Board Diversity Series: Voices of proxy advisers and other influences

January 10, 2017

Amanda Linett

Proxy advisers such as Institutional Shareholders Services (ISS) and Glass Lewis have started to respond to the changes in corporate governance relating to gender diversity, and to encourage further development. While neither ISS nor Glass Lewis have taken any specific positions on gender diversity, their approaches do signal growing support for board diversity and renewal. In its **2017 Proxy Season Guidelines** (2017 Guidelines), Glass Lewis notes that “nominating and governance committees should consider diversity when making director nominations within the context of each specific company and its industry” and that “shareholders are best served when boards make an effort to ensure a constituency that is not only reasonably diverse on the basis of age, race, gender and ethnicity, but also on the basis of geographic knowledge, industry experience, board tenure and culture.”However, with respect to the term and age limits, Glass Lewis has maintained in its 2017 Guidelines that rather than relying solely on age or tenure limits, boards should evaluate whether changes in board composition are necessary based on an analysis of the company’s desired skills and experience, as well as the results of director evaluations. Glass Lewis reiterates that director experience is a valuable asset to shareholders but supports the routine evaluation of directors and periodic board refreshment. Glass Lewis continues to believe that, once adopted, a term limit should not be waived. Consequently, it will consider recommending that shareholders vote against members of nominating and/or governance committees where such a waiver has been granted without a reasonable explanation.

Similarly, while not specifically addressed in its **2017 Canada Proxy Voting Guidelines for TSX-Listed Companies**, in its QualityScore Overview and Updates,[i] pursuant to which certain issuers are rated on their governance practices, ISS has included the number of women on an issuer’s board and the proportion of women on boards as factors scored in all regions, including Canada and the U.S. In support of this position, ISS points to studies showing that increasing the number of women on boards of directors correlates with better long-term financial performance. With respect to director term limits, the proportion of non-executive directors on the boards with lengthy tenure is now also a factor scored by ISS in Canada. ISS considers “lengthy tenure” by non-executive directors as greater than nine-years of service (which is on the low end of the historical nine to 12 years typically applied). It notes that tenure of more than nine years potentially compromises a director’s independence. While recognizing the existence of power imbalances between new and senior board members, as well as divergent loyalties to the issuer and management team depending on the length of time spent with either group, ISS believes that a balanced board with a diversity of viewpoints and experience is ideal.

In October of 2015, the **Canadian Coalition for Good Governance**(the CCGG) also published a new policy on board diversity.[ii] Acknowledging the general benefits of diversity and the persistent under-representation of women, the CCGG notes that gender diversity is an appropriate manner for improving board quality. Moreover, the CCGG believes that corporate response to the board diversity issue should go beyond the CSA-mandated “comply or explain” approach and expresses the view that the CSA should be recommending the adoption of gender diversity policies in corporate governance "best practices" guidelines.

The CCGG further recommends more disclosure regarding the board recruitment process and that the process be professionalized, as opposed to relying on the existing board's circles of relationships to identify candidates. Rather than recommending director term limits or mandatory retirement, the CCGG advocates strengthening the annual evaluation process of the full board, board committees and individual directors in a manner that incorporates consideration of the balance between experienced and fresh insights in board composition.[iii]

In 2015, nine large U.S. pension funds proposed an initiative aimed at enhancing U.S. disclosure requirements regarding diversity of director candidates. This petition to the SEC requested disclosure of candidates' gender, race, and ethnicity to be presented in a chart or matrix form. The petition also argued that current disclosure requirements lack clarity, making it difficult for investors to determine the gender, racial and ethnic diversity of directors. The SEC has indicated that it intends to consider these requests as part of its ongoing review of modernizing certain business and financial disclosure requirements in Regulation S-K termed the "*Disclosure Effectiveness Initiative*".

In Canada, Oceanrock Investments Inc. and the Shareholder Association for Research and Education (SHARE), both shareholders of Restaurant Brands International (RBI), recently requested RBI write a formal diversity policy as well as provide disclosure as to how and when the company intends to increase the number of women on its board of directors and in senior management positions. Although RBI declined to recommend how shareholders should vote, it amended its director nomination process to consider diverse candidates.[iv] In the United States, 94 similar proposals with specific focus on governance relating to board diversity were submitted by public sector pension funds and entities in the 2016 proxy season.[v]

Other notable actions taken by institutional shareholders and others include:

- The Thirty Percent Coalition set the goal of attaining 30 percent female representation on U.S. public company boards. Its membership includes companies, foundations, individuals, funds, and major institutional investors such as CalPERS and CalSTRS.
- The Australian Council of Superannuation Investors (ACSI) set the goal of attaining 30 percent female representation on ASX 200 boards by 2017. This council is composed of a collaboration of funds and asset owners.
- State Street Global Advisors opened an exchange traded fund called the SPDR SSGA Gender Diversity Index ETF (SHE) which invests in U.S. companies with the highest levels of gender diversity in their sectors[vi]

The road from here

The global consensus as to the desirability of gender diversity on public boards is evidenced by the consistent implementation of various regulatory and legislative models throughout the world.[vii] However, **CSA Multilateral Staff Notice 58-308 Staff Review of Women on Boards and in Executive Officer Positions**[viii] (**discussed earlier**) demonstrates that the upward trend in the representation of women on boards in Canada is slow and that the country remains behind other developed nations when it comes to gender-diverse boards. The Catalyst Report (**discussed earlier**) discusses in greater detail how the countries with the best representation of women on boards are those with more robust laws and regulations. For example, Norway, Finland, and France have the largest percentage of women with company seats (33.5%, 29.9%, and 29.7% respectively) and all have government-legislated quotas for advancing female representation.[ix]

While the increase in women's board representation of TSX-listed issuers can be attributed, at least in part, to the mandatory disclosure model, there is also generally consensus on the room for improvement.[x] Beyond a social issue or an issue of equity, this is alsoan important consideration for capital markets generally given some early research that demonstrates that boards with diverse members function better and increased representation of women may be correlated with better company performance.[xi] A 2015 MSCI report indicated that companies in the MSCI World Index with strong leadership generated a return on equity of 10.1 percent per year, as opposed to 7.4 percent for those without such leadership. The International Monetary Fund demonstrated that adding an additional woman to senior management or the board of directors of a company, without changing the size of the board, is associated with three to eight percent higher return on assets.[xii] According to the evidence from global models, going beyond more compliance is the most effective way to achieve results. The OSC's director of corporate finance has said it is necessary to establish a culture of diversity to reap the results. This culture of diversity will not only lead to fiscal results but will create a corporate environment that eliminates cognitive bias at the highest level.[xiii]

*This article is the fourth and final in a four-part series of articles discussing the Ontario Securities Commission's diversity disclosure requirements adopted in 2014, and how the issue of board diversity has evolved in Canada since then. The **first post in the series** addressed the disclosure rules that were adopted by the Ontario Securities Commission and other Canadian securities regulators. The **second post** discussed the results that the disclosure rules have achieved. The third post discussed recommendations for accelerating progress.*

[i] "ISS QualityScore Overview and Updates", *ISS*, November 2016. In November 2016, ISS replaced its corporate governance rating system known as QuickScore with QualityScore to reflect the qualitative factors considered in the rating analysis.

[ii] "CCGG Policy: Board Gender Diversity", *Canadian Coalition for Good Governance*, October 2015.

[iii] Mike Devreaux, Benoit Dubord, and Ramandeep Grewal, "Canada's governance landscape – key issues for the 2016 proxy season", *Canadian Securities Law Blog*, February 4, 2016.

[iv] "Tim Hortons Parent Company Rejects Gender-Diversity Proposal" *The Globe and Mail*, June 9, 2016.

[v]"2016 Proxy Season Review", *Sullivan & Cromwell* LLP, July 11, 2016.

[vi]David A. Katz, Laura A. McIntosh. "Corporate Governance Update: Gender Diversity on Boards: The Future Is Almost Here", *New York Law Journal*, March 24, 2016.

[vii] *Ibid.*

[viii] CSA Multilateral Staff Notice 58-308 *Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101 Disclosure of Corporate Governance Practices*. Staff Notice 58-308 is the second notice published by the CSA summarizing the findings of the CSA's review of the corporate governance disclosure of TSX-listed issuers. In September 2015, the CSA published the results of its first review of thecorporate governance disclosure of 722 issuers in CSA Multilateral Staff Notice 58-307 *Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101 Disclosure of Corporate Governance Practices*.

[ix] Catalyst, "Gender Diversity on Boards in Canada: Recommendations for Accelerating Progress", June 7, 2016, http://www.catalyst.org/knowledge/gender-diversity-boards-canada-recommendations-accelerating-progress.

[x] Canadian Research Team, “2016 Proxy Season Review”, *ISS,* March 4, 2016.

[xi] Mary Jo White, “Focusing the lens of disclosure”, *Harvard Law School Forum on Corporate Governance and Financial Regulation,* June 28, 2016.

[xii]*https://www.msci.com/documents/10199/04b6f646-d638-4878-9c61-4eb91748a82b*.

[xiii] Robert Thompson, “You Gotta Own It” *Listed*, Spring 2016.