnic Diversity in the Boardroom

A Review of Current Disclosure & Market Practice Among S&P 500 Companies

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Introduction

For many years, board composition has been a critical element of corporate governance. Diversity is a significant component of that, though exactly what constitutes diversity remains an ongoing conversation.

Some companies maintain that ensuring an appropriate mix of professional background, skills, and experience is the extent of their remit. Yet many investors have called for a wider definition that reflects factors like gender, and racial and ethnic diversity – or explicitly define those factors as components of relevant skills and experience, alongside professional background.

The issue has come to the fore in recent years, in part driven by recent social movements and regulatory changes. In our review of the 2020 proxy season, we identified the lack of sufficient board gender diversity as one of the leading drivers for directors who failed to receive majority shareholder support. In part, that reflects what can be measured — by and large, gender is disclosed, or evident from the pronouns used in director bios.

But absent specific disclosure, investors are often forced to determine racial and ethnic composition by looking at director profile photos or surnames, which can be problematic. Moreover, unclear and inconsistent data makes it was impossible to track changes or measure evolution over time.

These practical difficulties have spurred a growth in demand for more company disclosure of racial and ethnic data and related initiatives. Recently, a host of institutional investors have updated their engagement strategies and voting policies to address disclosure of board-level race and ethnicity, and/or board practices on this topic.

Additionally, many in the investment community are not solely looking for demographic data; they also want to know about the broader diversity policies and processes in place. This is particularly relevant for companies and industries that, for any number of reasons, have been slower to implement changes to the composition of directors or the wider employee base. For investors, disclosure of this information signals that the discussion is at least happening at the board level, even if it has yet to bear fruit.

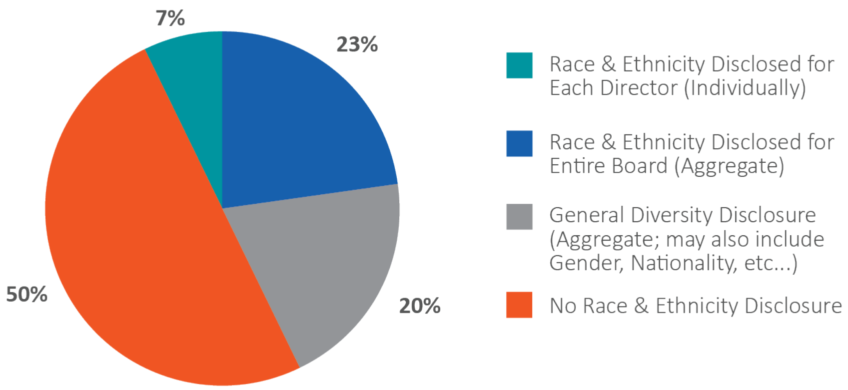
Examples of Disclosure Requested and Policies Regarding Race and Ethnicity

Institution	Disclosure Requested	Voting Policy
BlackRock	*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* Proxy voting guidelines for U.S. securities (p. 6)	*To the extent that a company has not adequately accounted for diversity in its board composition within a reasonable timeframe …we may vote against members of the nominating/governance committee for an apparent lack of commitment to board effectiveness* Proxy voting guidelines for U.S. securities (p. 6)
Vanguard	*We want companies to disclose the diversity makeup of their boards on dimensions such as gender, age, race, ethnicity, and national origin, at least on an aggregate basis* Investment Stewardship Insights: A continued call for boardroom diversity (p. 2)	
State Street	*Board-level diversity characteristics, including racial and ethnic makeup, of the board of directors* Guidance on Enhancing Racial and Ethnic Diversity Disclosures (p. 1)	*In 2021, we 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* Summary of Material Changes to State Street Global Advisors' 2021 Proxy Voting and Engagement Guidelines (p. 2)

Institution	Disclosure Requested	Voting Policy
CalPERS	*Boards should annually disclose their demographic information including race, ethnicity and gender* Commitment to Diversity & Inclusion Report 2019-20	*On a case-by-case basis, where our engagements are not successful, we will withhold votes from directors who are nominating/governance committee members, board chairs, or long tenured directors (greater than 12 years on the board) on boards which lack diversity and do not make firm commitments to improving the board diversity in the near term* Proxy Voting Guidelines (p. 2)
CalSTRS	*The board should disclose the policies or procedures used to ensure board diversity* Corporate Governance Principles (p. 6)	*CalSTRS will hold members of the board's nominating and governance committee and if necessary the entire board accountable if, after engagement about the lack of board diversity, sufficient progress has not been made in this regard.* Corporate Governance Principles (p. 6)
New York City Comptroller	The Boardroom Accountability Project 2.0 (BAP) called *on companies to adopt a form of disclosure … called the "Board Matrix," table describing the skills, gender, and race/ethnicity of individual directors on the board* Boardroom Accountability Project	BAP 2.0 called for *engagement with independent directors regarding "refreshment" opportunities to bring new voices and viewpoints into the boardroom;* BAP 3.0 calls on companies to *adopt a policy requiring the consideration of both women and people of color for every open board seat and for CEO appointments* Boardroom Accountability Project

It appears that many companies' disclosures relating to board diversity in the context of race and ethnicity are lacking relative to these evolving institutional investor expectations: In our review of proxy statements filed during 2020 by companies in the S&P 500, we found that most companies do not disclose any information regarding the race and ethnicity of their board.

S&P 500 RACE & ETHNICITY DISCLOSURE



Nearly half of these proxy statements did not disclose any statistical data related to its racial and ethnic diversity composition. For companies that are listed on the Nasdaq and in the S&P 500, 64% do not disclose any relevant metrics.

As part of our annual engagement program, in Q3 and Q4 2020 we spoke with over 50 companies within the S&P 500 about their processes for disclosing information regarding diversity policies and demographics. We met with a wide spectrum of companies to better understand the challenges for those who have not disclosed this information, and best practices from companies who have — in some cases for many years.

This special report provides a summary of what companies shared with us in those conversations, and what we learned from them. We hope it is relevant and useful to investors, public companies, and other stakeholders.

We strongly encourage interested parties to contact Glass Lewis to provide feedback or engage with us in response to this paper. Existing Glass Lewis clients should reach out to their dedicated CSM, or email clientservices@glasslewis.com; investors wishing to learn more about Glass Lewis' approach should contact GROW@glasslewis.com; and public companies wishing to access Glass Lewis research or engage with us should contact ENGAGE@glasslewis.com.

What Companies Shared with Glass Lewis

Many of the companies we spoke to that disclose the race and ethnicity of their directors raised the point that providing this information was a small step in the larger goal of achieving a more diverse board. These companies said that the process began with having a conversation amongst the board, or including a question about how directors self-identify in their annual evaluation.

Furthermore, several of these companies expressed their belief that the real diversity work lay in expanding the parameters of the nomination process, evolving its committee charters, and maintaining the leadership required for these processes to have meaning. While disclosure surrounding these actions is not indicative of a racially diverse board, it does illustrate that the board has had meaningful conversations around identity.

Reasons for Diversity Disclosure

Many companies shared that they began disclosing information about their racial and ethnic makeup and policies in response to what they heard during shareholder engagement.

- Two companies specifically mentioned their diversity disclosure was in response to the New York City Comptroller's Board Accountability Project, which requested that companies disclose a director skills matrix, and included race or ethnicity as part of that skills matrix.
- One utilities company explained that it wanted to provide investors with an alternative to relying on director photographs and surnames of directors to determine diversity.
- A financials company wanted to be proactive, noting the real possibility of receiving a shareholder proposal if it did not take steps to enhance racial and ethnic disclosure.
- A healthcare company said that questions from its shareholders lead them to begin disclosing the race and ethnicity of the board.

Based on our conversations, it appears that investors are understanding when it comes to potential sensitivities surrounding personal information. Companies that provided racial and ethnic data in aggregate reported that their shareholders were generally satisfied with that type of disclosure.

Culture & Leadership

Board culture and leadership were also cited as significant factors by many companies with whom we engaged.

- At least ten companies shared that board members volunteered the information or agreed to answer a survey because they felt it was important to provide this transparency to the public.
- One utility company specifically mentioned "What gets measured is valued", elaborating that more women are in the C-suite because gender is more easily measured than race.
- One healthcare company cited executives who wanted clearer measures in order to promote accountability in relation to diversity, beginning with the board.
- A communication services company also mentioned that it wanted its diversity to be measurable, stating that "Not giving a measure makes it a hollow promise".

Companies that chose to disclose race and ethnicity tended to have cultures that were supportive of diversity initiatives and led by executives who are equally committed.

Challenges to Disclosing Information

Companies that we spoke to that do not have any race or ethnic disclosure saw the value in diversity, but questioned the need to set out the information explicitly.

- Three companies felt the photos of board members was sufficient evidence for a diverse board.
- Several companies said that there was a lack of interest or push from their shareholders for increased disclosure.
- One company noted they did not feel comfortable asking the board to self-identify while another questioned how the disclosure would be helpful for investors.

In addition, many companies in this category felt that racial and ethnic disclosures could distract from the skills and experience that diverse directors bring to the board, reducing a board member's experience to their ethnicity and creating a hyper focus on race and ethnicity rather than skills and professional experience.

Reasons for Not Disclosing Race and Ethnicity

- *Privacy concerns regarding public disclosure*
- *Questioned the value of including additional information*
- *Photos and last names sufficient to illustrate board diversity*
- *Discomfort with asking the board for to self-disclose*
- *Lack of interest from shareholders*
- *Creates a hyper focus on race rather than skills and experience*
- *Lack of peers or examples on how to disclose information*

Advice for Companies Starting the Process

Many of the companies that do not provide diversity disclosure expressed an interest in doing so, but asked, "where do we start?" It is certainly a daunting task. However, there are several existing processes that public companies can use to begin their journey. From our engagements and observations, we found the following to be best practices:

Start the Conversation

The resounding advice from almost every company we spoke to that disclosed details relating to board race and ethnicity was simply to start the conversation amongst the board. In most cases, they found that their directors were open and receptive to providing and disclosing the information.

- A communications company and a financials company both strongly attributed their nominating and governance chairs' passionate leadership for starting the conversation on diversity.
- Two companies mentioned discussing the disclosure of race and ethnicity was a great way to start the conversation on broader diversity at the organization.
- Two financials companies further explained that providing the data was a way to tell the story of the company's diversity.

In relation to the last point, even zero can be a good thing. One healthcare company noted that they wanted to disclose they did *not* have a diverse board to set a starting point, and promote commitment to improving the number in the coming years.

The Rooney Rule

Discussing both formal and informal implementations of the Rooney Rule, a policy requiring the consideration of women and people of color for every open board seat and for CEO appointments, is another way to start the board-level conversation. Originally developed in the National Football League and named after former Pittsburgh Steelers owner Dan Rooney, the Rule has since become a feature among shareholder proposals and boards seeking to enhance their diversity, and formed part of the New York City Comptroller's Boardroom Accountability Project 3.0.

The Rooney Rule does not guarantee a racially diverse board, but it has been cited as a useful mechanism to ensure minorities are considered in the pool of candidates for a director or executive position. Out of 43 companies with at least 30% self-disclosed racial diversity at board level, only two had formally implemented this policy. However, through our conversations we found that many companies had effectively used it as an informal policy.

- One biotechnology company said they require diverse candidates from its third-party search firm when looking for new directors.
- A financial service company returned lists that did not meet their diversity criteria.
    - Both these companies disclosed a racially diverse board of 25% or less.

- One utility company eventually adopted the Rooney Rule as a formalization to the natural progression of considerations the company was making.
- One company with over 40% racial diversity on its board stated that while the rule works on an informal basis, they believe they have obtained better results by not formalizing it.

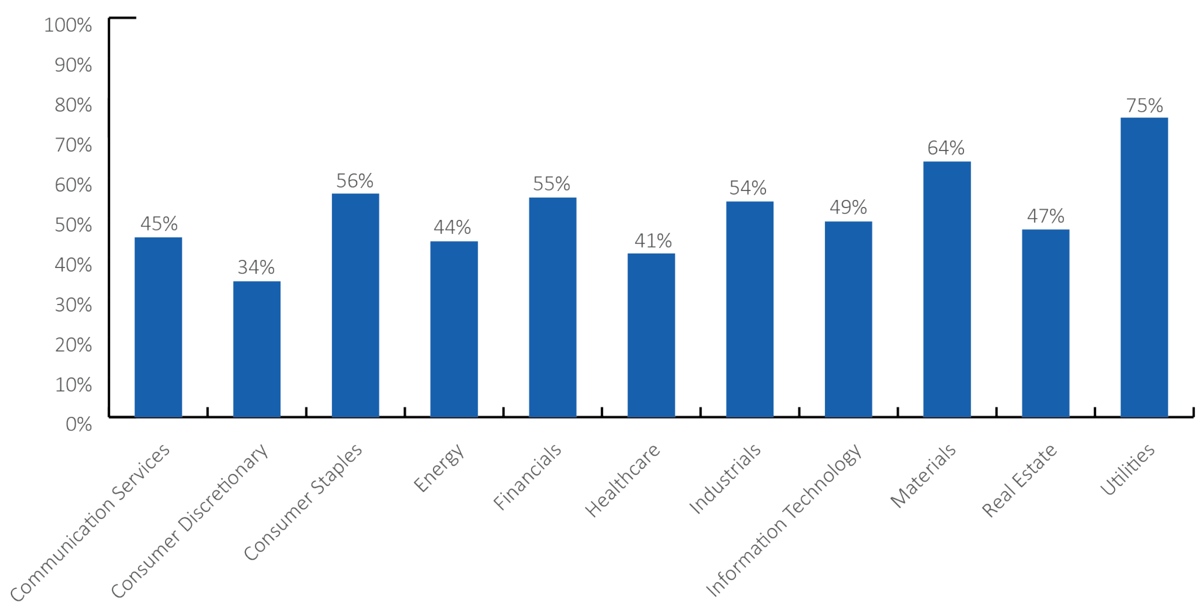
The lack of correlation between formal implementation and high levels of diversity is perhaps unsurprising. Companies with robust plans for recruiting diverse directors are less likely to need the Rooney Rule – a sentiment echoed by many of the companies we spoke to with relatively diverse boards. However, for companies with no disclosure about racial and ethnic diversity, considering the adoption of such a policy may provide another means of starting the conversation at board level.

Industry Comparisons

Another issue that many of the companies we spoke to cited was the lack of a consistent standard for how, and how much, to disclose. Many companies without individual disclosure said they were looking for guidance on best practices. Some companies noted that few of their peers provided race or ethnic disclosure, and three specifically mentioned that they did not consider such disclosure necessary on that basis. That could potentially create a chicken-and-egg conundrum, if a series of peers used each other's non-disclosure as a reason not to disclose themselves.

We took a sector-specific look to see where disclosure was available. Our breakdown showed that most sectors were roughly in line with the overall 50% of total S&P 500 companies disclosing race and ethnicity in some form, with three outliers – utilities and materials at the top, and consumer discretionary at the low end.

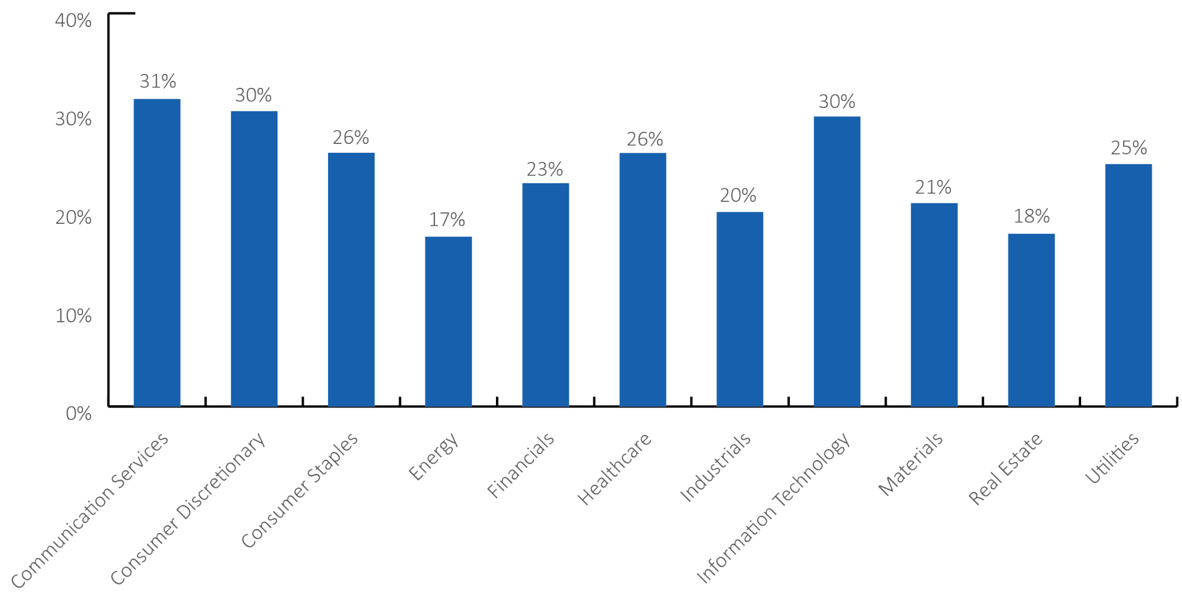
PERCENTAGE OF S&P 500 COMPANIES DISCLOSING RACE & ETHNICITY: SECTOR BREAKDOWN



Notably, while the consumer discretionary sector was relatively low, more than a third of companies in the sector provided racial and ethnic disclosure. Beyond the consumer discretionary sector, the proportion is much higher for other sectors. We recognize that many companies prefer to look at a relatively narrow set of direct competitors within their industry; that said, it appears that there are enough companies in each sector providing racial and ethnic disclosure for companies to be able to identify a peer.

We also looked at actual racial and ethnic diversity levels on the boards of companies that had self-disclosed this information. Any analysis of board-level diversity is complicated by the inconsistency and frequent unavailability of relevant disclosure. That said, it's worth noting that there isn't necessarily a correlation between the sectors with a high proportion of companies providing racial and ethnic disclosure, and the level of racial diversity on those boards.

AVERAGE RACIAL & ETHNIC DIVERSITY OF S&P 500 COMPANIES THAT SELF-DISCLOSE: SECTOR BREAKDOWN



While the utilities sector had the largest proportion of companies disclosing information about race and ethnicity, in terms of actual representation amongst companies that self-disclosed, the consumer discretionary, communication services, and information technology sectors, on average, had more racially and ethnically diverse boards. The nature of the top three industries may help to explain their performance in this area. In particular, consumer discretionary and communication services companies are often well-known brands with significant retail (and reputational) exposure.

- Several of the consumer discretionary companies we spoke to said they strive to have boards that reflect their customers' preferences and interests.
- One company in that industry told us that it was adamant in creating a board that looked like its core customer.

Similarly, many information technology companies are public-facing and rely on their brand. In addition, they are generally less tied to traditional processes, and talent networks, than companies in other industries. Moreover, it's possible that openness to implementing and disclosing diversity at the board level may be growing in response to the perception that the broader industry has problems in this area, with inquiries regarding gender discrimination at Uber, sexual harassment allegations leading to a walkout at Google, and Facebook facing racial discrimination lawsuits.

Creating a Racially Diverse Board

Companies which had at least 40% minority-representation on their boards shared a common theme of intentionality when discussing diversity, particularly in relation to refreshment and recruitment. Our discussions with these companies revealed some best practices for promoting board diversity.

Refreshment

Many companies wait for board members to announce their retirement before considering a replacement, generally taking a passive approach to board refreshment. By contrast, we found that most companies with at least 40% racially diverse boards had processes in place to routinely roll directors on and off their board, creating more opportunities to diversify.

- One company in the information technology sector discussed using annual board review to continuously assess the skills required for their business strategy. They also mentioned keeping an aspirational list of individuals that they would want to approach in the future to meet the company's evolving needs.
  - They emphasized they did not sacrifice skills for diversity.
- A company in the consumer discretionary sector took a more structured approach by implementing tools such as mandatory retirement and term limits, which forces its governance committee to plan for future resignations.

Of course, not all refreshment can be planned -- one communication services company explained that its board became much more diverse when a large group of directors all retired at the same time. Whether the openings are expected or not, the key is to fill them through a diligent recruitment process.

Recruitment

For many of these companies, recruitment went beyond simply hiring a search firm. They described an active approach featuring robust processes that reflect the emphasis they place on diversity.

- A consumer discretionary company we spoke to was intent on creating a board that reflected its customer base, so it began its search with a concentrated profile based on its core customers.
- More than one company attributed their success to working closely with search firms and returning lists that did not include diverse candidates. Companies have even gone as far as changing search firms when they continually did not receive a diverse pool of candidates.
- A communication services company emphasized their belief that the strong effort they put into recruitment and search processes yielded a better result than other companies who employ formal policies, like the Rooney Rule.

Moreover, many companies employ creative strategies to expand the pool of talent available to them, looking beyond the usual candidates like CEOs and CFOs for individuals with comparable experience, and demonstrating a willingness to coach new directors who haven't spent time in boardroom. In some cases that includes going outside the corporate world to recruit from academia, government, or professional services.

Of course, recruiting is a two-way street, and attracting minority candidates may be easier for companies with a reputation for promoting diversity.

- The same consumer discretionary company with the concentrated search profile believes that their strong brand and decades-long track record of commitment to corporate diversity has been key to attracting directors.
- Similarly, an information technology company credits its overall focus on diversity as an important factor in promoting diversity within the boardroom.

There are lots of different ways to create a more diverse board. What all the companies in this category emphasized is that is not impossible to find racially diverse candidates — but it likely requires a structured and persistent recruitment process.

Transparency

These companies were generally similar in having board members that were open to disclosing their race or ethnicity; however, there were differences in the boards' willingness to disclose in aggregate or individually.

- One consumer discretionary company believed that individual disclosure was most appropriate because they did not want the public to guess the race or ethnicity of its directors.
- A healthcare company decided to become more specific in its diversity disclosure as part of its accountability mechanisms.
- On the other hand, an information technology firm determined that aggregate disclosure was appropriate, for now, citing a desire to keep the individual focus on director skills.

As previously noted, some institutional investors appear to be agnostic on the question of individual versus aggregate disclosure. At this point, their focus is on simply getting consistent and reliable data that they can use to make an initial assessment.

Beyond the Boardroom

Organizational Structure & Leadership

Another common feature among companies we spoke to with high board-level racial and ethnic diversity is that their commitment to racial and ethnic diversity goes *beyond* the composition of the board. Many of them pointed to strong executive leadership on this topic, as well as institutional accountability embedded throughout the organization.

- A healthcare company included diversity as a bonus metric and strongly credits its chair for ensuring following through on its initiatives.
- A communications company emphasized the importance of having its Chief Diversity Officer report directly to the CEO, and of empowering its diversity, equity, and inclusion department (which employs a team of over 20 people and is still growing) more generally.
- A consumer discretionary company echoed that the Chief Diversity Officer should report the CEO and that his/her advice needs to be listened to; it should not just be a performative role.

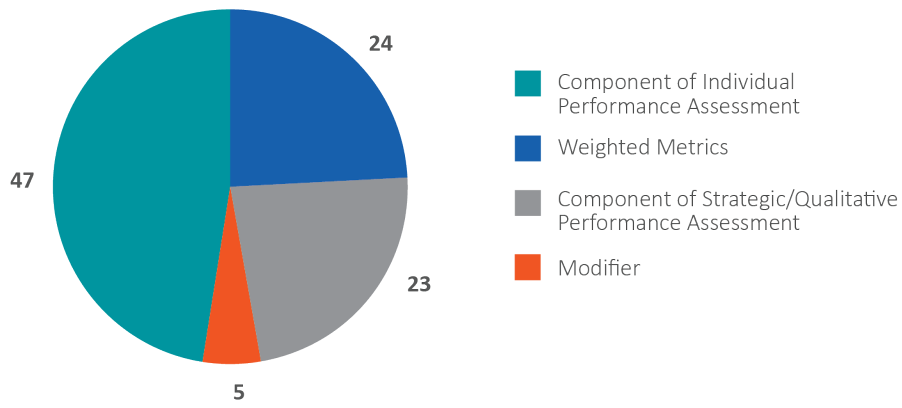
Notably, only about 10% of companies in the S&P 500 have a Chief Diversity Officer or someone of a similar title.

Diversity as a Compensation Metric

One method for embedding accountability for diversity employed by several companies we engaged with is to include it as part of the compensation structure. Although still relatively uncommon, diversity-related goals and considerations are increasingly appearing in executive pay programs. In the twelve-month period to September 30, 2018, 51 companies in the S&P 500 included a diversity metric in their compensation program. In the twelve-month period to February 1, 2021, that number had nearly doubled to 99 companies. Here are some examples of emerging market practice:

- Diversity & inclusion metrics are typically found in the short-term incentive plans, as opposed to long-term incentive plans.
    - Out of the 99 companies mentioned above, all of them used diversity in their STIP while 4 of them also used diversity metrics in their LTIP.
- Usually not a fully a weighted metric, but rather a specific consideration under individual performance or strategic goals.
- Generally, achievement is assessed subjectively — meaning there is not a quantifiable method to measure performance or set performance targets.
    - Usually no clear goals or achievements are described, but rather a brief sentence or two explaining what was considered.
    - Unlike quantifiable, well-established and comparable metrics like EPS or TSR, there is often no real standard for what is considered “good” performance because it is highly dependent on the company.
        - Each company starts at a different place, making it hard to make apples-to-apples comparisons.

TYPES OF DIVERSITY METRICS USED IN COMPENSATION PLANS FOR S&P 500 COMPANIES



The ambiguity of diversity goals in compensation programs stems from the difficulty in measuring them. In our engagements, public companies expressed the following sentiments:

- Most companies agree that diversity is important to their long-term success, but find it difficult to include it in incentive plans.
- The most challenging aspect is how to measure performance and how to disclose achievement.
    - While companies described the assessment process as rigorous, their considerations were often difficult to explain in brief, and in some cases considered sensitive.
    - Several companies cited the stigma associated with using a quota as the reason for avoiding quantifiable metrics.
- Some companies stated that diversity is not part of their incentive plans because it is something that is always expected to be considered by all executives, not something to specifically incentivize.
- Companies that don't include diversity metrics consistently noted that it is not something their shareholders have raised.

Notable Examples of Diversity Metrics and Goals:

- ***Verizon Communications Inc. (VZ) -*** *an early adopter of diversity and sustainability metrics, weighted at 5%, under their STIP that discloses tangible goals*
- ***Edison International (EIX) -*** *tangible goals disclosed for a weighted diversity metric under the STIP*
- ***Prudential (PRU) and Starbucks (SBUX) -*** *inclusion of a diversity modifier to a certain LTIP performance cycles with a quantifiable goal to measure performance*

Source: 2020 proxy statements

Roadblocks to Diverse Boards

Overboarding

Are investor and proxy advisor policies, like Glass Lewis' approach to overboarding, a deterrent to board-level diversity? Glass Lewis views overcommitment as a potential concern for directors, particularly in times of crisis when their skills and attention are needed most; our policy for the U.S. market is that non-executive directors should not serve on more than five boards, and executives should not serve on more than two boards.

Several of the companies we spoke to that don't disclose board-level race or ethnicity mentioned that the minority directors they were interested in bringing on were already serving on other boards, and could not join theirs due to the resulting overcommitment. In fact, the topic comes up frequently in our engagements, with companies inquiring if there is an exception to our overboarding policy in the case of minority directors. However, this assumes there are not enough qualified minorities available to serve as directors. As discussed above in Recruitment, many of the companies that we spoke to with diverse boards mentioned creative strategies towards identifying and onboarding minority director candidates. They provided the following advice:

- Be willing to bring on directors with no boardroom experience and investing resources in coaching new directors.
- Actively participate in the recruitment process and push back if search firms don't provide minority candidates. Companies have even gone as far as changing search firms when they continually did not receive a racially or ethnically diverse pool of talent.
- It is not imperative for every director to have CEO or CFO experience. Look for comparable experience, for example, a global head for a large multinational corporation.

A consumer discretionary company emphasized this last point: *"It is important to acknowledge that the fewer number of public company CEO's who identify as people of color limits the director pool if the only thing the nominating committee is only looking for is CEO experience."*

Diversity of Thought and Skillset

Another consideration we heard from many companies who either neglected to provide diversity disclosure or had low levels of board-level minority representation (or both) is the focus on "diversity of thought" on the board, and not wanting to sacrifice skillset for racial or ethnic considerations. However, this is perhaps a narrow approach to looking at diversity. A robust skills matrix and a thoughtful annual evaluation are important to ensure that diversity of thought encompasses diversity of race and ethnicity. As noted above, the New York City Comptroller's Boardroom Accountability Project 3.0 project explicitly included race and ethnicity within its approach to board skills. Many companies with relatively high levels of diversity advised the following strategies:

- Empower diverse members on board and place them in leadership positions where their skillset is appropriate, particularly on the nominating and governance committee.
- Refreshment should align with business strategy, not retirement.

- An annual evaluation of skills on the board that align with the business strategy can help to promote refreshment, and more refreshment provides more opportunities to increase diversity.
- Plan ahead, using a three-year timeline to know when to start the recruitment process.
- Skillset does not need to be sacrificed for diversity — instead, expand the search.

Glass Lewis Policy

Glass Lewis firmly believes that effectively managing issues related to board diversity, and providing reliable disclosures on the topic, are critically important for public companies. Our position reflects the growing emphasis on this area by institutional investors and regulatory bodies around the world.

Clear and consistent disclosure is key – without it, investors are unable to make an informed analysis. As set out in our 2021 U.S. Voting Policy Guidelines, our Proxy Paper analysis includes an assessment of diversity-related disclosure in the proxy statements of S&P 500 companies. We intend to expand the universe of companies included in this assessment in the coming years. Specifically, we are looking to see how a company's proxy statement presents the following:

- The board's current percentage of racial/ethnic diversity.
- Whether the board's definition of diversity explicitly includes gender and/or race/ethnicity.
- Whether the board has adopted a policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees (aka "Rooney Rule").
- Board skills disclosure.

We do not intend to make any vote recommendations on the basis of this disclosure during the 2021 proxy season. We will, however, be considering companies' disclosure when assessing their overall governance, and it may be a contributing factor in our recommendations when additional board-related concerns have been identified.

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