Board iQ

Fund Boards Bucking the Diversity Disclosure Trend

More and more corporate boards are opening up on diversity, but inertia is holding back their fund counterparts.

By Joe Morris | July 26, 2022

Though the momentum continues building for diversity disclosure at corporate boards, inertia is keeping the fund industry from following suit.

Nearly three-quarters of S&P 500 companies now disclose their board's race and ethnicity, from fewer than 60% last year and just 11% in 2018, according to Conference Board data. Next month, compliance kicks in for Nasdaq's board diversity rule, which requires disclosures for all Nasdaq-listed companies.

But among fund boards, only three are known to spell out their board diversity makeup: Morningstar Funds, Diamond Hill and Vanguard, whose board is both a corporate and fund board.

The others' reluctance has more to do with a lack of guidance and standards than a lack of will, said Nicole Crum, a partner at Sullivan & Worcester who consults for fund boards.

"It's not because it's not important, and it's not because they [directors] don't want the information to be available to investors," she said. "It's really about getting comfortable with what the disclosure will look like and what's the right information to capture."

Once boards resolve to compile disclosure data, Crum said, then they're confronted with a series of questions that can be nettlesome to answer: should questionnaires be limited to race and gender; what other categories are most relevant; how do you define gender.

"I think there's more complexity than maybe was first thought," Crum said.

The Securities and Exchange Commission, for its part, has not been especially helpful with guidance.

More than a year ago, the commission's Asset Management Advisory Committee recommended the regulator begin requiring board diversity disclosure. But there has been no follow-up since then. Chair Gary Gensler's Regulatory Flexibility Agenda, issued last month, makes no mention of action on any such rule.

An SEC spokesperson said the committee's recommendations "remain under consideration."

A separate SEC rulemaking, on environmental, social and governance standards, may actually be stunting progress on disclosure, said Perkins Coie partner Gwendolyn Williamson.

The commission made clear last year, when the Exams Division issued a risk alert, that it would start holding any ESG-related statements up to strict scrutiny. It then followed up with a rule proposal in May — still out for comment — mandating new ESG disclosure standards.

Board diversity disclosure would certainly fall under the category of ESG-related statements, meaning any fund board volunteering to disclose understands that SEC staff will be looking over their shoulder, Williamson said.

"Funds and advisors do not have to say anything about diversity or any other ESG topic, but if they do, they have a target on their back right now with the SEC's hot focus on ESG issues," she said.

No longer is disclosure a simple matter of filling out a survey and publishing it; now, Williamson said, chief compliance officers and counsel are intimately involved with ensuring the data presented measures up to the SEC's new specifications.

And yet, this was never a concern at Diamond Hill, which began disclosing board diversity early this year.

"It never came up," said D'Ray Moore, who was the board's chair at the time and remains a director. "I have to wonder if that's a bit of a smokescreen."

Moore said the process of adding the disclosure was cut and dried: the chief compliance officer drew up the form, and the directors filled it out.

"We simply added a disclosure to check the boxes, like you would anyplace else," she said.

Crum said the ESG rule shouldn't discourage disclosure; rather, it should encourage conscientiousness.

"It's why you need to be thoughtful on the front end about what information you collect and what you disclose," she said.

Diamond Hill's disclosure takes the form of a matrix with slots for descriptors for "gender identity" (female, male and non-binary) and "demographic background," which consists of the following options: "African American or Black," "Alaskan Native or Native American," "Asian," "Hispanic or Latinx," "Native Hawaiian or Pacific Islander," "White," "Two or More Races or Ethnicities" and "LGBTQ+."

The Morningstar Funds disclosure, now in its second year, lists its board-level gender and racial classifications: two women, two men, one Hispanic and four white.

Vanguard's features four charts. One displays the number of minorities (two) and non-minorities (nine); another shows men (eight) versus women (three); and the remaining two break down board tenure and director ages by ranges.

It's understandable that all three boards chose to disclose at the board level rather than individually, said Carolyn McPhillips, president of the Mutual Fund Directors Forum.

Doing so serves the purpose of sharing the relevant data without prying too much into personal matters.

"Sometimes even among diverse candidates, there is some hesitancy to self-identify because you don't want to be known as this 'other group' director," she said. "When you're on a board, you just want to be a director."

Morningstar's board took it upon itself to issue the disclosure, but the advisor "was 100% supportive of our work," said Theresa Hamacher, the chair.

"We did it because we think that there are at least some shareholders who are interested in it," she said. "Certainly, there is evidence from some of the proxy voting that shareholders are looking at what the diversity of boards are, so that was a motivator."

At Diamond Hill, it was the advisor that approached the board about adding the disclosure, and there was unanimous support among directors, Moore said.

"The credit goes to them [Diamond Hill]," she said.

Board diversity had started to come up in the request-for-proposal process with institutional clients, and the advisor opted to take the initiative.

"They wanted to be on the leading edge and be as transparent as possible, not just waiting until some regulatory body forces it," Moore added.

Unless other boards and advisors muster the same drive or until the SEC finally issues a mandate, it will be up to clients to make disclosure more widespread, McPhillips said.

"The only other way it would change is if there's pressure from some other avenues, if institutional investors really started putting some pressure on it," she said. "I could see that being a change."