May 8, 2013

International Corporate Governance Network
16 Park Crescent
London, W1B 1AH
United Kingdom

By email to: consultation@icgn.org

Re: **ICGN Position Paper on Gender Diversity**

We are writing in response to the International Corporate Governance Network (ICGN) request for comment on its *Position Paper on Gender Diversity*.

With approximately C$5 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will build long-term sustainable value for all stakeholders and provide higher risk-adjusted returns to shareholders. As noted in the paper, women are still under-represented in the boardrooms of listed companies, despite numerous studies identifying a correlation between gender diversity and outperformance on organizational excellence and financial metrics. We welcome ICGN's decision to prepare a position paper on diversity, at a time when we have been increasing our engagement focus on gender and other aspects of diversity. We also support the scope of the paper, which explores the potential for action not only by companies but also by policy-makers and investors.

Diversity is a value driver and a corporate responsibility

The paper highlights research suggesting that gender diversity on the board and within top management adds to corporate value. This is an important finding, but there are dangers in this argument. Women should not have to demonstrate that their presence in the boardroom generally helps companies to outperform before companies make an effort to recruit more diverse directors – equality is not achieved if women have to be "better" than men in order to be selected. Even if the presence of women were not found to make any meaningful difference to performance, we believe companies have a corporate responsible to encourage diversity as a social imperative. It is also possible that the positive value effect enjoyed by early adopters of corporate diversity will become more muted as compliance concerns, rather than strategic vision, drive companies to change practices.

The argument that companies should recruit an effective board, and that diversity may contribute to that effectiveness, could leave space for non-diverse boards to claim that they are already highly effective, and that they have been unable to find suitable female candidates that would add value to the board. Experience in countries where boardroom diversity quotas have been imposed suggests that once companies made a real effort to seek qualified women director candidates, they found them - and that they had not found them before because they were not looking hard enough.

We would agree with the statement that "board diversity is as much about the culture within the boardroom and acceptance of a diversity of views, as it is about having a diversity of gender around the board table" (p3). However, we believe strongly that companies should pursue both objectives, and that they are mutually supportive.

We appreciate the paper's acknowledgement that diversity is not restricted to gender – that board oversight responsibilities "can be accomplished more effectively by recruiting a board diverse in the broadest sense of gender, race, national origin, culture, expertise and thought" (p2). Our own perspective on diversity within our engagement and proxy voting practice is not limited to gender, but also embraces other attributes such as ethnicity, aboriginal status and sexual orientation. We question, therefore, the rationale for focusing narrowly on gender diversity within the paper.

Regulatory approaches

Question: In your opinion, which action would be most effective in improving gender diversity on boards, binding quotas, or a "comply or explain" approach?

In Canada, progress on board diversity has been painfully slow – even in the face of research suggesting that bringing women onto the board correlates with outperformance. The 2013 GMI Ratings *Women on Boards* survey found that among Canadian companies reviewed, the average percentage of women directors has risen less than 1 % since 2009, currently standing at 13.1%. It found that both representation of women on boards and growth in representation of women were much higher in countries that had mandated quotas.

Several initiatives are underway in Canada to help companies to increase board diversity. Catalyst Canada has issued a call for action for companies to increase the proportion of women directors to 25% by 2017.[1] The Canadian Board Diversity Council is providing publicizing 50 "board-ready" candidates each year who are diverse in terms of gender and other attributes.[2]

Some Canadian companies have already passed the 25% gender target, with notable leadership being shown by the banking sector. However, given the slow overall progress up to now, we feel that Canadian listed companies need to demonstrate much more effort on diversity in the short term if they wish to avoid a legislated solution. We are giving enhanced attention to diversity questions in our Focus List corporate engagement program in 2013.

Based on the experience of countries that have already taken this route, we would support well-designed policy initiatives on board diversity. In the short term, we would be content with a "comply or explain" approach to board diversity disclosure in Canada, similar to the approaches taken by stock exchanges in Australia and New Zealand, as this would push more companies to consider the issue. If boardroom diversity statistics did not improve as a result, it would then be appropriate to consider binding quotas.

We have some sympathy with the viewpoint that "boards constructed with the aim of effectiveness, with diversity being seen as an element to help deliver that effectiveness, are likely to perform better than those constructed with compliance in mind" (p3). However, the experience in countries that have imposed quotas appears to have been that, once the effort was made to look for them, there was no real shortage of qualified women candidates.

We do have concerns about the formulation of some quota proposals. Mandating equal quotas of women and men on the board (50/50) is inflexible from a board effectiveness perspective. It could also be potentially discriminatory for the minority of people who do not identify as either male or female, or who are transitioning. In our view, simply mandating a minimum quota of women on the board can also be problematic, as this implies that a 100% female board is

[1] Catalyst Accord: Women on Corporate Boards in Canada http://www.catalyst.org/catalyst-accord-women-corporate-boards-canada
[2] Canadian Board Diversity Council http://www.boarddiversity.ca/

acceptable. We believe this is undesirable from a diversity perspective – the perspective of men also brings value to the boardroom. We prefer proposals that call for efforts to achieve at least a minimum percentage of women and men on the board, with the target minimum percentage for each in the range 30-40% to allow flexibility.

Investor responsibilities in improving board diversity

The paper outlines a number of approaches available to shareholders to encourage diversity at investee companies:

- *Engaging in regular dialogue on governance practices with the boards of investee companies to seek the development and implementation of gender diversity policies.*
- *Advocating high corporate governance standards including those involving gender diversity.*
- *Developing governance and voting guidelines on appointment and re-election of board members.*
- *Using voting rights to effect improvements at board level of investee companies.*

Generally we would support this outline of responsibilities. We are already engaging on diversity issues and have proxy voting guidelines relating to board diversity and support for diversity proposals.[3] For example, we vote against sitting members of the nominating committee where we see no evidence of diversity of gender or other personal attributes on the board. In the 2012 proxy season we withheld our vote from members of the nominating committee at 51 companies because of lack of any diversity on the board. A challenge for implementation of our guidelines is that companies do not consistently disclose on diversity practices and performance in a way that facilitates voting.

Several of our other proxy voting guidelines and corporate engagement priorities contribute indirectly to board diversity, in the sense that they could encourage companies to look more widely for director candidates, beyond established networks and the current population of corporate directors. For example:

- We have a strict guideline on board interlocks, voting against directors that sit together on more than one board.
- We vote against directors that sit on more than four boards of publicly traded companies.
- We encourage companies to recruit directors with substantial expertise in environmental and social matters relevant to the company, which may lead to companies searching outside corporate networks for candidates in academia, public service or the non-profit sector where diversity may be more advanced.

We have also raised diversity questions in public policy interventions[4] and through our participation in the Canadian Coalition for Good Governance (CCGG).

Board responsibilities in improving board diversity

We agree that the priority is for boards to ensure they have knowledgeable and experienced members. But once again, women should not have to demonstrate that their presence in the boardroom generally helps companies to outperform before companies make the effort to recruit more diverse directors. The argument that companies should recruit an

[3] The NEI Investments Proxy Voting Guidelines can be found at: http://www.neiinvestments.com/NEIFiles/Flipbooks/Proxy%20Voting%20Guidelines/2012%20Proxy%20Voting%20Guidelines%20English%20final%20version.pdf

[4] See, for example: NEI Investments. Ontario Securities Commission: Staff Notice 54-701 Regulatory Developments Regarding Shareholder Democracy Issues. March 30, 2011 http://www.neiinvestments.com/neifiles/PDFs/5.5%20Public%20Policy%20and%20Standards/OSC%20Shareholder%20Democracy.pdf

effective board, and that diversity may contribute to that effectiveness, could allow non-diverse boards to claim that they are already highly effective. We doubt that most non-diverse boards see themselves as ineffective. Nevertheless, the correlation between diversity and outperformance is compelling from an investment value perspective. If companies tend to outperform when their boards are more diverse, the implication is that companies not taking steps to increase board diversity are risking underperformance – an unacceptable situation.

A number of basic board effectiveness measures could contribute to diversity. These include the following:

- Maintaining and disclosing an up-to-date director skills matrix, that incorporates the full range of skills and expertise needed – including expertise on sector-relevant environmental and social questions such as supply chain management, human rights or community relations.
- Looking widely, beyond established networks and the CEO community, for potential director candidates, and bringing in professional search assistance as appropriate.
- Maintaining lists of qualified director candidates, including candidates that would enhance diversity.

To avoid expanding the board size, boards also need to make space for diverse candidates. Corporate governance good practices that could indirectly influence diversity by expanding the director candidate pool without increasing the size of boards could include:

- Policies to avoid over-boarding (where directors serve on an excessively large number of boards).
- Policies to avoid interlocks (where directors serve together on more than one board).
- Policies to place limits on director tenure and encourage renewal of the board. To avoid creating entrenched board situations, it might be desirable if more directors operated under the expectation that they will be leaving the board after a period, unless they are specifically asked to remain because there is no obvious candidate to fill the skills gap.

Because non-diverse boards may argue that they are already "effective", and diversity is a corporate responsibility as well as a value driver, we believe boards should also adopt diversity-specific practices, including:

- Setting board diversity targets and providing disclosure on progress – including diversity statistics in the proxy circular that will facilitate voting decisions.
- Routinely identifying and considering at least one candidate who would enhance diversity when building the candidate list for each upcoming vacancy on the board – if necessary seeking professional search assistance.
- Ensuring that there is board discussion of diversity strategy and reporting across the company. Just as compensation committees at some companies are expanding discussion of compensation strategy beyond the senior executive level to ensure strategy is consistent throughout the organization, boards should provide oversight on diversity strategy throughout the organization and ensure that the company reports on diversity at all levels.

Reporting responsibilities

We see scope in Canada for policy action to enhance diversity reporting, such as the recommendations and requirements recently put in place for stock exchanges in Australia[5] and New Zealand[6]. In the interim, we strongly encourage companies to enhance disclosure voluntarily.

[5] Australian Securities Exchange. Corporate Governance Council Principles and Recommendations. June 2010. http://www.asx.com.au/governance/corporate-governance.htm

[6] NZX. Guidance Note – Diversity Policies and Disclosure.17 December 2012. https://nzx.com/files/static/cms-documents/FINAL%20Diversity%20Guidance%20Note.pdf

We would like companies to disclose on their diversity strategy, policies and key initiatives, as well as on their targets for diversity performance at the board and company level, and the progress against those targets. We would also like more companies to facilitate decision-making in director elections for investors like ourselves that conduct proxy voting based on diversity-related guidelines. This disclosure should be placed prominently in the proxy circular to ensure it is taken up in the vote decision.

We value the specific disclosures on the percentage level of diversity on the board that are already provided by some Canadian companies. For example, Laurentian Bank, which has a laudably high percentage of women on the board, discusses board gender diversity in the corporate governance section of the proxy circular:

"Various other selection criteria are also applied, such as geographic distribution and gender ratio. With 38% of its directors being women, the bank is a leader in gender diversity in its field. The Committee strives to continue to increase the Board's representativeness and diversity."

Goldcorp provides the following disclosure in the proxy, as well as more detail on its approach to diversity:

"During the year ended December 31, 2012, women and non-residents each constituted 18.2% of the Board. If all the Nominees are elected by shareholders, the proportion of women on the Board and the proportion of non-residents will each be 20%."

To the extent that the directors concerned are willing to identify themselves voluntarily within the board environment, and respecting their right to privacy, we would also value generalized disclosure on other aspects of diversity such as ethnicity, aboriginal status, or sexual orientation. For the purposes of voting we do not need to know which directors specifically are contributing to wider diversity on the board, but only the extent to which aspects of diversity are present and whether diversity is increasing or decreasing in percentage terms.

In the absence of such generalized disclosure, particularly on less obvious aspects of diversity, we are sometimes reduced to guesswork based on names, biographies or profile pictures. This is not only time-consuming, but we may be penalizing nominating committee members on boards that do in fact include broader diversity.

As part of our 2013 Focus List for corporate engagement, we are engaging companies to begin providing generalized board diversity metrics or to enhance or broaden the scope of the metrics.

Conclusion

In conclusion, we would like to commend ICGN for seeking comments on the paper, and would reiterate the following points:

- Women should not have to demonstrate that their presence in the boardroom generally helps companies to <u>outperform</u> before companies make the effort to recruit more diverse directors. Diversity is a basic corporate responsibility, as well as a value driver.
- As the paper notes, diversity is broader than the question of gender alone. We therefore suggest that ICGN should look at the diversity issue more broadly.
- There are roles for companies, regulators and investors to advance the diversity agenda.

- Various basic board effectiveness measures should contribute to diversity over the long term, but to ensure relatively rapid progress there is also a need to make space for diversity on entrenched boards, and for boards to implement specific diversity measures.
- As a first step, companies should be making it easier for investors to vote based on diversity proxy voting guidelines by providing generalized diversity statistics in the proxy circular.

Should you have questions with regard to this submission, please do not hesitate to contact Michelle de Cordova (Director, Public Policy & Standards, NEI Investments) at mdecordova@NEIinvestments.com or +1-604-742-8319.

Sincerely,
NEI Investments

Robert Walker
Vice President, ESG Services & Ethical Funds

CC: Board of Directors, NEI Investment