



# Fund Boards Split on Diversity Disclosures

Despite two fund boards' recently revealing diversity metrics of their own directors, the fund industry lags significantly behind the disclosure requirements of corporate boards even though some wish to set the same standard.

By Alex Cardno | May 2, 2023

Mutual fund boards are split over whether to make public disclosures about their directors' diversity even as the number of boards making such disclosures has risen slightly in recent months, BoardIQ research revealed. Fund directors noted various reasons why boards are hesitant to make disclosures, as well as the lack of a prescriptive disclosure framework for doing so.

The small handful of fund boards that have made public disclosures about their own diversity efforts have done so for various reasons: to track their diversity over time, to aid succession planning, to publicly indicate they are taking the issue seriously, and to match a standard set by their corporate board peers.

The Securities and Exchange Commission established that standard on Aug. 6, 2021, when it approved the Nasdaq Stock Market's rule proposal to encourage greater corporate board diversity disclosures for Nasdaq-listed companies. The rule, originally proposed in December 2020, establishes a matrix by which board diversity must be disclosed.

The rule requires corporate boards to make annual disclosures about diversity, but mutual fund boards have no formal mechanism or requirement, which means diversity disclosures are made voluntarily and usually in the statement of additional information to fund supplements.

The dichotomy that presents is that mutual funds regularly scrutinize the diversity of corporate boards in whose companies they invest, while their own boards face no such scrutiny themselves.

“I am surprised that hasn’t received more attention,” said Theresa Hamacher, independent chair at Morningstar Funds Trust.

“I’m not sure how much attention diversity disclosures are getting at the fund board level. I suspect there are boards discussing it, but at the moment there is not an industry movement towards making public disclosures.”

Industry participants also appear split on the issue.

In a BoardIQ reader poll conducted in late April, 49% of respondents said their fund boards, or fund boards they serve, had considered making public disclosures about diversity, while 45% had not considered disclosures and 6% were undecided.

Despite the lack of a formal framework, there is some regulatory emphasis. During remarks made at the Investment Company Institute (ICI) conference in March, William Birdthistle, SEC director of the Division of Investment Management, highlighted diversity as an important component of changing demographics, which he identified as a key theme facing the asset management industry.

Data from the ICI meanwhile, illustrates that board diversity is growing, albeit slowly.

According to ICI data, 34.1% of all independent directors were female as of the end of 2021, up from 31.6% the previous year.

While the ICI cautioned that number does not represent the entire fund director community, its data showed the number of female directors has grown steadily in percentage terms for more than five consecutive years.

Ethnicity lags further behind however, with 86.6% of all independent directors who participated in ICI research indicating white ethnicity as of the end of 2021, compared to 8.4% Black/African-American, 2.3% Hispanic and 2.3% Asian.

The number of white directors has fallen steadily from 92.4% since 2015, while the number of Black and African-American directors has grown steadily in that time, while the number of Hispanic and Asian directors has also grown though at a more modest clip, ICI’s data showed.

But while board diversity may be increasing, there are still just a small handful of fund boards that voluntarily disclose their own diversity efforts.

In July last year, BoardIQ identified Morningstar Funds Trust, Diamond Hill and Vanguard as the only three entities known to publicly disclose their own board’s diversity makeup.

Vanguard is in a unique position to do so, as its board is both a corporate and a fund board, but Morningstar and Diamond Hill have since been joined by Optimum Funds Trust and

by Boston Trust Walden, which both published inaugural diversity matrixes pertaining to their boards in April this year.

The boards in question had different reasons for the disclosures.

In the case of Diamond Hill, board chair Tamara Fagely explained the board works in conjunction with listed company Diamond Hill Investment Group, which makes diversity disclosures on behalf of its corporate board.

“It was brought to our attention before we made any disclosures, because leadership at the firm had come up with their own matrix from a corporate standpoint,” Fagely explained.

“We look at our diversity matrix and the disclosure of it as a positive thing from a governance standpoint. The metric helps us track diversity over time and provides transparency and accountability.”

Meanwhile at Optimum Funds Trust, independent chair Pamela Moret said diversity metrics had become a key part of the discussion of board succession planning as some of its previous directors rotated off the board in recent years due to term limits.

Accordingly, the board decided to include diversity as an additional screen to skills and experience in its recruitment of directors, and once that had been agreed, the board discussed whether it was appropriate to include its own diversity matrix in its public disclosures.

Before doing so, the Optimum Funds Trust board sought advice from both its own independent counsel and from fund counsel about how to present the information.

“We saw it happening in the public company context and felt it was a good idea, so we decided to include it, understanding it is a relatively small number of mutual funds currently doing that,” Moret said.

For both Morningstar and Boston Trust Walden, the decision to make formal disclosures also came down – in part – to external relationships.

In the case of Morningstar Funds Trust, Hamacher explained the board regularly asks its service providers and its subadvisors to account for their diversity efforts and to demonstrate how they are attracting talent.

“If we are going to be asking our service providers to disclose at least to us, we feel we need to hold ourselves to the same standards,” Hamacher explained.

Similarly, Diane Armstrong, independent chair of Boston Trust Walden Funds, said the board felt its own practices needed to correspond to the efforts its funds make to engage

external stakeholders on ESG and principles of promoting transparency and responsible investing.

But the lack of disclosure across the broader universe of fund boards has to do with several factors.

As Carolyn McPhillips, president of the Mutual Fund Directors Forum, explained, it is not that boards don't think about diversity but that some are hesitant to make additional disclosures they are unsure about that might be scrutinized by regulators.

Other perceived risks among directors include revealing misalignment on diversity between the advisor and the board or the possibility of facing litigation over a diversity strategy which, as BoardIQ's sister title, Agenda, has reported, is a growing risk in the corporate board space.

"Some boards may not want to disclose because they do not want to attract attention to their overall profile or because individual board members may not be comfortable disclosing ethnicity or how they identify," Armstrong added.

Other directors suggest an inertia at the policy level has also hindered the issue.

"It is strange to see the SEC come out with statements encouraging diversity while not clarifying, for example, where and how mutual funds and their boards should make diversity disclosures," said one director speaking on condition of anonymity.

Whether that changes remains to be seen. Of the boards that have made disclosures so far, none have heard of any impetus on the rulemaking side for diversity disclosures.

In the context of succession planning, many boards revert to the discreet use of candidate databases created by ICI and MFDF, as well as separate working groups MFDF has set up to focus on diversity, equity and inclusion and directors of color respectively.

That is not to say those which have decided to make public disclosures would not welcome others doing so, and indeed there is a suggestion that, if larger fund complexes started to make disclosures on fund board diversity, that could be the impetus for more to follow.

"I think it would be healthy for boards to go in this direction and if diversity factors are being used, it would be healthy for further details to be disclosed," added Moret.

"If larger fund complexes moved in this direction, I think a lot of people would see that as an intriguing practice, and that may encourage more to follow suit."