



ALL ABOARD

Increasing Corporate Board Diversity

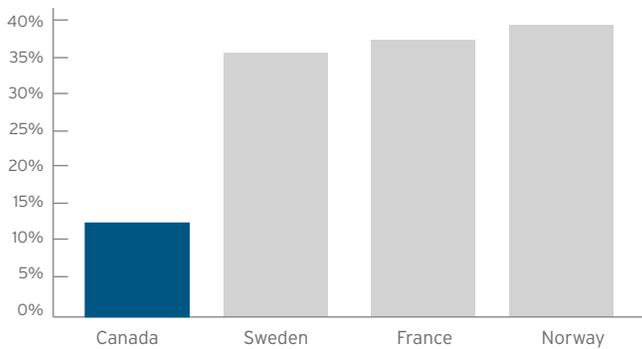


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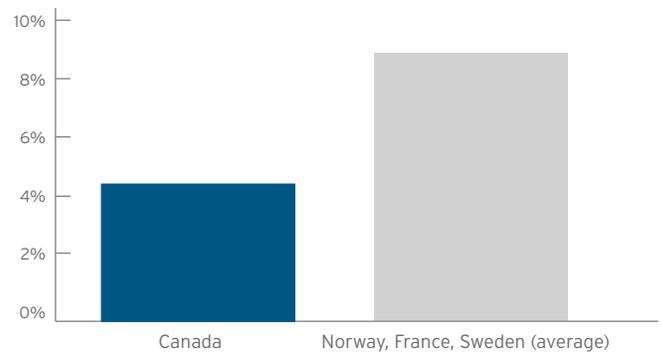
Canada has an enviable record on many aspects of gender equality - half of our Federal cabinet members are women, 62% of university graduates are female, women won 16 of Canada's 22 medals at the 2016 Summer Olympics and our ratio of female to male labour force participation is among the highest in the world at 87.2%.¹

But these achievements have not been mirrored in our corporate boardrooms. In 2017, only 14% of Canadian board seats were occupied by women, while just over 4% of TSX Composite Index companies had a female chair.² That is why diversity, and board diversity in particular, is a core component of our engagement program at NEI.³ Our long-term vision for the Canadian board landscape is one where corporate boards reflect the diversity and strength of Canadian society.

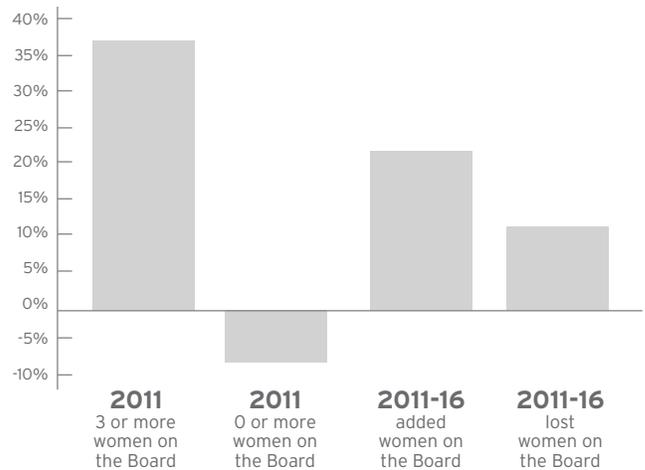
2016 PERCENTAGE (%) OF WOMEN ON BOARDS



2011-2016 AVERAGE 5-YEAR GROSS COMPANY RETURNS



5-YEAR EARNINGS PER SHARE (EPS) BY NUMBER OF WOMEN DIRECTORS (U.S. PUBLIC COMPANIES)



Research demonstrates a strong correlation between diversity and corporate performance. Relative to non-diverse boards, diverse boards display consistently better performance across multiple metrics, including excess stock market returns, higher return on equity, lower costs of acquisition and higher valuations.

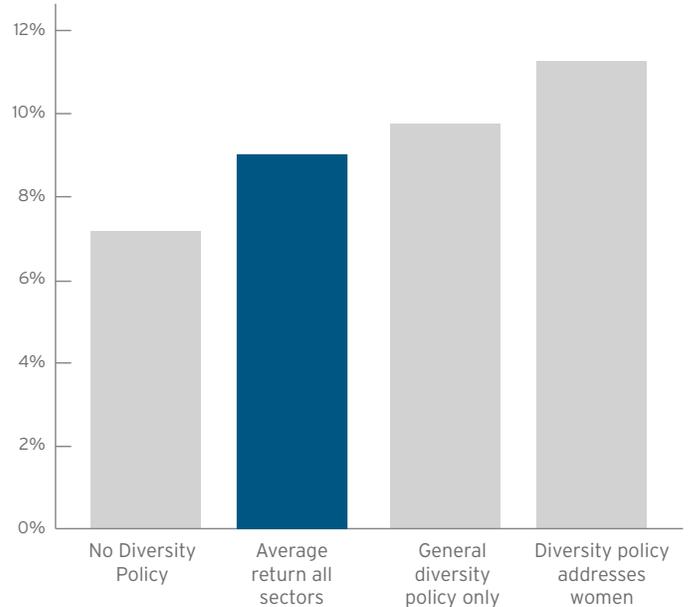
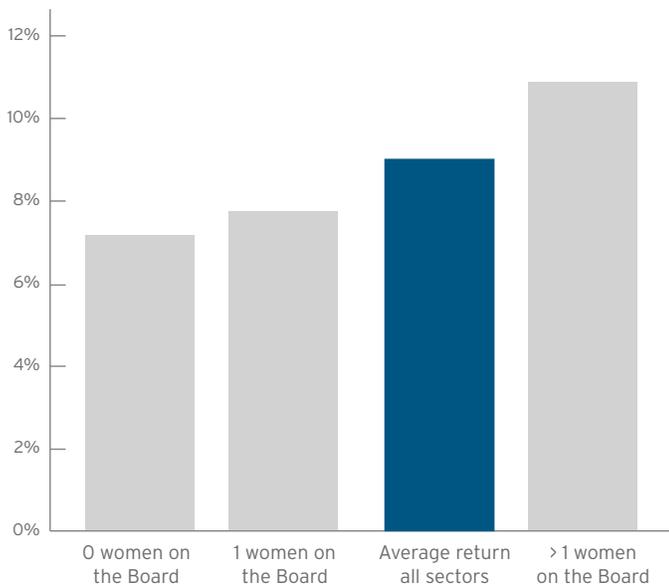
Of particular concern to investors in Canada should be the lack of diversity in the mining and oil and gas sectors, where 46% and 55% of companies, respectively, have no women on the board. Encouragingly, the mining sector showed one of the biggest jumps in gender diversity in 2017, improving 16% from 2016. Nevertheless, while the ESG risks these extractives companies now face have changed dramatically and become increasingly complex, many boards are still structured to meet the challenges of yesterday, not today.

Our analysis of 2016 Canadian data tells us that the link between the number of women on a board and shareholder returns is in line with the findings of academics globally: Canadian companies with more than one woman on the board had a five-year average return on equity significantly higher than companies with no women. Perhaps more surprising was the even more emphatic finding that companies with a diversity policy that addressed the gender gap provided a much greater return on equity than companies with no policy at all.⁴ It is tempting to focus on the attractive returns that diversity appears to bring to shareholders, but women shouldn't have to outperform men just to get a seat at the table.

It is tempting to focus on the attractive returns that diversity appears to bring to shareholders, but women shouldn't have to outperform men just to get a seat at the table. The justification for achieving board diversity is simple: we don't have it now and we should.

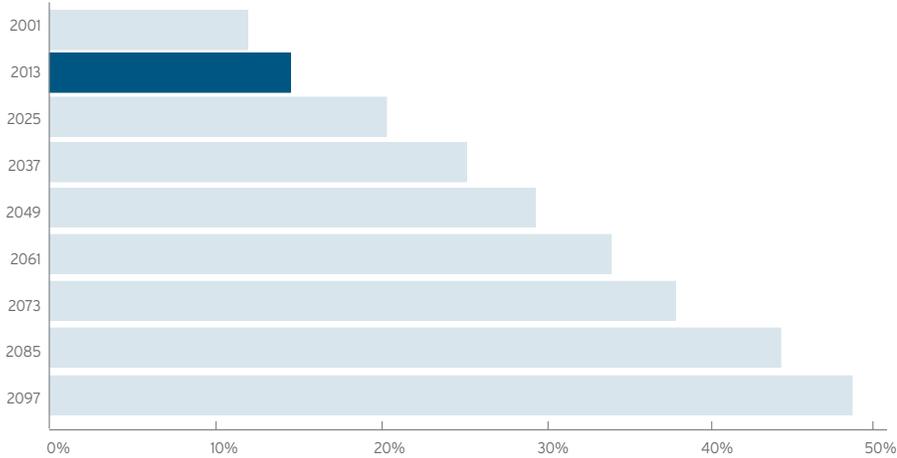
5-YEAR AVERAGE RETURN AND FEMALE REPRESENTATION

5-YEAR AVERAGE RETURN AND DIVERSITY POLICY



Recognizing the problem of board diversity has been easier than solving it. While we have seen a relatively steady improvement in board diversity rates – between 2014 and 2016, 301 new female directors were appointed in Canada – progress has been unacceptably slow. At the current rate of change, women will not reach parity with men until 2100!⁵

FEMALE REPRESENTATION ON FINANCIAL POST 500 (FP500) BOARDS IN 6 SECTORS



As tracked by the Canadian Board Diversity Council, the graph shows actual and projected female representation on FP500 boards in six sectors:

- Financials & Insurance
- Utilities
- Retail/Trade
- Manufacturing
- Mining
- Oil & Gas

Companies from these sectors accounted for 70% of the FP500 board seats in 2013.

The root causes of our board-level gender imbalance run deeper than one simple solution can fix. The lack of board-level diversity is a symptom of a broader societal challenge that needs to be addressed at its roots. However, as investors, we have unique leverage in regard to corporate boards: we have the ability – and the responsibility – to affect tangible, near-term change.

Walking the Walk

2015-2017

NEI withheld support for board members 706 times because of diversity concerns.

2017

NEI adopted a board diversity policy with a target of 30% gender diversity by 2020.



OUR ACTIONS

Voting for Diversity

For more than 15 years, we have used the proxy ballot – one of the most direct means shareholders have to affect change – to push for greater board diversity. We consistently withhold support for members of the nominating committee where there is no gender diversity, or less than 10% diversity of identity on the board with no credible commitment to enhancing diversity. We often write to boards to explain how diversity concerns impacted our voting decisions.

More carrot, less stick

While too many boards still lack diversity, the number of diversity-related votes against board members has decreased in recent years – a reflection in part of the impact of our engagement – while the number of companies where we've made a diversity-related decision has increased – mainly due to the positive impact of diversity on our votes (e.g. situations where we would have voted against directors were it not for positive diversity practices).

Major institutional investors are increasingly comfortable with voting against board members based solely on diversity concerns and many have adopted proxy voting guidelines that emulate NEI's. For example, the Vanguard Group and BlackRock have both made diversity a key aspect of their governance agenda. With majority voting rules increasingly becoming the norm – meaning directors can lose their jobs if they lose a vote – this threat of investor censure will lead to real change. NEI is proud to have been one of the catalysts for this change.

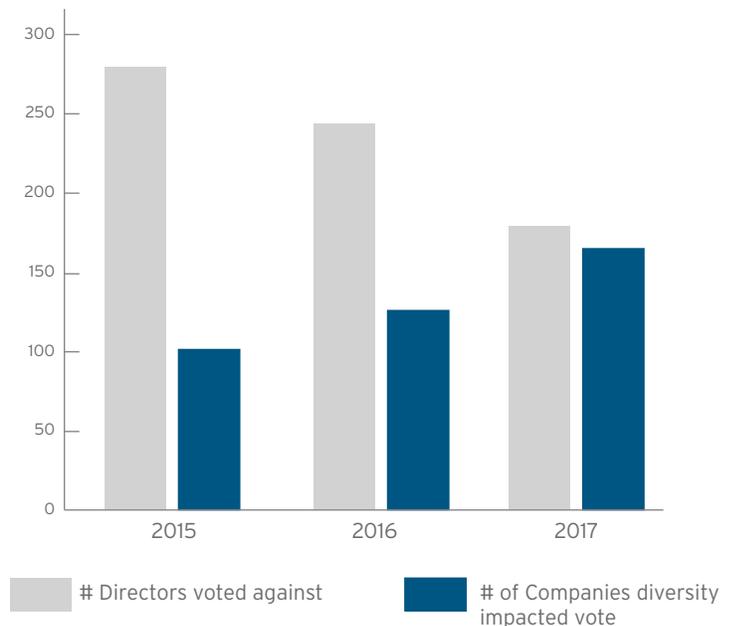
Dialogue on Diversity

We go beyond exercising our vote against directors and actively engage with boards and management to seek better performance. Specifically, we are asking companies to develop and disclose a credible, time-bound plan for increasing diversity at the board level. Many of the companies we have engaged with have gone on to increase their diversity and/or set goals for improvement, including Boyd Group, Black Diamond, Dollarama, Lumenpulse, Mitel, Mullen Group, Parkland and Winpak.

It's a target, not a quota!

Through numerous engagements with companies on this issue, we have found that the resistance to setting diversity targets is often rooted in a conflation of targets with quotas. Setting a quota means that board diversity levels must be reached regardless of whether good candidates can be found. Setting a target is acknowledging a desirable outcome (e.g. 30% diversity) and making credible efforts towards meeting that outcome, something companies do all the time. This is what investors are asking for.

NEI'S DIVERSITY-RELATED VOTES



OUR EXPRESS SUPPORT FOR BOARD DIVERSITY IS LAID OUT IN OUR PROXY VOTING GUIDELINES

[\(CLICK TO VIEW\)](#)

What we are asking for?

- 1 ADOPT A ROBUST DIVERSITY POLICY
- 2 DISCLOSE A CREDIBLE IMPLEMENTATION PLAN
- 3 SET TARGETS
- 4 DEMONSTRATE INCREASED DIVERSITY

The 30% Target

Achieving 30% gender diversity is a current best practice and a broadly shared interim target towards more balanced corporate boardrooms. Corporate leaders such as those in the 30% Club and signatories to the Catalyst Accord have publicly committed to achieving 30% gender diversity.⁶ NEI supports this goal and is committed to not only achieving this with our own board but also to working through our engagement program to build momentum towards this goal across our portfolio.



Perception is (not) reality?

Despite our success in engaging companies, we have often found a common thread between companies where diversity is lacking - namely the lack of recognition that a problem exists or that viable solutions are available. Research backs this up: a PWC study found that 93% of female board directors felt that the existing talent pool for potential female directors was big enough to start increasing diversity now, while only 64% of male directors agreed.⁷ Most companies that set diversity targets or adopted written diversity policies in 2017 already had relatively strong diversity, whereas boards with no women seldom saw the need for targets or even policies. This disconnect is a fundamental challenge we face in getting boards to improve their performance, and an area where our engagement can make a real difference. Nowhere is this lack of recognition more apparent than in the meritocracy defence - namely that a board should be blind to gender and should focus solely on the merit of the individual.

Meritocracy and unconscious bias

The meritocracy defence suggests a deep misunderstanding of what investors are asking for. It is implicit that boards should focus on merit, but research clearly shows that the best way to ensure you have the most effective board is through diversity: a diverse board is a superior board. This makes it difficult to understand how merit could be the only determinant if a board has never nominated a female candidate. Given the abundance of highly qualified female board candidates (already on boards or in management) it is clear that what is lacking is the ability of boards to find and attract women.

We believe that unconscious bias - biases we hold that we are not even aware of - plays a major role. Unconscious bias explains, at least in part, the inability or unwillingness of some boards to take a deeper look at why their concept of a meritorious candidate is overlooking clearly qualified candidates. Everyone has unconscious biases of some sort. What is critical is that we acknowledge and actively work to counteract such biases, and this is what we are pushing board directors to do in our engagements.

Diversity Disconnect

The more diverse the board, the more likely it is to have adopted diversity measures. Of the companies in 2016 with zero women on the board only 8.5% had adopted a policy to address their lack of diversity, whereas 20% of boards with one female director had done so, and fully 36% of boards with two or more women had adopted a written policy. Likewise, the numbers for diversity targets suggests that having more than one woman on board correlates with setting targets: less than 2% of boards with no women had set a diversity target, and just under 7% of boards with a single woman had done so, whereas over 26% of boards with two or more women chose to set a diversity target. In fact, the average diversity of boards that chose to set a target, and already had at least one woman on board, was 27%. It is probably not surprising that, where diversity is concerned, the most proactive boards are those that have already seen the value of diversity.

How to counteract unconscious bias:

EXPAND YOUR HORIZONS:

87% of boards say they rely mostly on fellow board member recommendations for new candidates. Boards need to look beyond candidates who already sit on boards or are CEOs or risk an overly narrow and homogenous candidate pool.

EXPAND YOUR BOARD:

There is a consistent link between board diversity and board size: less diverse boards tend to have fewer directors than average.

EXPAND YOUR MIND:

Leading companies are instituting unconscious bias training, giving directors and senior management the skills to uncover and address their own biases.

UTILIZE CONSULTANTS:

Rather than relying on the recommendations of sitting directors, ensuring that external resources with a clear diversity mandate are utilized can help expand the search.

CONSTANTLY RENEW:

Boards should constantly think about developing a pipeline of candidates. Having board term limits is one way a board can force itself to continuously be on the look-out. ISS has found that boards with shorter average tenure tend to be more diverse.

INCREASE WOMEN IN MANAGEMENT:

Increasing the number of female board candidates will ultimately require upping the number of female executives. Right now, only 5.8% of CEOs in Canada are women.

Lobbying for diversity

Achieving broad change requires appropriate regulatory drivers. For more than eight years we have been urging policy makers and standards setters to adopt governance recommendations aimed at creating the right conditions for growing diversity. Increasing transparency on recruitment practices, disclosing a director skills matrix, setting tenure limits and reducing the number of boards directors can sit on all encourage board renewal and put the onus on directors to explain how and why they choose new directors. More explicitly, mandating companies to disclose how they are working to increase diversity, such as through a diversity policy or setting diversity targets, directly benefits diversity efforts. Our comments and input have helped shape the positions of prominent governance associations such as the Canadian Coalition for Good Governance (CCGG)⁸ and the International Corporate Governance Network (ICGN)⁹ and have influenced important policy changes by Canadian regulators.

Raising Canada's Diversity Game

We first raised the issue of board diversity with the Ontario Securities Commission (OSC) in 2011. In 2014 we were one of several investors that strongly supported the OSC in adopting a mandatory "comply or explain" expectation for non-venture companies on adopting board diversity policies, diversity targets and implementation plans for diversity. In 2016, we successfully lobbied the Alberta Securities Commission to follow suit with similar expectations. As a result, all the public companies in our Canadian investment universe are now required to provide information on how they are working to increase the diversity of their boards.

Maintaining the Momentum

Change is afoot. Canadian boardrooms are becoming increasingly diverse but we are still very much at the beginning of the evolution towards true diversity. If we want the pace of change to quicken it's up to shareholders to acknowledge that the status quo is unacceptable and demand better from the companies they own. Until the boardroom starts to genuinely reflect Canada's diversity strengths, NEI will continue to make diversity - gender and otherwise - a top priority.

Publication authored by ESG Services Department:

Jamie Bonham - Manager, Corporate Engagement

Rosa van den Beemt - Senior ESG Analyst, Healthcare & Telecommunications

Sources & Footnotes

¹Government of Canada; Statistics Canada; Globe and Mail; International Labor Organization http://data.worldbank.org/indicator/SL.TLF.CACT.FM.ZS?locations=CA&year_high_desc=true

²MSCI, The Tipping Point - Women on Boards and Financial Performance; MSCI Indices

³Although diversity encompasses every form of identity such as gender, ethnicity, Indigeneity, sexual orientation or disability, we are focusing on board gender diversity - the representation of women on corporate boards - as a first step toward addressing the board diversity gap

⁴CSA Multilateral Staff Notice 58-309: Staff Review of Women on Boards and in Executive Officer Positions - Compliance with NI 58-101 Disclosure of Corporate Governance Practices

⁵Canadian Board Diversity Council: https://www.boarddiversity.ca/sites/default/files/CBDC-2013-ARC_ENG.pdf

⁶30% club: <https://30percentclub.org/about/chapters/canada> - Catalyst: <http://www.catalyst.org/>

⁷PwC's 2016 Annual Corporate Directors Survey

⁸NEI is a long-term member of CCGG and we sit on the Environmental & Social Committee

⁹NEI is a long-term member of ICGN

For more information on board diversity, including all our policy submissions. Please visit:



<http://www.neiinvestments.com>

<https://www.ethicalfunds.com/en/learning/corporate-board-diversity/>

<http://www.neiinvestments.com/pages/about-nei/about-ethical-funds/esg-difference/public-policy-and-standards/>

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