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SEC Provides Guidance on Director Diversity Disclosure

New Compliance and Disclosure Interpretations Encourage Companies to Disclose How Self-Identified Diversity Characteristics of Directors Factor Into Nomination Decisions

SUMMARY

On February 6, 2019, the Securities and Exchange Commission's Division of Corporation Finance released [Compliance and Disclosure Interpretations 116.11 and 133.13](#), which address the disclosure of self-identified diversity characteristics with respect to board members and nominees under Items 401 and 407 of Regulation S-K. The C&DIs provide that to the extent a reporting company's board nominating committee considers self-identified diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background), the SEC would expect the company's disclosure to include identifying those characteristics and how they were considered.

BACKGROUND

Item 401(e) requires a description of the specific experience, qualifications, attributes or skills that led to the conclusion that a person should serve as director. Item 407(c)(2)(vi) requires an explanation of how a board enforces any policies regarding the consideration of diversity in selecting director nominees. Under both Item 401 and Item 407, companies are required to discuss the nominating processes, policies and nominee qualifications.

DISCUSSION

Diversity Discussion Encouraged. The new C&DIs (which are identical) address the question of what disclosure of self-identified diversity characteristics is required under Item 401 or, with respect to nominees, under Item 407. The SEC explains that, "to the extent a board or nominating committee in

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determining the specific experience, qualifications, attributes or skills of an individual for board membership has considered [certain] self-identified characteristics . . . of an individual who has consented to the disclosure of those characteristics,” it would expect the company’s Item 401 discussion to include “identifying those characteristics and how they were considered.” Similarly, the SEC would expect any description of diversity policies followed by the company under Item 407 “to include a discussion of how the company considers the self-identified diversity attributes of nominees” as well as any other qualifications taken into account by its diversity policy (such as diverse work experiences, military service, or socioeconomic or demographic characteristics).

Guidance Mirrors Investor Demands. The Division’s focus on disclosing self-identified diversity characteristics reflects the increasing demand for board diversity and information regarding nomination decisions from institutional investors and proxy advisors. A significant number of the nation’s largest investors now list board diversity, particularly in terms of gender, among their top priorities for the companies in which they invest. Improving board diversity remained a frequent shareholder governance proposal in 2018, and the Institutional Shareholder Services (ISS) 2019 Voting Guidelines recommend highlighting boards with no gender diversity.

Corporate Diversity Bills. The SEC’s release of the C&DIs also comes at a time when corporate diversity issues are gaining traction with lawmakers. In 2018, California passed a board diversity law that requires publicly traded companies headquartered in the state to have at least one female director on their boards. Similarly, bills are being introduced in New Jersey and New York that require public companies to disclose data on diversity (e.g., the racial, gender, and ethnic composition of company leaders).

CONCLUSION

The new C&DIs appear to provide companies with a roadmap to effectively explain how they factor diversity into nomination decisions and other company policies. To follow this approach, essentially a company needs to ensure that its directors self-identify as diverse and then link their diversity characteristics to the company’s relevant policies to the extent those diversity characteristics were considered.

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