U.S. Board Study

Board Diversity Review

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Key Takeaways

- While gender diversity still dominates the board diversity conversation, other dimensions of diversity, such as ethnicity, skills, background, and age are becoming more important to shareholders.
- The U.S. is improving in boardroom gender diversity, but still lags most other large developed markets. Women are joining U.S. boards in record numbers, but gender diversity in some sectors, such as Energy and Information Technology, is falling behind.
- The number of women in leadership positions – board chairs, lead directors, or committee chairs – remains very low; for instance, fewer than 4% of board Chairs in the S&P 1500 are women.
- While women are more likely to have multiple board seats than men, this has not led to a higher rate of overboarded female directors.
- The presence of ethnic minorities on U.S. boards has also reached record levels, but the rate of increase is slow.
- Board renewal rates improved in 2017, a continuation of a trend that started five years ago. However, there are fewer younger directors on boards, which raises the question of whether boards should start considering improving their age diversity.

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Methodology

ISS annually undertakes a review and analysis of the structure and composition of boards and individual director attributes among Standard & Poor Composite 1500 companies, (i.e. companies in the S&P 500, MidCap 400, and SmallCap 600 indices), in order to identify the latest practices and emerging trends.

This report focuses on board diversity, taking into account boards' composition in terms of gender, ethnicity, tenure, and age. In particular, the report provides an update on the most recent trends in diversity and examines how gender diversity correlates with other director characteristics, such as ethnicity, tenure, and age.

This report covers data reported in public filings (primarily company proxy statements) related to shareholder meetings occurring from Jan. 1, 2017 to Dec. 31, 2017. The companies and directors in the study are classified into the following S&P indices:

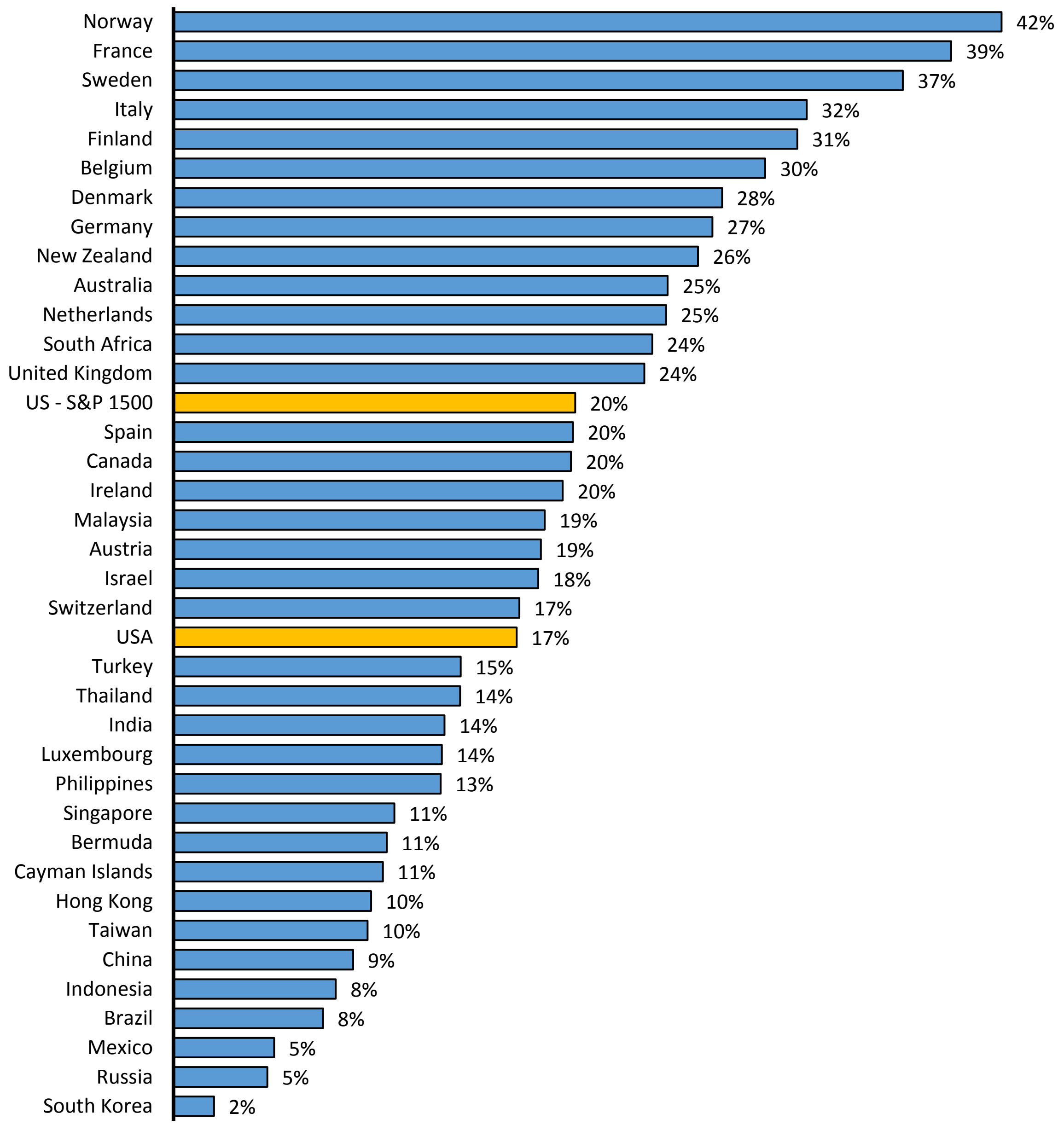
INDEX	NUMBER OF BOARDS	NUMBER OF DIRECTORSHIPS
S&P 500	497	5,348
S&P 400	395	3,681
S&P 600	597	4,969
S&P 1500	1489	13,996

Global Context: Despite gains, US Gender diversity lags

While more women have joined U.S. corporate boards in recent years, the country ranks lower in board gender diversity compared to most other developed markets. The U.S.'s relatively low participation of female directors on corporate boards occurs in the midst of multiple calls for improving gender diversity by some of the largest U.S. asset managers, who are raising the issue as a top engagement and stewardships priority.

U.S. lags many global markets in boardroom gender diversity

percentage of directorships held by women; includes all companies in ISS Core coverage with at least 200 directorships profiled (as of 04/05/2018)



Source: ISS Analytics

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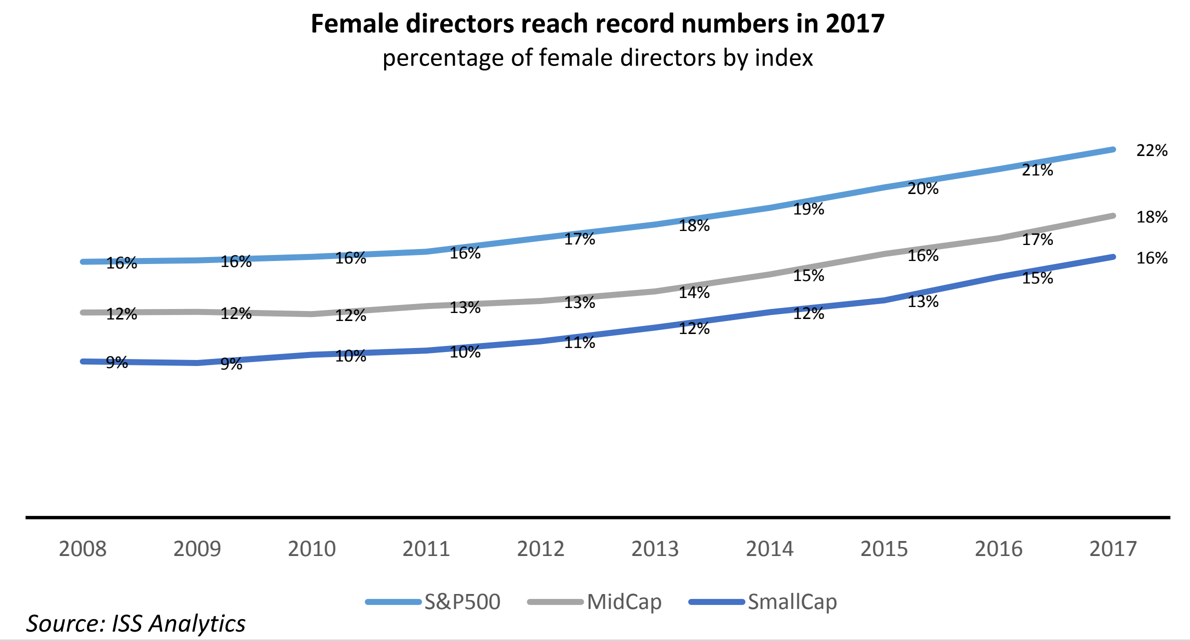
The higher rates of female board participation in Europe and other developed markets may be attributed to quotas or general guidelines adopted by these markets to encourage gender parity in the boardroom, but may also reflect longer-standing cultural norms in place in those counties. These regulatory initiatives indicate a very different approach in public policy, which may have long-term effects in the corporate culture. Despite advances in board gender diversity globally, most countries continue to experience a gender gap in the C-suite, which will likely become the next diversity frontier for investors and policy makers. With this global context in mind, we now take a closer look gender diversity at U.S. boards.

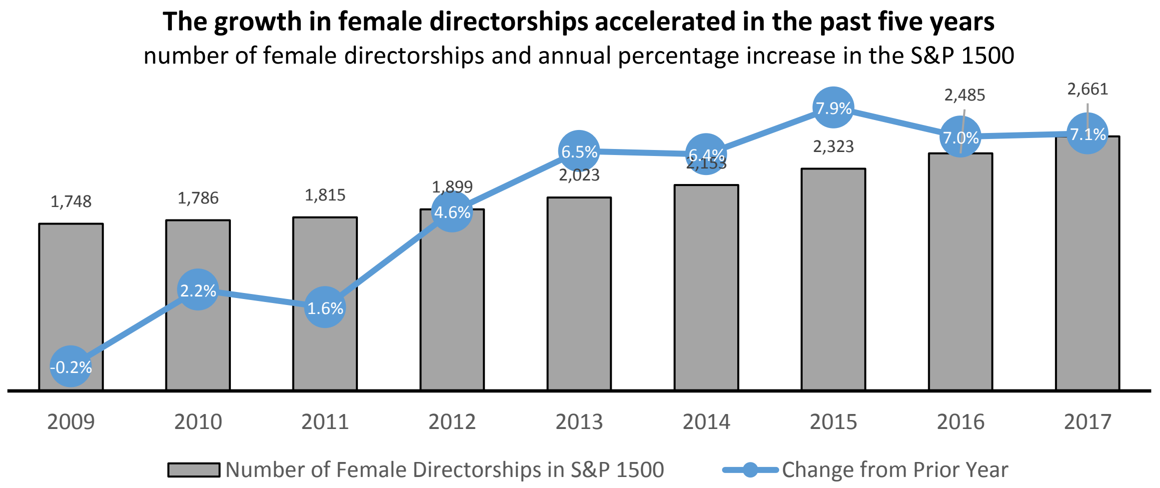
General Trends: Women join boards in record numbers

Women continue to gradually occupy a greater number of director seats at U.S. companies. In 2017, women occupied 19 percent of the board seats in the S&P 1500 Index, an increase of more than 50 percent from 2008 when women occupied roughly 13 percent of the board seats in the same index. The participation of women directors in S&P 1500 boards continues to increase in 2018. Based on preliminary 2018 board profiling data, the percentage of female directors has already increased by at least one percentage point. Large-cap companies generally demonstrate higher levels of gender diversity with 22.4 percent of board seats held by women, followed by 18.3 percent at mid-cap companies, and 15.8 percent at small-cap companies



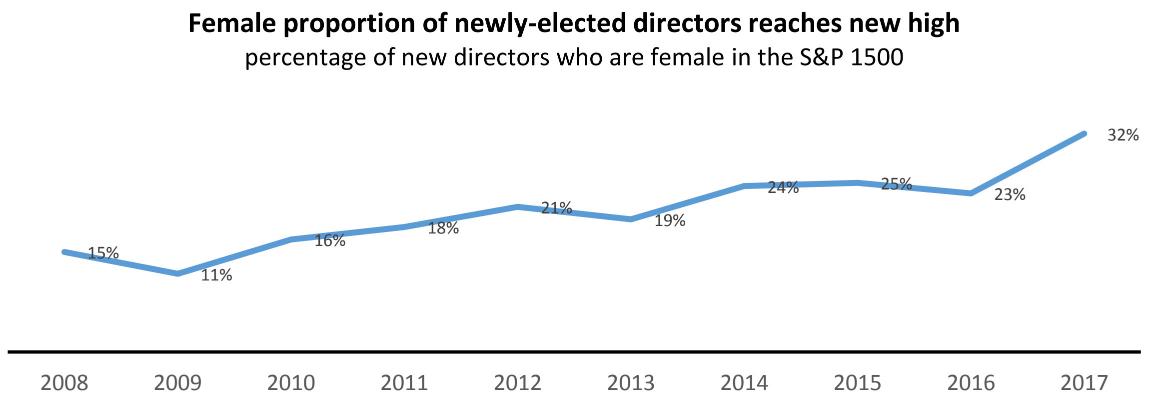
Source: ISS Analytics

In all three indices, female board representation increased by more than a full percentage point. In fact, the past few years have seen an accelerated growth of female directors. More than 80 percent of the increase in the number of female directorships of the past decade occurred during the past five years, with annual growth of female directorships exceeding 7 percent in each of the past three years.



Source: ISS Analytics

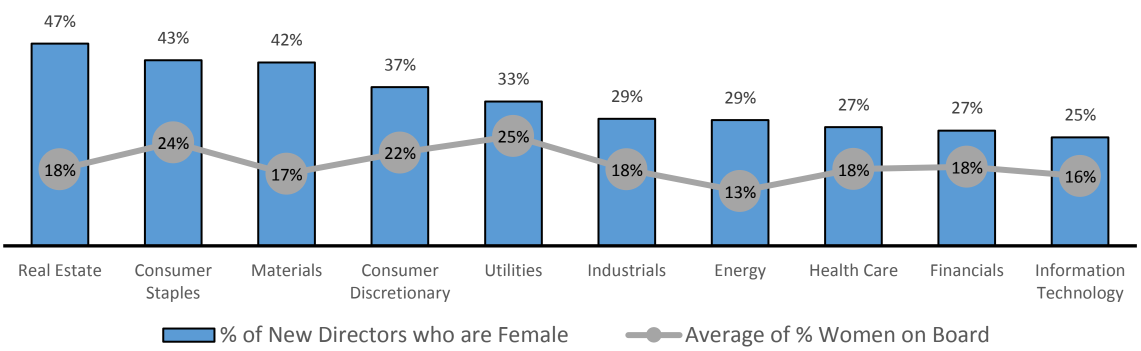
The growth in women on boards is underpinned by the characteristics of the incoming 2017 director class. Of the nearly 14,000 directors on S&P1500 boards, 655 directors were new in 2017. These 655 directors were elected to 468 boards, with some companies adding more than one new director. Female representation within this newly elected director class was robust. At 208 directors, approximately 32 percent of the incoming director class at S&P 1500 companies were women, the highest since ISS began tracking in 2008. In the S&P 500, 36 percent of the incoming 2017 directors were female, the highest of the three underlying indices.



Source: ISS Analytics

Sector Review: Gender diversity shows sector variance

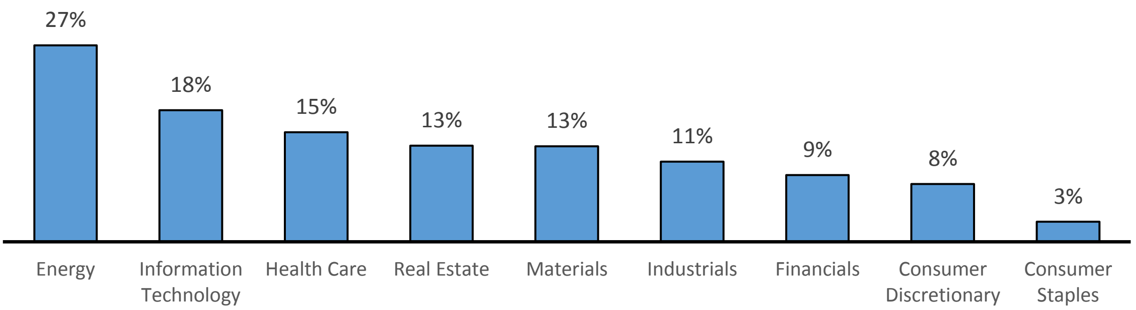
The recruitment of new female directors varies by sector. Real estate, consumer staples, and materials had the highest rates of new directorships offered to women, with each sector choosing women to take more than 40% of new directorships. Notably, the recruitment in real estate and materials, where average female board representation is relatively low, may suggest that companies in these sectors are making an effort to improve gender diversity on their boards. In contrast, health care, financials, and information technology, which also have relatively low levels of board gender diversity, seem to also lag other sectors in new female director appointments.



Source: ISS Analytics

The energy and information technology sectors have the highest prevalence of boards that lack gender diversity, with 27 and 18 percent of companies in each sector without a female director, respectively. The lowest rates of all-male boards were observed in the consumer staples and consumer discretionary sectors, where all-male boards appeared at only 2.7 percent and 7.9 percent of companies, respectively.

The lack of women at the boards of energy and technology companies may relate to a broader lack of women in the workforce of each industry. According to a Boston Consulting Group report, women represent approximately 20 percent of the oil & gas workforce, a significantly smaller share of the workforce than other industries.[1] Additionally, while women hold just over a quarter of computer and mathematical jobs in the U.S, this figure is below the levels observed in 1960.[2] Each industry, therefore, may need to start focusing on employee and upper level management recruitment in order to create a larger pool of qualified female candidates for board positions.

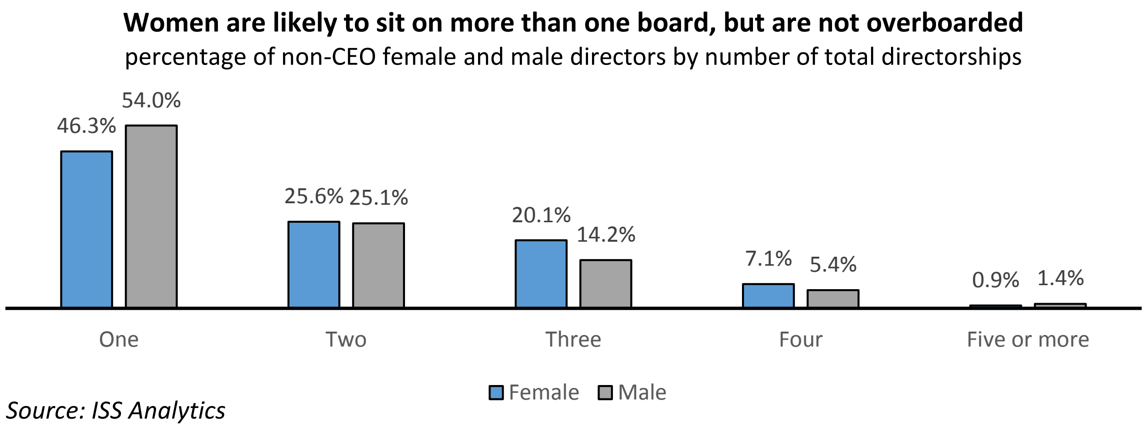


Source: ISS Analytics

[1] Katharina Rick, Ivan Marten, and Ulrike von Lonski, "Untapped Reserves: Promoting Gender Balance in Oil and Gas," Boston Consulting Group, July 12, 2017, accessed April 5, 2018, https://www.bcg.com/publications/2017/energy-environment-people-organization-untapped-reserves.aspx
[2] Laura Colby, "Women and Tech", Bloomberg, August 8, 2017, accessed April 5, 2018, https://www.bloomberg.com/quicktake/women-are-underrepresented-in-the-high-tech-industry-globally

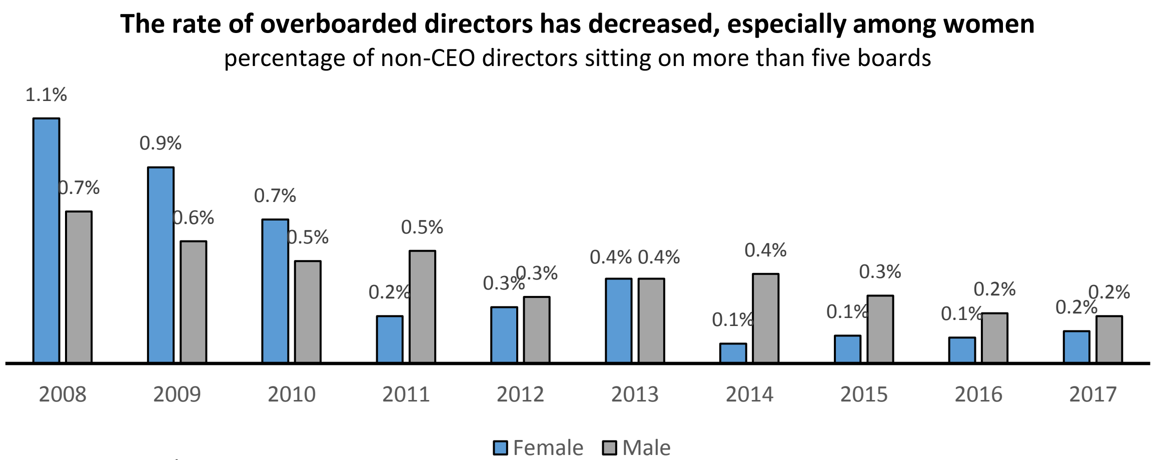
Board Commitments: Board gender diversity has not led to overboarding

In the market as a whole, it is indeed a broadening pool of director candidates that is driving the increase female representation in the boardroom, as opposed to the same women appearing on multiple boards. Historically, a higher rate of female directors sat on more than one board compared to men. However, the recent surge of new female directorships has not led to large numbers of overextended female directors. A majority of the newly elected female directors in 2017, 57 percent, were not serving on other public company boards at the time of their election. In fact, while women directors are more likely to sit on three or four boards, they are less likely than men to sit on five or more boards.



Source: ISS Analytics

The rate of overboarding among female directors is actually decreasing. The number of directors serving on more than five boards has shrunk to approximately one-quarter of 2008 levels. This trend is more emphasized among women, where the rate of directors sitting on more than five boards decreased from 1.1% in 2008 to 0.2% in 2017. As of 2017, 29 directorships of non-CEOs in the S&P 1500 involved directors who served on six or more total boards. Only four of these directorships were held by women.



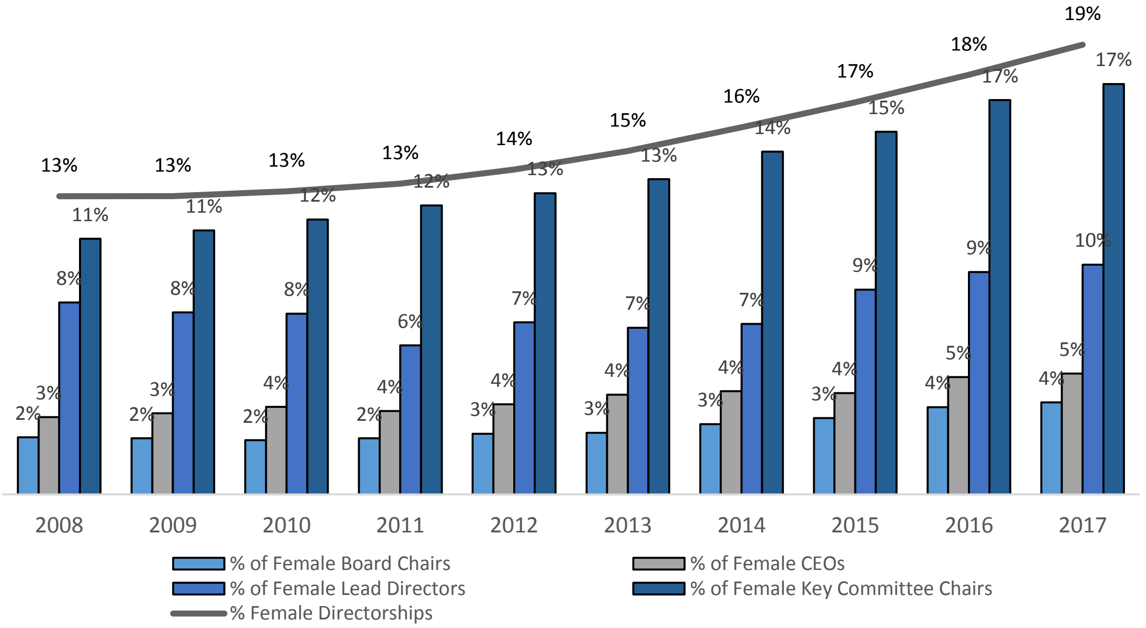
Source: ISS Analytics

Board Leadership: Women in leadership positions still lagging

The number of women in leadership positions remains considerably low, even as more women join corporate boards. In 2017, only 5 percent of S&P1500 companies had a female CEO, and less than 4 percent of board chairmanships were held by women. The percentage of female lead directors reached double digits at 10% for the first time in 2017. The only leadership roles that seem to directly follow the trend of overall female directorships are the chairs of key committees, where approximately 17 percent of committee chairs are women.

The percentage of women in leadership roles increased, but has not followed the trajectory of female directorships

percentage of female directors, board chairs, and CEOs in the S&P 1500

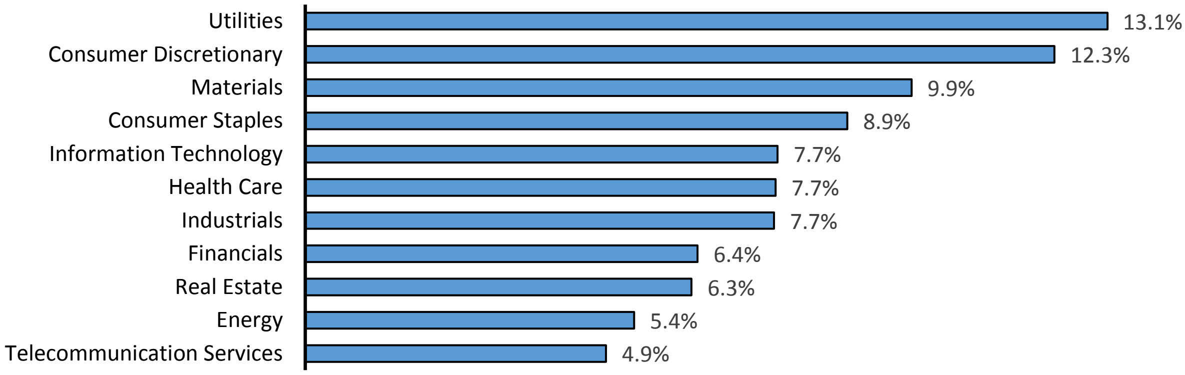


Source: ISS Analytics

Inevitably, the rise of women in leadership positions will need to follow a stronger female presence in the C-suite. Many investors and advocates are already pushing for more diversity at top management positions along with talent development and succession planning.

Currently, only 8.5 percent of top executive officers at S&P 1500 companies are female, according to ISS Analytics data, with financials, real estate, energy, and telecommunications having the lowest rates of women in the C-suite.

Percentage of Female Named Executive Officers by Sector in the S&P 1500



Source: ISS Analytics

Nonetheless, there are some encouraging signs already, as 2017 saw the highest number of women CEOs in the S&P 500 since ISS began tracking in 2008. Of the 30 women CEOs in the S&P 500, an increase from 22 at the end of 2016, five CEOs were newly appointed (**PG&E Corp**., **Reynolds American Inc**., **Nasdaq Inc**., **Mattel Inc**., and **The Hershey Company**).

Diversity Targets: All-male boards continue to decline; 30% remains a distant goal

At the time of their 2017 annual meetings, 99 percent the S&P 500, 90 percent of the S&P 400, 77 percent of the S&P 600, and 87 percent of the companies in the S&P 1500 had at least one woman on the board. Only 179 companies in the S&P 1500 had no women on the board. At the time of their 2017 annual meetings, only four companies in the S&P 500 had no female directors.

Shareholders who believe that diversity improves corporate decisions have developed different strategies to increase gender representation on boards. Some have filed proposals seeking access to companies' diversity policies and workforce data; others have implemented voting guidelines pressuring boards to increase board diversity.

On Feb. 2, 2018, BlackRock Inc. announced that it expects companies in its portfolios to have at least two female directors. BlackRock wrote to companies in the Russell 1000 Index with fewer than two women on their board, and requested disclosure on the companies' efforts to improve boardroom diversity. BlackRock's new policy builds on increasing shareholder focus on greater gender diversity on companies' boards and workforce. State Street Global Advisors, for example, announced in March 2017 that it would vote against the nominating or governance committee chair if a company is identified as lacking gender diversity. State Street did not impose a quota of directors for companies to meet, but nonetheless lived up to its 2017 promise, voting against the re-election of directors in 400 companies who had no women on their board and did not show efforts to improve board gender diversity.

Other institutional investors are members of the Thirty Percent Coalition, an organization committed to women holding 30 percent of board seats across public companies. In 2017, 102 companies in the S&P 500, representing just over 20 percent of the index, met the coalition's goal. Diversity trends vary by company size, however, as this number dropped to 15 and 11 percent in the mid-cap and

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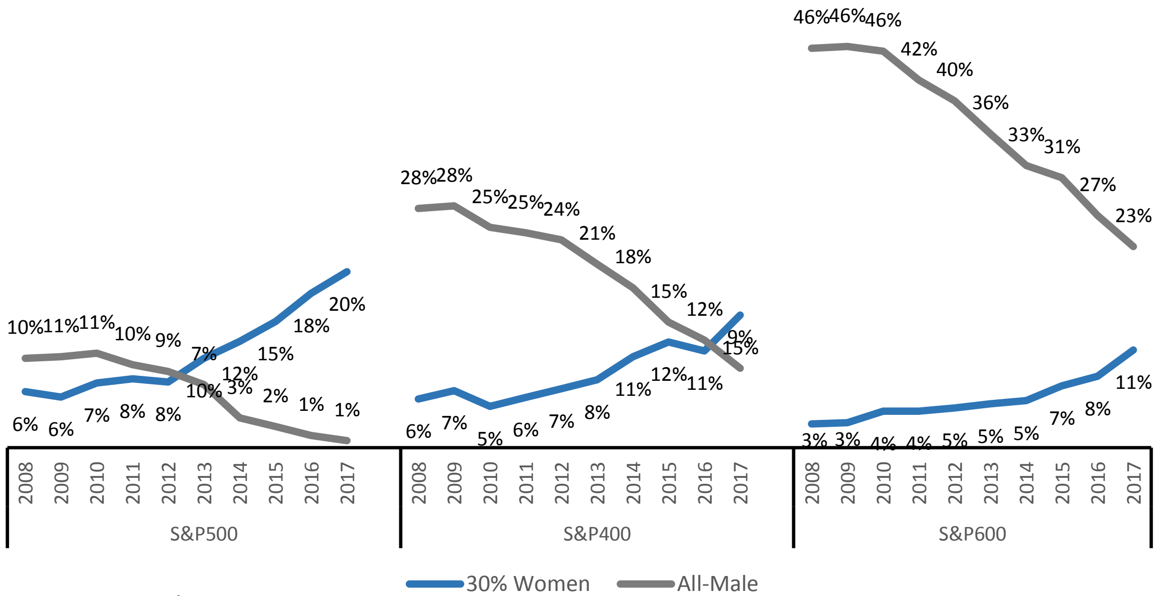
small-cap indices, respectively. Both the S&P 500 and S&P 400 now have a greater percentage of companies with 30% female director representation versus an all-male board. For the first time in the S&P 1500 as a whole, the percentage of companies with at least a 30% female board members exceeds the percentage of companies with all-male boards.

Gender diversity trends vary by company size

Percentage of companies with 30% women and all-male boards by index



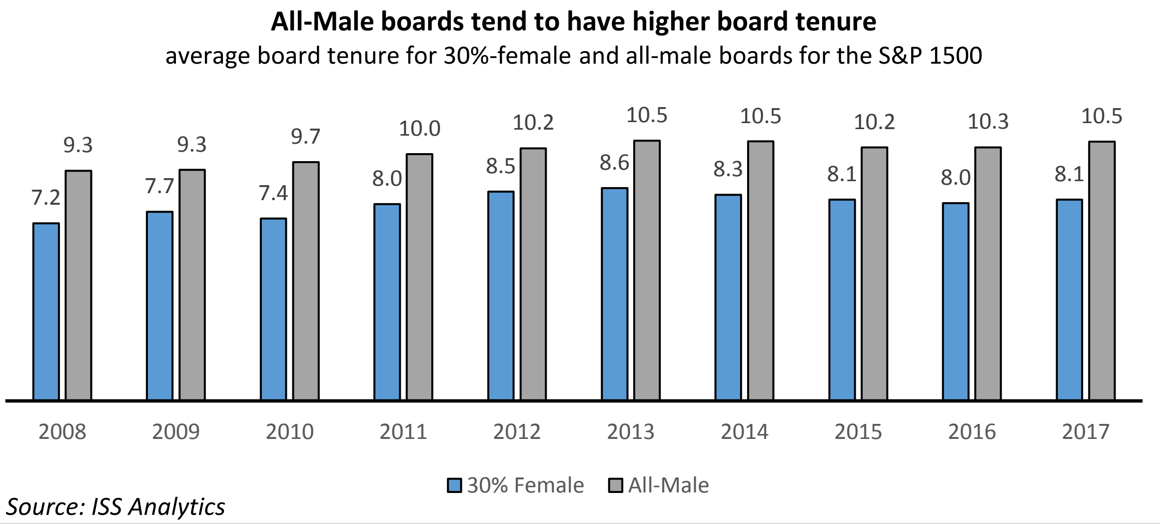
Source: ISS Analytics

A small number of companies have had at least 30% women on the board for a lengthy period of time. Of the S&P 500 companies in 2017 that met the Thirty Percent Coalition goal, thirteen companies had at least 30% female directors continuously since 2012, while seven companies in the S&P 400, and eight companies in the S&P 600 had at least 30-percent gender diverse boards during the same period.

Diversity Correlations: Gender-diverse boards are also diverse in ethnicity, age, and tenure

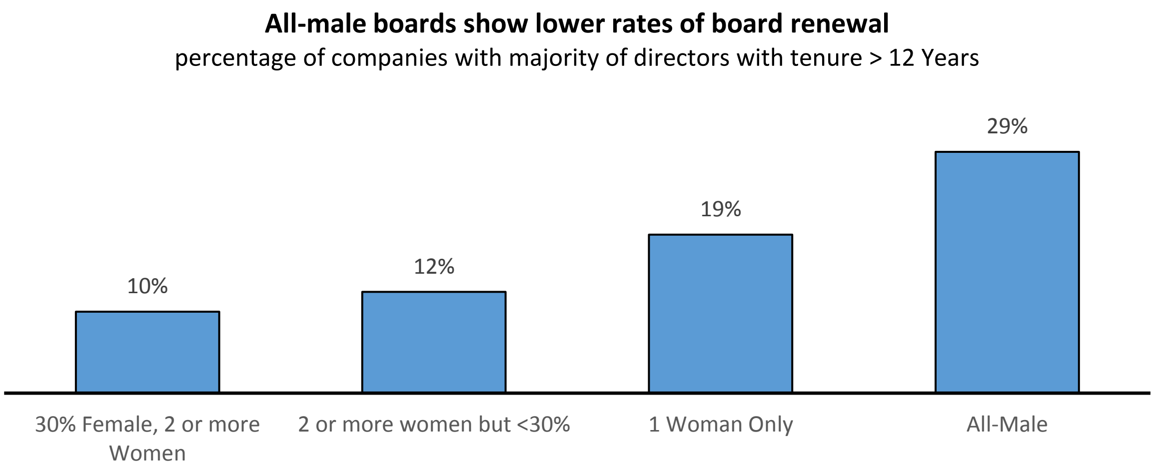
It may not come as a surprise that the composition and structures of the 179 S&P 1500 all-male boards differ from those of the 231 companies with gender-diverse boards, defined as having 30 percent or greater female representation. At nearly 78 percent, male-centric boards tend to be focused at small-cap S&P 600 companies. Conversely, at 44 percent, most gender-diverse boards are in the S&P 500. However, there are certain characteristics of gender-diverse boards that carry across all size segments of the market.

Gender-diverse boards have historically exhibited a lower average board tenure than all-male boards, indicating better rates of board renewal. In 2017, the board tenure divergence was most pronounced at S&P 600 companies, with average tenure of all-male boards 2.4 years greater than gender-diverse boards in the index. At S&P 500 companies, by comparison, the difference narrowed to just 1.5 years. All-male boards also tend to be older, with average director age of 63.1 years in 2017 at all-male boards versus 61.6 years at gender-diverse boards.



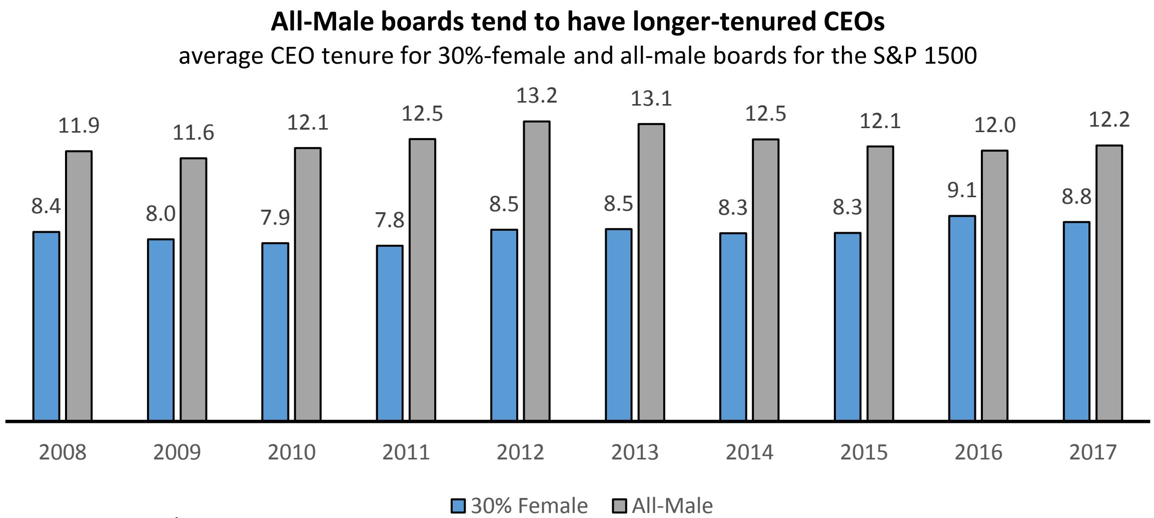
Source: ISS Analytics

The higher rates of renewal among gender-diverse boards become evident when reviewing tenure composition based on the prevalence of boards with a high percentage of directors with high tenure. All-male boards are three times more likely to have a majority of directors with tenure exceeding twelve years compared to boards that have at least 30 percent female directors. In fact, higher rates of gender diversity tend to correlate with higher rates of board renewal.



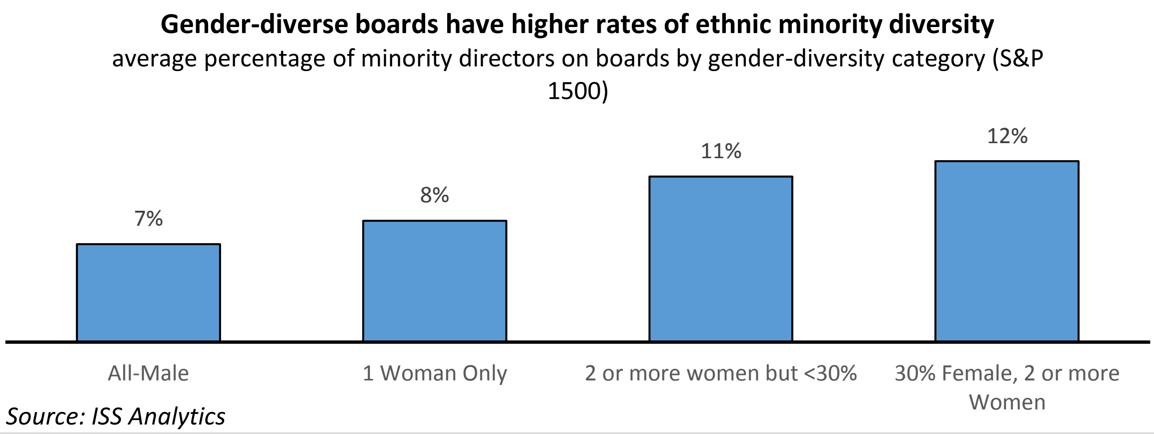
Source: ISS Analytics

Keeping with tenure, CEO tenures also tend to be longer at companies with an all-male board. CEO tenure at companies with all-male boards has averaged at or above 12 years since 2010, while diverse boards averaged no more than 9 years over the same period. In 2017, the average age of CEOs at companies with an all-male board was 58.2 years, slightly higher than 57.7 years at companies with a gender-diverse board.



Source: ISS Analytics

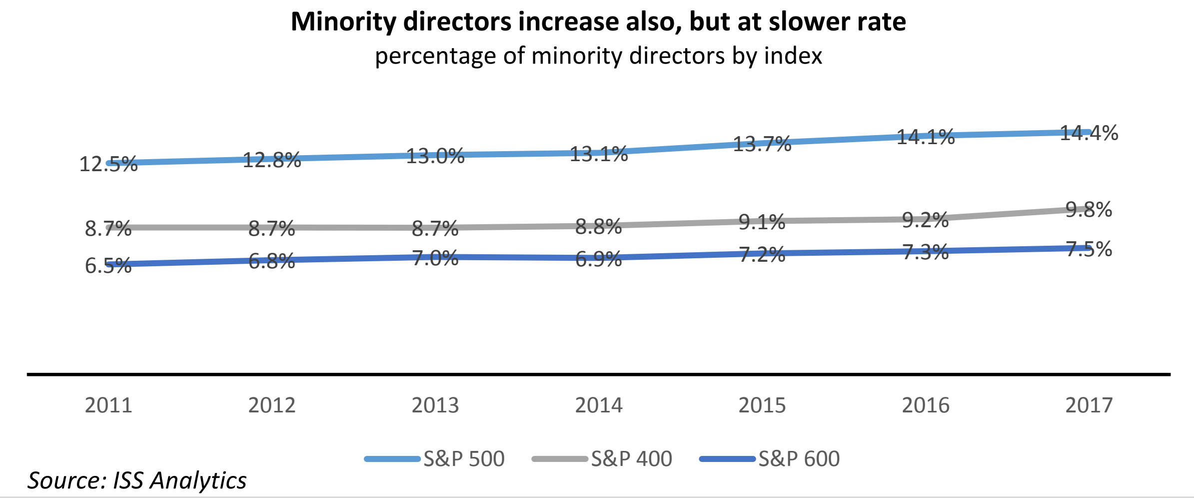
Gender-diverse boards also have greater representation of minority directors. Minority representation is higher at diverse boards compared to all-male boards in the S&P 1500 as a whole. Further, minority representation at gender-diverse boards exceeds the baseline minority representation at each index. In fact, the level of minority representation appears to be directly correlated with the level of gender diversity on the board, as shown in the graph below.



Source: ISS Analytics

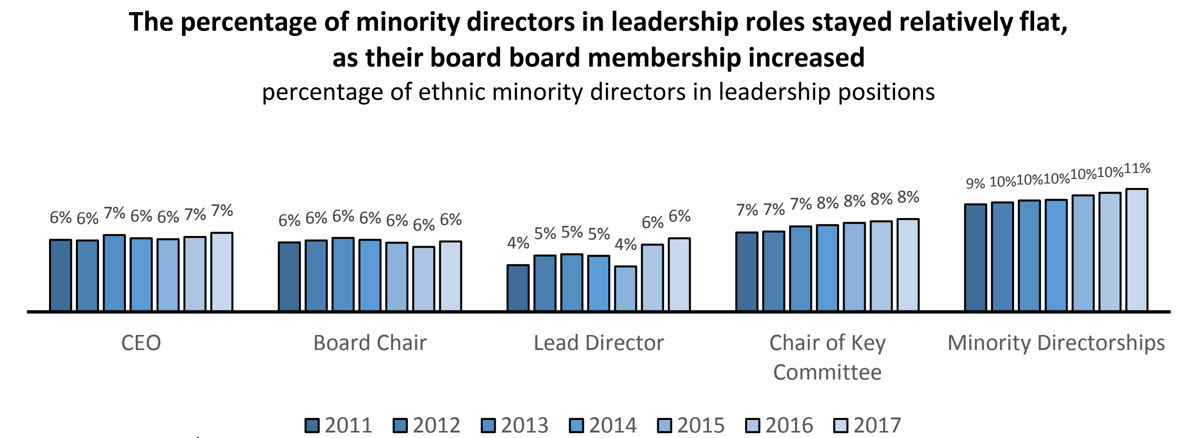
Ethnic Diversity: Minority representation increases but slowly

The percentage of ethnic minority directors has also increased, although at a slower rate compared to women. In 2017, minorities represented 10.6 percent of directorships in the S&P1500, the highest level in 10 years. As of their 2017 annual meetings, 50 S&P 1500 companies had at least four minority directors. This is an increase from 48 companies in 2016, 41 in 2015, and 39 in 2014. Of these 50 companies, minority directors accounted for a majority of the board at 15 companies.



Source: ISS Analytics

The rate of ethnic minority directors in leadership positions, such as board chairs and CEOs is actually higher compared to female directors. However, the rate of minority CEOs and board Chairs has remained relatively flat during the past seven years. As observed in the case of female directors, leadership roles that are separate from the executive function, such as chairs of key committees and lead directors, are more directly correlated with directorship numbers. In the S&P 1500, 100 companies had a minority CEO in 2017, a slight increase from 98 companies in 2016.



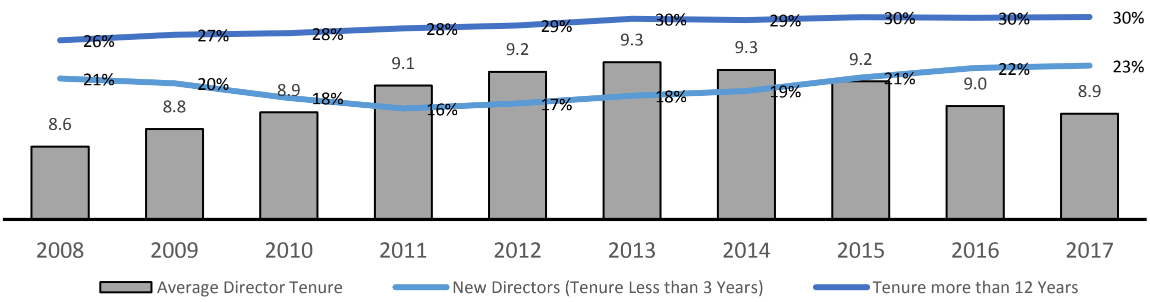
Source: ISS Analytics

Board Refreshment: Board renewal rates continue to improve

In the past few years, board renewal became a focus item for a number of investors, with several groups introducing voting policies focusing on board tenure and refreshment. The emphasis on board renewal appears to have resulted in an increased level of new director appointees. In the S&P 1500, the percentage of directorships where directors had a tenure of less than 3 years increased from 16% in 2011 to 23% in 2017. Average board tenure in the S&P 1500 decreased from its peak of 9.3 years in 2013 to 8.9 years in 2017.

The growing rate of new directors has not resulted in fewer highly-tenured directors, as the percentage of directors with a tenure of more than 12 years has remained steady at approximately 30% during the past five years. The data suggests that, as companies renew their boards, they prefer to maintain a proportion of valued board members with substantial experience in the company in their attempt to strike a balance between renewal and continuity.

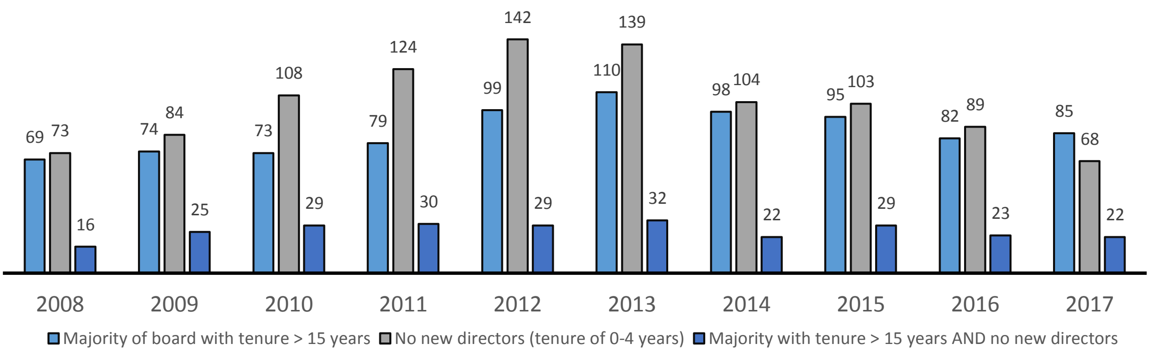
As the rate of board renewal increases, averrage board tenure decreases, while the perecentage of high-tenure directors remains steady
average director tenure and percentage of new and high-tenure directors in the S&P 1500



Source: ISS Analytics

The improvement of board renewal rates is also evidenced by the decrease in the number of companies whose boards are dominated by highly tenured directors. The number of S&P 1500 companies with a majority of directors with a tenure of more than 15 years has decreased since 2013, when it reached its peak of 110 firms. Similarly, the number of companies that failed to add new nominees for five years or longer has also decreased since its peak in 2012. Companies with a majority-tenured board and no new directors are rare, but they do exist with 22 such firms identified in 2017.

Number of companies with signs of poor board renewal continues to fall
number of S&P 1500 companies with poor board renewal indicators



Source: ISS Analytics

Director Age: Boards got older, but board renewal may have slowed the aging process

The past ten years have seen an increase in average director age, the rate of which appears to have been moderated by the increased focus on board renewal. The percentage of S&P 1500 directors who are older than 70 years old increased from approximately 10 percent in 2008 to 16.6 percent in

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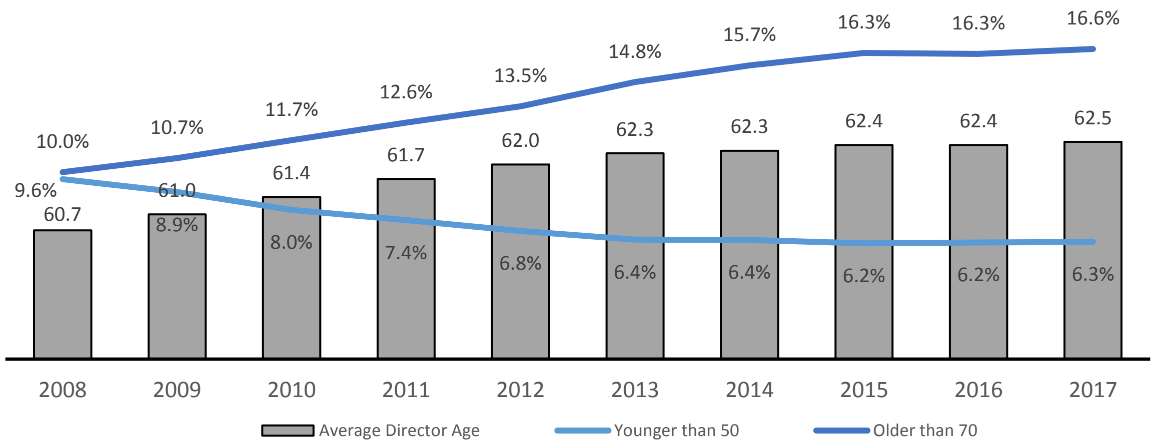
2017. During the same period, the percentage of directors who are younger than 50 years old was reduced from 10 percent to 6 percent. Most of this change in board composition in relation to director age occurred from 2008 to 2013, while the trend of aging boards has continued at a slower rate during the past five years. The number of S&P 1500 boards with a majority of directors above the age 70 has increased from 16 boards in 2008 to 48 boards in 2017. This number has remained relatively stable in the past three years.

The percentage of older directors increases, while younger directors are fewer

average director age and percentage of directors in youngest and oldest age groups



Source: ISS Analytics

The increasing number of directors above the age of 70 should not be surprising, as perceptions about age continue to evolve, and health standards improve. However, the decreasing number of younger directors raises a number of questions. Are boards becoming less open to recruiting younger nominees, or are there fewer younger candidates meeting boards' qualification criteria? As the percentage of younger directors decreases, some boards be missing certain skills that may be more prevalent among younger directors.

Wherefore Diversity?

Board diversity has become a key priority for some of the largest investors in the world, since it serves as a measure of a board's openness and inclusiveness. Ultimately, boards and investors want to make sure that that the board nomination process is robust, and takes into account the most qualified candidates representing the market that the company serves. Therefore, lack of board diversity and lack of board renewal can only be seen as potential symptoms of a problematic nomination process. The end goal remains to have a qualified, engaged, and competent board. As such, a review of board composition from a diversity lens may help facilitate more in-depth discussions about the qualities a company seeks in its directors, and the process it uses for identifying the right members for its board.

Improving board diversity and board renewal can also help improve the overall skillset of the board. The timing for evaluating board composition from this perspective could not be more appropriate. Director skills relevant to some of the most pressing issues for boards today may be in short supply. A review of ISS Analytics data of Russell 3000 companies shows that risk management, government

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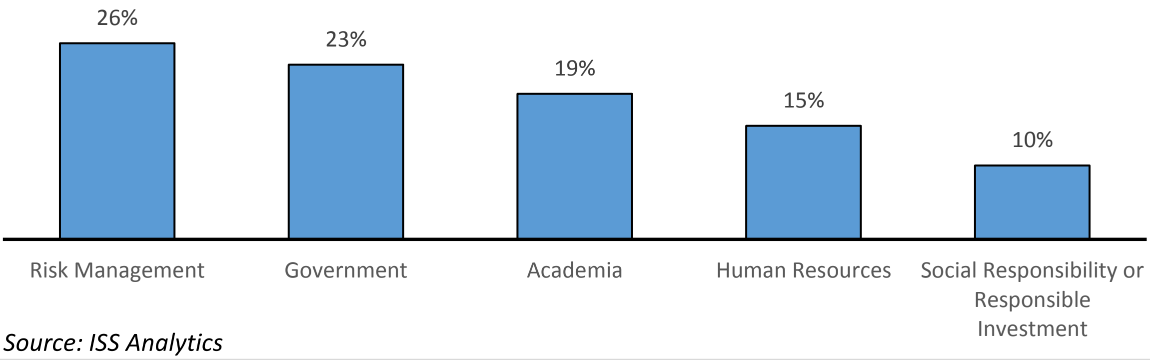
relations, academia, human resources, and social responsibility are the five least commonly cited director skills. At a time when cybersecurity, changing regulations, workplace misconduct, and climate change appear to be on the top of the agenda for investors and boards alike, many U.S. boards may be ill-prepared to face these challenges.

Five Least Common Director Skills Reported at Russell 3000 Companies
percentage of companies with at least one director reported to have expertise in each category



Source: ISS Analytics

As board diversity improves, and as companies provide better affirmative disclosure about their board characteristics and nomination process, investors and boards will likely be able to improve the quality of their engagements to ensure that boardrooms are adequately prepared to face future challenges.

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