

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

June 17, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: June 20, 2019, “Diversity in the Boardroom: Examining Proposals to Increase the Diversity of America’s Boards”

The Committee on Financial Services will convene a hearing entitled, “Diversity in the Boardroom: Examining Proposals to Increase the Diversity of America’s Boards,” at 10:00 a.m. on Thursday, June 20, 2019, in room 2128 of the Rayburn House Office Building. The witnesses for this one-panel hearing are:

- Ms. Chelsa Gurkin, Acting Director, Education, Workforce and Income Security Team, U.S. Government Accountability Office (GAO)
- Mr. Luke Visconti, Founder and Chairman, DiversityInc
- Mr. Ron Lumbra, Managing Partner, Heidrick and Struggles
- Ms. Linda Akutagawa, Chair, Alliance for Board Diversity
- Ambassador Vilma Martinez (Ret.)
- Dr. Stephanie Creary, Assistant Professor of Management, Wharton School of Business, University of Pennsylvania

Overview

This hearing will examine options for diversifying the gender, racial and ethnic composition of corporate and federal boards. In addition, three legislative proposals to address board diversity will be presented for discussion during the hearing.

Diverse Boardrooms Can Enhance Industry Competitiveness

Public companies and federal regulators assemble boards as a forum for shareholder and industry accountability. Among other duties, board directors often advise on or approve of leadership selections and may establish oversight committees. Some board directors are also compensated for their work. T. Rowe Price noted in its 2018 proxy voting guidelines that “boards lacking diversity represent a suboptimal composition and potential risk to company’s competitiveness over time.”¹ Similarly, over 90 percent of companies that participated in Deloitte’s 2017 board diversity survey agreed that increased board diversity will improve their companies’ ability to innovate as well as their overall business performance.² After analyzing the performance of approximately 90 U.S. bank holding companies, two federal reserve

¹ T. Rowe Price Group, *Proxy Voting Guidelines* (2018).

² Deloitte, *Seeing is believing: 2017 board diversity survey* (2017).

economists also concluded that banks with more gender diversity on their boards (those with a female share of about 13 to 17 percent) perform better.³ Moreover, they suggested that “banks' continued voluntary expansion of board gender diversity is likely to bring performance benefits, provided that the banks are well-managed or capitalized.”⁴

Although federal boards may have some constraints and guidelines that make them atypical of corporate boards, they are similarly charged with governance activities, including leadership and accountability for board diversity. For example, the boards of each of the 11 Federal Home Loan Banks (FHLBank) annually report their board diversity statistics as required by the Housing and Economic Recovery Act of 2008.⁵ When selecting board candidates, Federal Reserve banks also review current demographics and areas of expertise to fill board vacancies.⁶

Boardroom Seats Remain Mostly Occupied by White Men

Although companies and federal entities have acknowledged that their boards should reflect the diversity of their shareholders, consumers and other industry participants, the majority of corporate and federal board appointees continue to be white men. The Alliance for Board Diversity reported that among Fortune 500 companies, 80.7% of new board directors in 2017 were white men.⁷ Federal boards have similar statistics. For example, GAO reported that on FHLBank boards, “racial [and] ethnic minorities have limited representation in board leadership positions.”⁸ Although the Federal Reserve System was established in 1913,⁹ it was not until 2017—over a century later—that the first African American and openly gay man was appointed as a federal reserve bank president and chief executive officer, a rotating position on the Federal Open Market Committee.¹⁰

Some reports suggest that women and minorities have made more progress in board representation in recent years; unfortunately, the rate of change is still slow and, in some cases, stagnant. For instance, Heidrick & Struggles' Board Monitor annual report noted that women were appointed to more than 38% of all independent board seats at Fortune 500 companies in 2017.¹¹ Further, one Native American was appointed in 2017, the first such corporate board appointment documented by Board Monitor since it began tracking in 2009.¹² Conversely, for the same period, Board Monitor tracked that the share of new corporate board appointments for Latino and Asian Americans remained at 6 percent. Research sponsored by the Alliance for Board Diversity found that although African-American women (increased by 26.2

³ Owen, Ann L., and Temesvary, Judit, *Gender Diversity on Bank Board of Directors and Performance*, FEDS Notes (February 12, 2019).

⁴ Ibid.

⁵ Pub. L. No. 111-289, § 1116(4), 122 Stat. 2654, 2682 (2008) (codified at 12 U.S.C. § 4520(d)).

⁶ Government Accountability Office (GAO), *FEDERAL RESERVE BANK GOVERNANCE: Opportunities Exist to Broaden Director Recruitment Efforts and Increase Transparency*, GAO-12-18 (October 2011).

⁷ Alliance for Board Diversity, *Missing Pieces Report: The 2018 Board Diversity Census for Women and Minorities on Fortune 500 Boards*, as prepared by Deloitte (2018).

⁸ GAO, *FEDERAL HOME LOAN BANKS: Steps Have Been Taken to Promote Board Diversity, but Challenges Remain*, GAO-19-252 (February 2019).

⁹ Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 251 (1913).

¹⁰ House Committee on Financial Services, *Chairwoman Waters Introduced by Dr. Raphael Bostic, President & CEO of the Federal Reserve Bank of Atlanta During Capitol Hill Reception; Waters is the First Woman & First African American Chair of the Financial Services Committee; Bostic is the First African American & First Openly Gay President of a Regional Federal Reserve Bank*, press release can be found at <https://waters.house.gov/media-center/press-releases/chairwoman-waters-introduced-dr-raphael-bostic-president-ceo-federal> (January 4, 2019).

¹¹ Heidrick & Struggles, *Board Monitor Appointments of Women to Boards Hit Record High* (2018)

¹² Ibid.

percent) and Asian women (increased by 38.6 percent) made the largest percentage increases in corporate board seats gained at *Fortune 100* and *500* companies gained in 2018, the total numbers are still small in comparison to white males.¹³ For example, in 2018, white men occupied 750 corporate board seats at *Fortune 100* companies compared to 17 Asian American women and 42 African American women at the boardroom table.

The Alliance report also noted that among Fortune 100 companies, minority men have made an additional 1 percent gain in corporate board seats from 2016-2018, which is almost as much progress as achieved over the past 12 years.

Call for New Strategies to Seat Diverse Talent at the Boardroom Table

Deloitte's 2017 board diversity survey found that "although 90 percent of [board] directors want greater diversity, about half [of] surveyed organizations lack a process for recruiting candidates with diverse skills sets or new perspectives."¹⁴ Solutions to increase board diversity include:

Required Disclosure of Corporate Board Demographics

Public companies are currently required to report the minimum skills, experiences and attributes required of their board members in their public, annual reports to the Securities and Exchange Commission (SEC).¹⁵ However, in March 2015, several large institutional investors petitioned SEC for rulemaking to require issuers to specifically disclose in matrix format the race, gender and ethnicity of their board members.¹⁶ To create transparency and accountability around who is serving on corporate boards, state and federal lawmakers have proposed that companies be required to disclose demographic information about the composition of their boards.

- **States have passed laws regarding board diversity requirements:** The Illinois General Assembly recently passed the Diversity Disclosure Bill that will require most Illinois based companies to annually report detailed demographic board diversity information to the Illinois Secretary of State.¹⁷ California, Massachusetts and Pennsylvania have also passed laws requiring gender diversity on corporate boards.¹⁸
- **Rep. Maloney's bill on board diversity disclosure:** Rep. Carolyn Maloney's bill, H.R.3279, would affirmatively require issuers to specifically disclose to shareholders with respect to the gender, racial, and ethnic diversity of their board of directors, among other things. For example, SEC would also be required to establish a diversity advisory group and to report annually to the House Committee on Financial Services on issuer board diversity data.

¹³ Missing Pieces report, 2018.

¹⁴ Deloitte board diversity survey, 2017.

¹⁵ SEC's guidance stated 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 referred to above (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background) of an individual who has consented to the company's disclosure of those characteristics, we would expect that the company's discussion required by Item 401 would include, but not necessarily be limited to, identifying those characteristics and how they were considered." SEC's Compliance and Disclosure Interpretations for Regulation S-K (February 2019) at <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#116-11>.

¹⁶ California Public Employees Retirement System, et.al. Petition For Amendment Of Proxy Rule Regarding Board Nominee Disclosure – Chart / Matrix Approach (March 31, 2015).

¹⁷ Blatchford, John T., et.al. *Illinois General Assembly Passes Bill to Require annual Reporting of Board Diversity Information*, National Law Review, (June 5, 2019).

¹⁸ Hentze, Iris, Gender Diversity on Corporate Boards: What Will 2019 Bring?, The NCSL Blog (May 31, 2019).

- **Rep. Meeks’ Corporate Diversity Bill:** Rep. Gregory Meeks’ bill, H.R. 1018, would require public companies to annually disclose the voluntarily, self-identified gender, race, ethnicity and veteran status of their board directors, nominees, and senior executive officers. Among other requirements, the SEC Office of Minority and Women Inclusion would publish best practices for compliance with diversity disclosures.

Investors and Institutional Funds Pushing for More Board Diversity

Investors, proxy firms, large pension funds and others have commented that diversity starts at the board level,¹⁹ and therefore conclude that boards “composed of diverse individuals...are appropriate to [a] company’s current and long-term business needs.”²⁰ For instance, Institutional Shareholder Services (ISS), which develops corporate governance solutions for companies, recommended in its 2018 proxy voting guidelines that shareholders should, “generally, vote for proposals requesting a company disclose its diversity policies or initiatives.”²¹ In its review of board diversity for 2019, ISS also reported that as board renewal rates continue to increase, board diversity, among other things, is a high-priority for companies and investors.²² As of March 31, 2018, Washington State Investment Board (WSIB) manages \$129.1 billion in investments for 17 retirement plans for firefighters, judges, teachers and others in Washington State.²³ As of March 31, 2018, the fund had a total of \$129.1 billion assets under management.²⁴ In their 2018 proxy voting policy, WSIB said that they “look for boards with talented directors who have a diversity of backgrounds and experience that will enable them to understand the issues particular to the company where they serve, and who collectively have the ability to review and judge the critical issues they decide on behalf of shareholders.”²⁵

Solutions to Identify Diverse Board Director Candidates

There are several proposals about how companies and federal entities could better identify new pools of talent and more effectively consider and appoint women and minorities for board director opportunities.

- **Rep. Beatty’s bill on interviewing at least one woman and minority board candidate:** Rep. Joyce Beatty’s bill, H.R. 281, would require federal reserve banks to interview at least one individual reflective of gender diversity and at least one reflective of racial or ethnic diversity when appointing federal reserve bank presidents.
- **Fill interim board seats with women and minority candidates who are not necessarily CEOs:** GAO reported that FHLBank interim board seats could be filled with women and minority candidates and that board candidate searches should look beyond the CEO ranks, which increases the likelihood of identifying and ultimately selecting a woman or minority for the position. Further,

¹⁹ National Association of Corporate Board Directors, *Investor Perspectives on Board Diversity*, (2018). A

²⁰ California State Teachers’ Retirement System (CalSTRS), *California State Teachers’ Retirement System Corporate Governance Principles*, CalSTRS (2017).

²¹ Institutional Shareholder Services (ISS), *United States Proxy Voting Guidelines: Benchmark Policy Recommendations*, ISS (2018).

²² ISS analysis is based on its review of 19,791 directorships in the Russell 3000. See *U.S. Board Diversity Trends in 2019*, (May 31, 2019).

²³ *Investor Perspectives on Board Diversity* (2018).

²⁴ *Ibid.*

²⁵ Washington State Investment Board, *Global Proxy Voting Policy* (2017).

“when a female or minority director is elected for an interim term, the election increases the likelihood of the director being elected by the member institutions for a following full term.”²⁶ Over two years ago, the Federal Housing Finance Agency, FHLBanks’s regulator, also allowed the eleven FHLBanks to add an additional independent director to expand their diversity, but only seven chose to do so.²⁷

- **Consider candidates beyond corporate America that have transferable executive experience:** In an article on board candidate searches, experts from the executive search firm Heidrick and Struggles recommended that “other possibilities for diverse candidates may be found among presidents of universities, retired career military officers, and former government officials.”²⁸ Even though some boards have been initially reticent about such choices, the article noted that such practitioners have previously been trusted advisors and are experienced executives. Additionally, such candidates have well-honed leadership and influencing expertise that should be a welcome addition on boards.²⁹
- **Regularly analyze diversity data to identify diversity deficiencies and best practices:** Some corporations confidentially share diversity data with trade and industry organizations for analysis. DiversityInc. collects such information and annually recognizes the top organizations that participate in its diversity survey.³⁰ For companies ranked among the “Top 10” from the survey: 1) 80% link executive compensation to diversity metrics; 2) 85.7% of CEOs and their direct reports participate in mentoring; and 3) 34.2% of their board seats are occupied by women.³¹ Similarly, Chairwoman Waters and Diversity and Inclusion Subcommittee Chair Beatty also sent notices to 44 bank holding companies (those with assets over \$50 billion) requesting their diversity and inclusion data and policies from 2015 to the present.³²

²⁶ GAO-19-252. By regulation, when a director leaves the board in mid-term, the remaining board directors may elect a new director for the remaining portion of the term.

²⁷ Waters, Maloney and Beatty Statements on GAO Report on Diversity at Federal Home Loan Banks, press release (March 20, 2019) at <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=402485>.

²⁸ Lumbra, Rom and Reese, Victoria, *Getting board diversity out of the doldrums*, Heidrick and Struggles (September 29, 2016).

²⁹ Ibid.

³⁰ To be eligible for the list, participants must meet certain criteria, such as they must have at least 1,000 U.S. employees and submit a notarized form signed by either the CEO, the chief human resources officer (CHRO) or a corporate officer (other than the chief diversity officer or person responsible for diversity & inclusion) affirming that all data submitted is accurate. See DiversityInc website for full survey methodology and requirements at <https://www.diversityinc.com/diversityinc-top-50-methodology/>

³¹ See DiversityInc website, 2019 Top Facts and Figures at <https://www.diversityinc.com/facts-figures/>

³² Waters and Beatty Continue Push for Diversity Data from Big Banks, press release (June 6, 2019) at <https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=403860>.