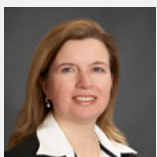


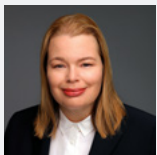


Q&A

How Investors are Driving Positive Change on Diversity, Equity, and Inclusion



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Diversity has risen up the investor agenda in recent years. However, more progress is needed not just on boards, but also across the entire workforce. In this Q&A, Helen Ford, Global Head of Investment Specialist Group, and Jocelyn Brown, Head of Governance, EMEA & APAC, discuss the current diversity, equity and inclusion (DE&I) landscape – including the need to go beyond gender, the importance of inclusive corporate cultures especially in the wake of the pandemic, and how investors should hold themselves and others to account.

Helen Ford: Jocelyn, how much progress has there been so far in terms of diversity on boards?

Jocelyn Brown: In the UK we are seeing progress, but it takes time. The percentage of women serving on FTSE 100 Boards increased from 12% in 2011 when the Davies Review¹ was launched to 39% last year. That is a huge leap in a decade and shows that it simply wasn't true that talented diverse candidates were not available.

The government-backed Hampton-Alexander and Parker reviews² helped push forward board representation for women and ethnic minorities. The focus started with board seats and has now shifted to what roles directors are holding on the board and progression at all levels across the workforce.

There is still some way to go for companies outside the FTSE 350, as the recent Women on Boards UK³ report shows. Only 5% of FTSE 350 companies have all-male executive leadership teams, but that figure jumps to 50% for listed companies outside the FTSE 350. That said, we typically see that the business case for diversity on boards is accepted. Studies on the relationship between diversity and financial performance have been helpful here. Importantly, the conversation has moved on from why a company should consider diversity as a material business issue, to how companies are implementing their diversity policies.

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Policymakers are also making headway outside the UK. European Union negotiators recently agreed on a 40% quota for women on boards of large businesses by June 2026 aiming to tackle slow progress in some member states. The legislation was first proposed in 2012 so has been a long time coming. Regulators are always balancing when to legislate (which risks being overly prescriptive) versus when can Codes or market initiatives deliver the required change. Clearly the view was that there had not been sufficient progress in the last decade across the EU and so legislation was required.

Helen Ford: Investors can use their influence through stewardship and engagement to effect positive change. What is T. Rowe Price doing in this area?

Jocelyn Brown: The objective of T. Rowe Price's stewardship programme is to foster long-term success for investee companies. Typically, we have the option of engaging directly or voting an equity holding. It's important that our expectations are clearly communicated and that there is an escalation plan in place if our expectations are not met within a reasonable timeframe. We talk about our approach to escalation in our UK Stewardship Code report. One of our escalation strategies is to look for the opportunity to join a collective engagement with the company through a third-party initiative, where we believe the dialogue will constructively raise issues of concern. Another option is making a public statement, and in 2022 we have begun selectively pre-disclosing votes for the first time. On a systemic level, investors should also work with policymakers and regulators to encourage the implementation of rules on appropriate disclosure and practice expectations.

Gender diversity is a core part of our stewardship programme and should be for any investor. We have a global voting guideline which says we will vote against the relevant senior director at all single gender boards globally, with higher expectations for female representation in certain markets depending on the local norms.

Helen Ford: The way companies address DE&I differs across the world, with some countries taking a tougher stance than others. How should investors approach regional variations?

Jocelyn Brown: Investors must tailor their stewardship approach to the market. In the UK there is the supporting infrastructure of the annual Hampton-Alexander review and the 30% Club UK Investor Group to put pressure on the laggards, but it is up to individual investors to keep a close eye on how an investee company's non-executive recruitment is progressing, and to vote against the Chair if progress is too slow. We recently extended our voting guideline to reflect our expectation that company boards in the FTSE 100 should include at least one director from an underrepresented ethnic or racial group. We will take the same approach to engaging with the laggards there as we did for gender diversity.

¹ The Davies Review was an independent, government-backed UK review launched in 2011 to look at the underrepresentation of women on boards.

² The Hampton-Alexander review was launched to continue the work of the Davies Review. In 2016, the business-led initiative was set up to increase the representation of women in leadership and on the boards of FTSE 350 Companies. The independent Parker Review was launched in the same year to focus on the ethnic and cultural diversity of UK boards. Both reviews have been supported by the UK government.

³ <https://www.theguardian.com/business/2022/jun/12/smaller-ftse-firms-still-failing-on-boardroom-diversity>

Some of the most interesting conversations recently have been with ambitious high-growth companies in emerging markets. We see a recognition from such companies keen to access capital from international investors that having an all-male board makes them less attractive.

A market where board diversity has been a focus for our voting and engagement in recent years is Japan, which has an unusually low proportion of female directors amongst developed markets. To put this in context, 2021 was the first year a majority of Japanese listed companies had at least one female director. Our regional Portfolio Manager has championed board diversity in his conversations with management, and the investment analysts will reinforce the message by raising the topic with the companies through off-season engagement to warn them that they are at risk of a vote against the Chair if we see no progress by the next annual general meeting. As a result, we have seen the number of single-gender boards in his portfolio decrease significantly.

Board diversity is also a way into a broader discussion about board composition. In Japan we see a lack of international directors even on businesses where the majority of revenues are from overseas operations, and there are a lot of cultural considerations in developing the appropriate skillsets to hold management to account.

The latest version of Japan's Corporate Governance Code requires the company to disclose a policy and voluntary measurable targets in respect of promoting diversity in senior management by appointing females, non-Japanese and mid-career professionals. It is fair to say that while many companies are establishing programmes to retain and develop senior female talent, we are not seeing the same to date for international managers and mid-career switchers, despite the Code's expectations.

Helen Ford: Despite advancements, some hurdles remain regarding diversity data and disclosure. How can companies and investors address certain sensitivities with a view to driving positive change?

Jocelyn Brown: Broadening out what characteristics are considered diverse, and recognizing that this will vary by market, is key. A lack of comprehensive and comparable data is an ongoing challenge for the investment industry, but there have been some interesting developments. In the US, we are seeing companies voluntarily beginning to widen the range of diversity characteristics on which they report. In 2021 we saw⁵ 32 boards include LGBTQ+ disclosure in their proxy statement – which is approximately 6% of the S&P500. One board disclosed having a disabled director and three boards disclosed having a director who was a veteran.

However, on these 32 boards, only five LGBTQ+ directors were willing to be identified by name. While the very fact this information was disclosed at all shows evidence of a thoughtful approach to the perspectives directors are bringing to the boardroom, it does raise the question of how much directors are willing to share on their invisible characteristics, and how much it is appropriate for investors to request.

Helen Ford: It's important that investors hold themselves to the same standards that they hold portfolio companies. Jocelyn, how are we holding ourselves accountable at T. Rowe Price from a corporate point of view?

Jocelyn Brown: 40% of the T. Rowe Price Group board directors are female and 40% are ethnically diverse. We also disclose that 30% of our directors were born outside the US, which is key for an international business with local offices in 16 countries, and 30% are veterans.

For our corporate initiatives, having a diverse and inclusive workforce and providing equitable opportunities to all associates is a business, ethical and cultural imperative. Recruiting from the broadest pool of top talent is crucial because it enables us to identify investment opportunities others might overlook.

We have seen encouraging results so far. In 2021, 66% of our new hires across the firm were either female or ethnically diverse. For every open senior role at the firm, our goal is that at least 30% of interviewed candidates will be female and/or ethnically diverse, and during 2021, 59% of such candidates were ethnically diverse or female.

Of course, hiring is only the first step. Employers also need to retain people and ensure they stay engaged and motivated. As part of our engagement process, we ask our portfolio companies about specific initiatives. Applying that lens to ourselves, our sales, investments and technology groups have targeted programmes to achieve a better gender balance and foster an inclusive environment. These include talent sourcing and development, improving inclusive leadership competencies, and supporting caregivers through planned leave. Our associate-led business resource groups create a sense of belonging for ethnically and culturally diverse, LGBTQ+, female associates and veterans, as well as their allies. Moreover, we monitor and publish our employee engagement scores both internally and externally, to hold ourselves accountable for our efforts in this area.

Ultimately, DE&I should be a core value for every company and its stakeholders and a failure to meet these expectations will likely have a negative impact on the ability to compete for talent and market share.

⁴ The 30% Club UK Investor Group is an initiative that brings together 40 investors to drive change with companies on inclusion and diversity.

⁵ Spencer Stuart 2021 S&P 500 Board Diversity Snapshot

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