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ONE GOAL, DIFFERENT PATHS TO A DIVERSE BOARD

October 16, 2019
By Bonnie W. Gwin

It seems that almost every country, company, and board is focused on achieving greater governance diversity. It is core to thriving in today's complex global businesses. Achieving it is in every company's interest, considering the growing and indisputable body of evidence underscoring the advantages a diverse board and diverse leadership confer—whether in terms of shareholder value or, equally important, but harder to measure, in terms of reputation value. Worth noting, however, is that companies are taking vastly differing paths toward this common goal.

Our firm takes a broad view of diversity, which we define as the mixture of experience, backgrounds, and functional skills boards require to advise on and oversee companies' strategies and senior leaders. And we recognize that depending on an individual country's or company's culture and regulatory practices, that mix, and the way to get there, will vary. Useful approaches taken in various countries that can highlight different paths to success follow.

Global Practices

Heidrick & Struggles' recent Board Monitor US 2019 and Board Monitor Europe 2019 reports capture a snapshot of diversity on boards across these key regions:

- Of the 462 newly filled nonexecutive director seats at Fortune 500 companies in 2018, 39.6 percent went to women and 23 percent to ethnic or racially diverse candidates.
- Of the 503 newly filled nonexecutive director seats on the boards of large European companies in 2018, 38 percent went to women and 36 percent to candidates from countries other than where their company is headquartered. (Companies studied were listed on the following exchanges: FTSE 250, CAC 40, DAX 30, IBEX 35, AEX 25, PSI 20, and ISEQ.)

Comparing Europe and the US, and also looking more granularly at statistics for board diversity within individual countries in Europe, we see a great deal of variation in approach. Generally speaking, those countries that have legally mandated gender diversity on boards lead the pack. Consider France, where 43.4 percent of directors on the boards of the 120 largest French companies are female, and Norway, with 42.1 percent female directors under the same conditions. Others, such as the United Kingdom, which is on track to reach 33 percent female directorship by

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2020, have taken a voluntary approach to achieving gender parity on boards. Still others, such as Spain and Switzerland, with "soft laws" that don't impose sanctions on noncompliant companies, lag behind with 22 and 21.3 percent female representation on public company boards, respectively.

US companies are in a similar position to Spain and Switzerland and, despite the 40 percent of new board seats that went to women in the United States in 2019, women still comprise only 22.5 percent of the total seats on Fortune 500 boards. This is so even though US companies are among those feeling significant pressure to demonstrate diversity on their boards, including from key stakeholder groups that have the power to spur investment in particular companies—or withhold it.

Useful Board Practices

In response to these demands, US boards are enforcing their own measures to ensure greater diversity, and to reach their goals with greater speed. Looking at successes around the world that any nominating committee is capable of putting into action, whether regulations require them to do so or not, we recommend a few clear steps that will lead to more effective boards that are better equipped for future challenges:

1. Set the board up for success by elevating board effectiveness metrics. Many boards have institutionalized regular assessments geared toward maintaining a more productive team. When diversity is viewed as a key to greater board effectiveness, metrics for diversity are included in such assessments because diversity enables access to a range of views and innovative solutions in board discussion and decision making. Consider adding inclusion performance to the board assessment to measure the success of the board's recruitment and onboarding efforts.

2. Align board competencies with company strategy. Strong board leaders recognize that they need board members whose expertise ranges beyond that of traditional CEO candidates. Future-fit directors possess crucial operating experience and institutional knowledge. Modern boards also often require additional competencies—including digital, leadership development, and international expertise—if they are to compete in a rapidly and continually transforming business environment. Nominating committees seeking these skills will almost certainly seek directors who are more diverse by default, as directors with the skills needed now tend to exist among people of different genders, ages, areas of functional expertise, nationalities, and industry backgrounds.

3. Mandate diversity as a criterion for every director search. Boards increasingly understand that diversity doesn’t happen by accident, and that natural evolution needs to be pushed along. In that spirit, many leading companies now require a diverse slate of director candidates for each and every director search. This practice is increasing awareness of the diverse talent that does exist, and is making a difference in the forward progress of board diversity overall.

Whether in Europe or in the US, whether the catalyst for greater diversity on boards is principally external or internal, the objective is the same. The faster boards work toward transforming into diverse, strategically aligned teams, the more effectively they will be able to serve their companies and all their stakeholders.

Ref. https://blog.nacdonline.org/posts/one-goal-different-paths-to-a-diverse-board

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ESG RISKS TRICKLE INTO FINANCIAL FILINGS

October 21, 2019 By Leah Rozin

Investors in 2019 have increasingly turned their attention to environmental, social, and governance (ESG) topics, and are demanding more information on how companies are thinking about the potential long-term risk and opportunities related to specific environmental and social factors. As companies prepare for the 2020 proxy season and engage with shareholders, directors should understand the current state of ESG risk reporting in public filings.

Standards setters such as the Sustainability Accounting Standards Board and the Taskforce on Climate-Related Financial Disclosures provide frameworks to disclose ESG risks that could have a financial impact. Despite, or perhaps due to, the myriad standards and suggested disclosure frameworks, companies struggle to identify the most relevant risks to disclose, and where in their reporting to disclose them. In 2019, 66 percent of companies in the Russell 3000 Index discussed ESG risk but approaches varied widely.

To help directors and their management teams understand the current landscape of ESG risk disclosure, NACD mined MyLogIQ – Multidimensional Public Company Intelligence's data to identify trends in 10-K filings, specifically in the risk-factors section and in management's discussion and analysis of financial condition and results of operations (MD&A). While companies may describe risks anywhere in their 10-K filings, they must list all major ones in the risk-factors section. Previously, risks were listed in the MD&A, a practice that continues in some companies.

Our study compared disclosures by industry, using MyLogIQ's classification for eight sectors. Almost all energy and mining companies discussed ESG risk in their 10-K, with the lowest amount of ESG risk disclosure in the entertainment, media, and communications industry at a still relatively high 41 percent of companies.

A review of how three key ESG risks—climate change risk, human capital management risk, and water scarcity risk—are being disclosed follows:

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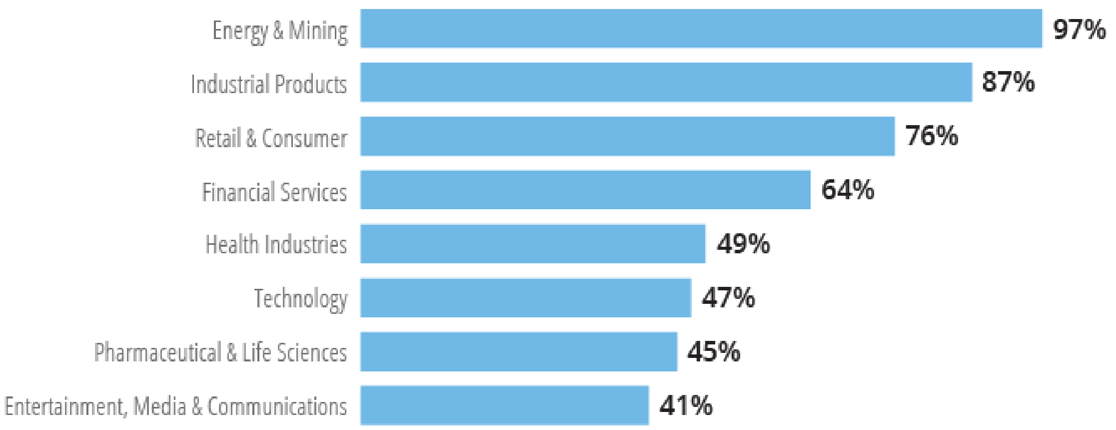
10-K ESG Risk Disclosure
Percent of each sector, Russell 3000



Source: Data and company intelligence collected from MYLOGIQ - Multidimensional Public Company Intelligence, NACD analysis (as of October 2019).

Climate Change Risk

Thirty percent of Russell 3000 companies discussed climate change as a risk in their 10-K statement, with only 3 percent of companies discussing climate change risk in the MD&A section. Predictably, the energy and mining sector had the most disclosure on climate change risk. Retail and consumer sector companies, which are not thought of traditionally for being exposed to climate change risk, also had a high rate of disclosure, citing damage to their supply chain and access to raw materials as risks.

Disclosures for every sector focused on the risk of regulatory and market responses to climate change, including legislative regulation of air emissions, caps, and carbon taxes. Other companies were more detailed in their discussion of climate change risk as it relates to their specific operations, such as Monster Beverage Co.'s 10-K, which states that, "In addition, public expectations for reductions in greenhouse gas emissions could result in increased energy, transportation and raw material costs, and may require us to make additional investments in facilities and equipment. As a result, the effects of climate change could have a long-term adverse impact on our business and results of operations."

The high volume of disclosure in this category could be driven by 2010 amendments to Regulation S-K, one of two key regulations governing public company disclosures. Regulation S-K, adopted in 1977, affects nonfinancial disclosures. Under the 2010 amendments to Regulation S-K, the US Securities and

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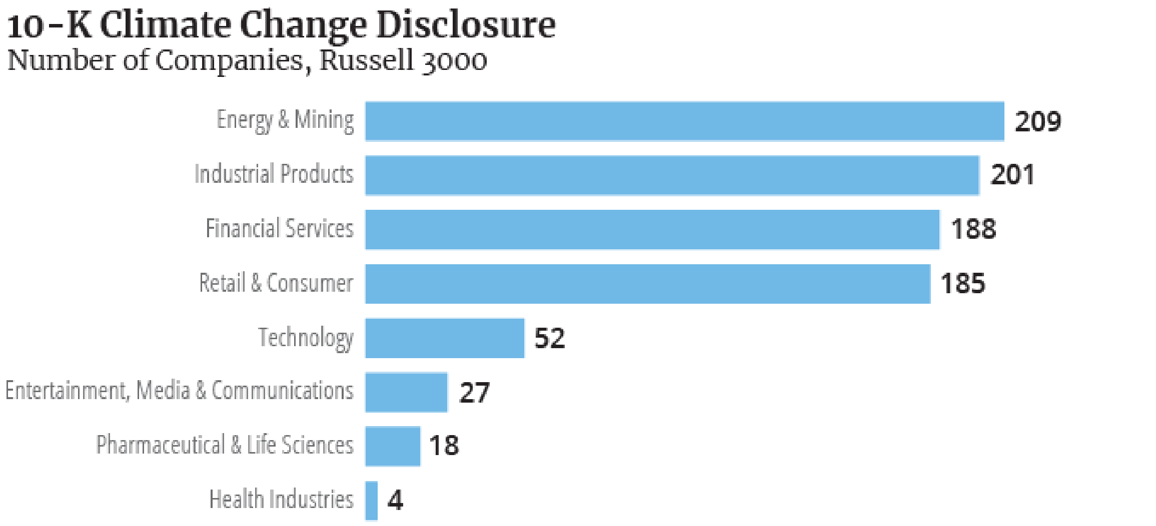

Source: Data and company intelligence collected from MYLOGIQ - Multidimensional Public Company Intelligence, NACD analysis (as of October 2019).

Exchange Commission (SEC) requires that "registrants whose businesses may be vulnerable to severe weather or climate related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents."

While there have been no recent changes to mandatory climate change disclosure, in 2019 thus far there have been 52 legislative bills put forth on climate that could impact mandatory disclosure in the future. Directors across industries would do well to heed the trends in climate disclosures and task their company's government relations departments with watching and reporting on any legislative developments that might impact the company's disclosures in 2020 and beyond.

Human Capital Management

The Human Capital Management Coalition defines human capital management as encompassing "a broad range of corporate practices related to the management of employees, including, but not limited to, hiring and retention, employee engagement, training, compensation, fair labor practices, health and safety, responsible contracting, ethics, desired company culture, and diversity, both with respect to a company's direct employees and to the employees of vendors throughout the company's supply chain." This disclosure category is particularly relevant for companies moving into 2020 given the August 8, 2019, proposed amendments by the SEC to Regulation S-K.

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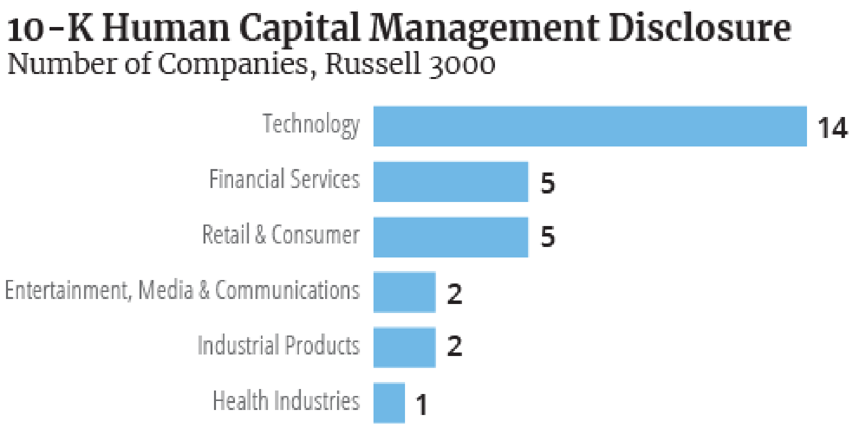
The proposed amendments include a requirement to disclose human capital measures that management focuses on in 10-K filings, if those measures are material to the business. The SEC cites in their potential amendments a 2017 rulemaking petition from a group of 25 institutional investors, representing $2.8 trillion in assets, which called for mandatory disclosure on human capital management performance, policies, and practices. In 2019, just 8 percent of the Russell 3000 disclosed a risk for human capital management with the highest prevalence of disclosure at technology companies. (It is worth noting that this is reflective of the exact phrase, “human capital management,” not elements of the term such as retention, talent, and so on.)



Source: Data and company intelligence collected from MYLOGIQ - Multidimensional Public Company Intelligence, NACD analysis (as of October 2019).

Water Scarcity

Water scarcity and water crises are top global risks, according to the World Economic Forum. A recent Ceres report discusses water risk in more detail, stating, “Many [asset] managers reported capturing information such as the percentage of corporate facilities in high water risk areas, and how water- or waste-intensive a company or product is overall.” Many investors are looking for more information on the risks to a

company or product is overall.” Many investors are looking for more information on the risks to a company’s operations from water scarcity, but only a few companies are disclosing. Just 32 percent of Russell 3000 companies discussed water risk or water scarcity risk in their 10-K disclosure. Eighty-seven percent of these disclosures were found in the risk-factors section, with 13 percent found in the MD&A.

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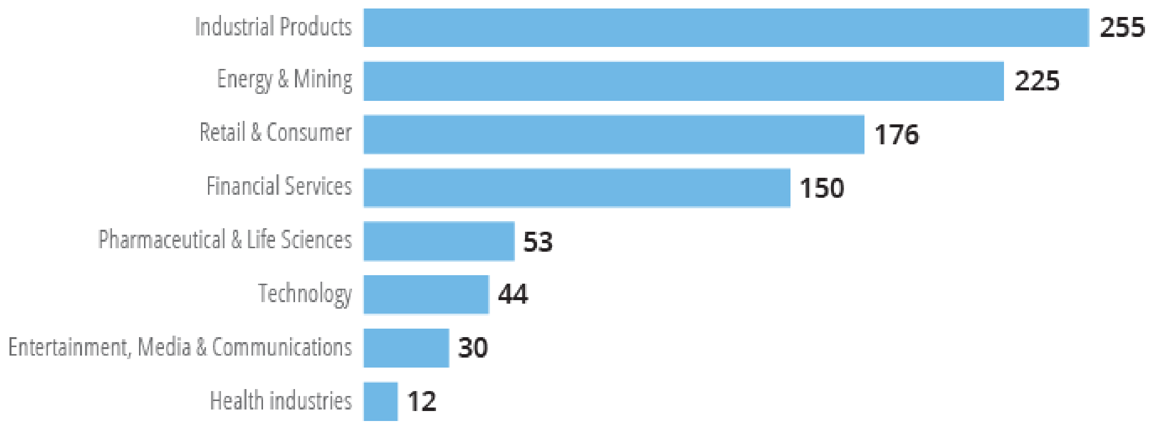
10-K Water Scarcity Disclosure
Number of Companies, Russell 3000



Source: Data and company intelligence collected from MYLOGIQ - Multidimensional Public Company Intelligence, NACD analysis (as of October 2019).

Questions Directors Should Ask Management

Disclosures for this risk range from the inclusion of water shortages a laundry list of other risks to detailed discussions of the potential implications of a water crisis on their operations. For example, Golden Entertainment discloses that "Our properties use significant amounts of water, electricity, natural gas and other forms of energy. Our Nevada properties in particular are located in a desert where water is scarce and the hot temperatures require heavy use of air conditioning. While we have not experienced any shortages of energy or water in the past, we cannot guarantee you that we will not in the future. We expect that potable water in Nevada, where the majority of our facilities are located, will become an increasingly scarce commodity at an increasing price."

As we enter 2020 proxy season, investor expectations of ESG risk disclosure is unlikely to wane.

Directors can prepare their management teams to demonstrate effective oversight to investors and stakeholders by asking them the questions listed below.

- Has our company identified the most salient environmental, social, and governance (ESG) risks to our business operations?
- If the company has identified risks, are they incorporated into our broader enterprise risk management system?
- Are our disclosure practices around key ESG risks in line with those of our industry and proxy peers?
- What questions are shareholders, regulators, employees, customers, or other stakeholders asking about long-term strategy and the potential impact of ESG risks on corporate performance?

Ref.
https://blog.nacdonline.org/posts/principles-oversight-digital-transformation