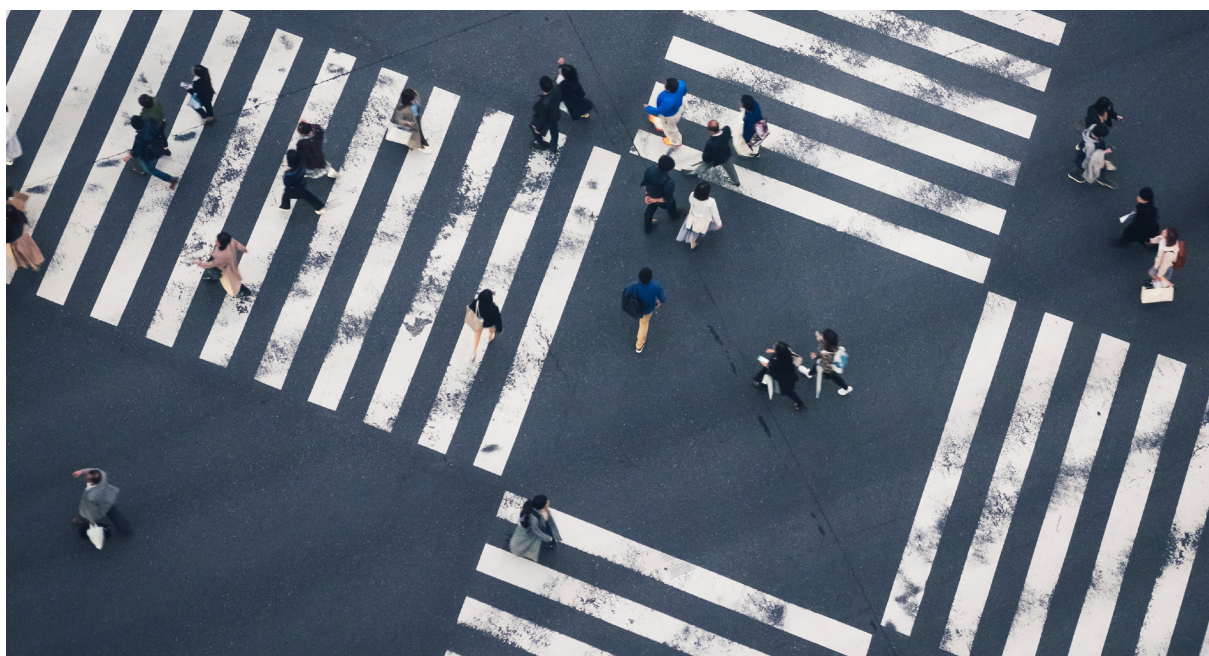


# DE&I State of Play:

## Without a Regulatory Framework, Investors Demand Transparency

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At his March 2<sup>nd</sup> confirmation hearing before the Senate Banking Committee, President Biden’s nominee to chair the Securities and Exchange Commission, Gary Gensler, voiced support for the SEC’s role in strengthening corporate diversity. In response to questioning from Sen. Pat Toomey (R-Pennsylvania) arguing that corporations should not face mandates to disclose “immaterial” diversity, climate risk, or political spending information, Gensler said, “It’s about investors making a choice as to what’s significant, or what’s material to be more accurate.” Gensler’s comments encapsulate the trend that social, investing, and government forces are coming together to drive transparency and progress in the corporate DE&I space. In a similar vein, acting SEC Chair Allison Herren Lee voiced support for “require[ing] disclosure of workforce diversity data at all levels of seniority and strengthen[ing] our guidance on disclosure of board candidate diversity characteristics.”

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Lee's comments come on the heels of years of individual states' efforts to introduce legislation mandating that public corporations disclose and improve the gender and racial diversity of corporate boards. While these efforts are moving the needle, it's the investing community that's the true change agent. Investors, including individual shareholders, institutional investors, and corporate governance agencies, are increasingly pushing for standardized and consistent disclosures to benchmark companies, uncover risks and exert pressure on those that are underperforming on diversity, equity and inclusion (DE&I). Irrespective of regulation, it's their influence that led 37 of the nation's 100 largest companies to make their EEO-1<sup>1</sup> forms public, up from 25 last fall, and 30 additional companies to pledge to publish that information in the near future<sup>2</sup>.

With growing recognition of DE&I as a driver of business performance, the impulse to mandate diversity improvements not by social contract, but by law, has intensified. To this end, investors and regulators are exploring diversity disclosures, requirements, and improvements concurrently, with each group's efforts reinforcing those of the other. Although legislation exists in few states at the present, trendlines and shifting demographics and expectations of youth groups in the U.S. ensure this space will continue to develop.

### Current Regulatory Landscape

Legislating diversity disclosures and representation is a complex issue that has seen highly different opinions from state to state. Notably, demands from the investing community frequently exceed any legislative

efforts even in states that have made the most progress on this issue.

For instance, disclosures have all but become best practice for companies looking to lead on DE&I. Companies with strong DE&I reporting provide more granular trend data, examining how diverse representation fluctuates across leadership levels or business units (for instance, engineering vs. non-engineering roles, or manufacturing vs. corporate headcount) and reporting diverse make up of new hires and promotions. Although companies have access to gender and racial representation data due to EEO-1 forms, they are also expanding self-ID efforts to better understand other dimensions of diversity in their workforces.

By comparison, to date, all state legislation has focused on only gender or race. To the extent that states have considered setting targets, they have only done so at the board level. Our analysis<sup>3</sup> identified twelve states as having introduced or implemented legislation mandating either the disclosure of corporate diversity statistics and/or representation of diverse groups in positions of power (like corporate boards) by the end of 2020. These states included California, Colorado, Hawaii, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, and Washington state.

### Key Players

The conversation around legally mandated disclosure and representation requirements has elicited support from activists looking to diversify corporations and criticism from detractors who fear new bills create undue burden, particularly for smaller companies.

<sup>1</sup> EEO-1 reports reflect the racial and gender composition of a company's workforce, and all companies with more than 99 employees (and federal contractors with 50 or more employees) must file their EEO-1 forms with the Equal Employment Opportunity Commission.

<sup>2</sup> <https://www.bloomberg.com/graphics/diversity-equality-in-american-business/>

<sup>3</sup> In late 2020, Teneo conducted a research project to understand the landscape of legislation pertaining to corporate DE&I across all 50 states. States were included if their legislatures had introduced or passed legislation that would either require companies to disclose the diversity of their corporate boards or, in some cases, mandate certain gender or racial compositions of Boards of Directors for companies headquartered in-state.

Larger companies with the resources and scale to invest in more comprehensive DE&I initiatives have increasingly spoken out in favor of diversification pledges, but there is limited public support for legislative mandates. Beyond the legislators who introduce these kinds of bills, diversity mandates garner support from advocacy organizations focusing on the needs of underrepresented populations. Groups in favor of legislation typically argue that voluntary progress has proved too slow.

While it is more difficult for organizations to position themselves against this kind of legislation, a handful of firms have done so, primarily by arguing the legislation is unconstitutional. Other groups may contest legislation on the grounds that quotas may do more harm than good for underrepresented groups. In this vein, mutual fund manager Vanguard Group has committed to encouraging companies to make their boards and workforce more diverse but specifically will not set hard targets, with Investment Stewardship Officer John Galloway saying, “We don’t believe in quotas, because we believe they could be counter-productive.”

Of note, Reps. Carolyn Maloney and Gregory Meeks, both New York Democrats on the House Financial Services Committee, recently reintroduced the Improving Corporate Governance Through Diversity Act, which would require public companies to publish diversity data via the SEC. The House passed this act last session, but it was not taken up by the Senate, where Sen. Bob Menendez (D-New Jersey) also recently reintroduced it. Notably, the U.S. Chamber of Commerce has voiced support for the legislation.

### Looking Ahead

With minimal momentum around federal legislative efforts, the new administration could move to incentivize or encourage corporations

to disclose relevant data or implement new diversification practices, such as the Obama-era Fair Chance Business Pledge, which called on companies to address discrimination against applicants with criminal records. Newly activist tendencies at the SEC could also encourage similar initiatives.

Outside the regulatory process, investors will continue to press corporations towards greater DE&I standards. Diversity considerations are now stated criteria in BlackRock’s proxy voting and Goldman Sachs’ underwriting of IPOs. Some companies (including U.S. Bancorp and JPMorgan Chase) have also adopted variations on the “Rooney rule,” a National Football League policy requiring that at least one ethnic-minority candidate be interviewed for all open coaching positions.

Finally, pledges may originate from outside the government but still take on a regulatory cast. Investors may “de facto” legislate diversity disclosure and progress via proxy policies and other engagement because they increasingly see the issue as fundamental to value creation. For instance, NASDAQ has submitted a proposal to the SEC that would create new listing standards – after a phase-in period, most companies would need to have at least one female board director and one who is an “underrepresented minority” or “LGBTQ+” to qualify for the index.

The outlook for the NASDAQ proposal and a timeline for a decision is unclear, as are the trajectories for SEC-mandated disclosures or additional state-level regulations. However, it is evident that movement in this direction will continue. Investors, activists, the broader business community, and the next-generation workforce are coming together, all with the goal of driving companies to pursue voluntary disclosures and ultimately, to push for more diverse and inclusive working environments for all.

## Key Takeaways for Companies

Challenges exist in disclosing DE&I policies, data, and standards. However, the value of transparency continues to outweigh any uncertainty. Recognizing some of the obstacles early on will help in meeting the expectations of investors and other stakeholders.

- Multiple incoming requests for disclosures need to be assessed across a broad spectrum of costs and benefits. Establishing a process, including potentially setting up a cross-functional internal team structure, helps in managing those assessments.
- For large global companies, obtaining DE&I data may conflict with privacy laws in some countries. Understanding what data can be collected and shared in each geographical area is important.

Investors are increasingly seeking standardized data in consistent formats for ease of benchmarking peer companies.

- While the regulatory landscape evolves in what is likely to be increased disclosure, the current frameworks (SASB, GRI) are well recognized sources for providing investors with the ability to benchmark peers.

Managing all stakeholders is important in the process of disclosing DE&I information.

- Include other significant stakeholders such as employees and business and community partners in DE&I transparency and communications plans.
- Be prepared for discussions with shareholders during regular engagements. Also be aware of changing dynamics and trends in different markets and communities.



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