

**Testimony of**  
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**Before the**  
**United States House of Representatives**  
**Committee on Financial Services**  
**Subcommittee on Diversity and Inclusion**

**Hearing on**  
**“By the Numbers: How Diversity Data Can Measure Commitment to Diversity, Equity,**  
**and Inclusion”**

**March 18, 2021**

Chair Beatty, Ranking Member Wagner, and other Members of the Subcommittee:

Thank you for the opportunity to testify at today's hearing. My name is Anne Simpson, and I am the Managing Investment Director for the Board Governance and Sustainability program for the California Public Employees' Retirement System ("CalPERS"). I am pleased to appear before you today on behalf of CalPERS. We applaud and support the Subcommittee's focus on the importance of diversity and inclusion in our capital markets and the need for mandatory disclosures about diversity and inclusion metrics so that investors can make informed decisions.

I will provide an overview of CalPERS, discuss our governing principles, and discuss the importance of corporate diversity and inclusion to the long-term success of fiduciaries like CalPERS. I also will discuss the necessity of standardized, decision-useful diversity disclosure as transparency into corporations' commitment to diversity is critical to capital formation with the objective of achieving the best returns and value for shareowners over the long-term. Ultimately, CalPERS' primary responsibility is to our beneficiaries, so our long-term investment returns are central to our views on what information we need to make the right investment choices.

## **CalPERS**

CalPERS is the largest public pension fund in the United States ("U.S."), with approximately \$450 billion in global assets and equity holdings in over 10,000 public companies globally. CalPERS is a fiduciary that provides nearly \$25.8 billion annually in retirement benefits to more than 2 million members. Delivering investment returns is our investment office's number one job. Nearly 55 cents of every dollar paid in those benefits come from investment returns. Moreover, achieving good investment returns helps us avoid increasing the contributions required from California's communities. Increasing contributions takes away budget resources otherwise available for those communities to provide public services. This means that our members depend upon safety and soundness in the capital markets as well as long-term value for their retirement security. For these reasons, we are focused on our portfolio companies' commitments to diversity and inclusion.

## **CalPERS' Investment Beliefs and Diversity Principles**

CalPERS is guided by its fiduciary duties of prudence, care and loyalty, and we ensure full compliance with all laws and regulations. To promote long-term returns, our Board has adopted Investment Beliefs,<sup>1</sup> which recognize the importance of today's hearing for long-term fiduciaries, especially Investment Beliefs Two, Four, and Ten:

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<sup>1</sup> <https://www.calpers.ca.gov/docs/board-agendas/201702/pension/item7-01.pdf>.

- Investment Belief Two: “A long time investment horizon is a responsibility and an advantage”;
- Investment Belief Four: “Long-term value creation requires effective management of three forms of capital: financial, physical and *human*” and CalPERS “engage[s] investee companies and external managers on their...Human capital practices, including but not limited to...diversity” (emphasis added); and
- Investment Belief Ten: “Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives,” in particular “[d]iversity of talent (including a broad range of education, experience, perspectives and skills) at all levels (Board, staff, external managers, corporate boards) is important.”

Therefore, CalPERS engages companies and managers on their human capital management practices, including their commitment to attracting talent from all available resources, as demonstrated by their commitment to diversity.

CalPERS has developed and implemented a set of Governance and Sustainability Principles (“Principles”).<sup>2</sup> These Principles are a statement of our views on best practices to guide the internal and external managers of CalPERS when making investment decisions and provide the framework by which we advocate with policy-makers, execute our shareowner proxy voting responsibilities, and engage portfolio companies to achieve long-term returns. In Section B of our Principles, we emphasize the importance of board quality, including the need for board diversity. Specifically, we state that “The board should facilitate a process that ensures a thorough understanding of the diverse characteristics necessary to effectively oversee management’s execution of a long-term business strategy” and a “robust process for how diversity is considered when assessing board talent and diversity should be adequately disclosed.”

In August of 2016, the CalPERS Board of Administration adopted a five-year Sustainable Investment Strategic Plan (“Strategic Plan”) for the purpose of minimizing risk, maximizing returns, and ensuring accountability from all those involved. Together, our Investment Beliefs, Principles, and Strategic Plan support advocating for a robust reporting regime for publicly traded companies that would address issues that impact shareowner value over the long-term, including board and workforce diversity. Together, they have guided us to work with partners and advocate for policies that address improvements to board diversity. I applaud this Subcommittee for focusing on certain matters that we consider critical to long-term value.

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<sup>2</sup> <https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf>.

## **Diversity is Important to Long-term Value**

As a fiduciary that must pay benefits long into the future, we are focused on corporate practices that drive long-term value. We believe, and research increasingly demonstrates, that companies with a diverse board, inclusive of gender and race/ethnicity, are better positioned to execute good governance, effective risk management, and optimal decision-making, as well as enhanced customer alignment, employee engagement, and transparency. For instance, the Office of the Illinois State Treasurer published a white paper titled “The Investment Case for Board Diversity” which provides an extensive and comprehensive review of academic and practitioner research on the value of gender and racial/ethnic board diversity for investors.<sup>3</sup> The examination finds that “the gender and racial/ethnic composition of corporate boards does indeed have a material and relevant impact on company performance and investors.”

ISS has found similar results. To help measure the benefits of diversity on performance, ISS launched the ISS ESG U.S. Diversity Index in 2020. The index integrates ethnic and gender representation for directors and named executive officers of 300 large-, mid-, and small-cap U.S. companies. Since its inception, the index has outperformed the S&P 500 and the Russell 1000.<sup>4</sup> Moreover, ISS has found that “companies with greater gender diversity exhibit better market performance and higher financial quality than those companies that do not prioritize gender diversity.”<sup>5</sup>

On a more granular level, ISS has found that “boards with at least two women outperform the average Russell 3000 returns over three-, four-, and five-year periods, while male-dominated boards underperform against the index over the same periods”<sup>6</sup> and that “board compositions with ethnically diverse directors (defined as three or more directors that belong to a minority ethnicity) outperformed boards without such individuals.”<sup>7</sup> Conversely, “[o]ver four- and five-year holding periods, the less-diverse boards underperformed the Russell 3000 by about 0.25%.”<sup>8</sup> As a result, “investors with holdings concentrated in companies without ethnic diversity would have lost out on 1.27% average additional returns annually over a four-year period.”<sup>9</sup>

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<sup>3</sup> THE INVESTMENT CASE FOR BOARD DIVERSITY: A Review of the Academic and Practitioner Research on the Value of Gender and Racial/Ethnic Board Diversity for Investors, Office of the Illinois State Treasurer (October 2020),

[https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/il%20treasurer%20white%20paper%20-%20the%20investment%20case%20for%20board%20diversity%20\(oct%202020\).pdf](https://illinoistreasurergovprod.blob.core.usgovcloudapi.net/twocms/media/doc/il%20treasurer%20white%20paper%20-%20the%20investment%20case%20for%20board%20diversity%20(oct%202020).pdf).

<sup>4</sup> *Volatile Transitions: Navigating ESG in 2021*, at 13, White Paper Series, ESG Themes & Trends 2021, ISS-ESG (herein after “ISS-ESG”).

<sup>5</sup> Id.

<sup>6</sup> Id. at 14.

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> Id.

As an investor with a long-time horizon, CalPERS must take into consideration these performance differentials.

### **Diversity is Material and Must be Disclosed**

The federal securities laws were designed to “close [] the channels of...commerce to security issuers unless and until full disclosure of the character of such securities has been made.”<sup>10</sup> These disclosures are not solely for the “protection of investors,” as some have argued, but are also intended to provide investors and the public with important information about the securities so as to promote the efficient allocation of capital and the public interest.

A corporation’s diversity metrics are material because they influence investment decisions; they are also in the public’s strong interest.

Unfortunately, for too long, issuers have declined to provide this information, despite the plain language of the federal securities laws, and the Securities and Exchange Commission (“SEC”) has failed to compel its disclosure. The SEC should quickly work to ensure that this information is provided in a clear, reliable, and comparable format.

The materiality standard, as established by the Supreme Court in *Northway, Inc. v. TSC Industries, Inc.*, is whether information would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available:

The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. (emphasis added) This standard is fully consistent with Mills' general description of materiality as a requirement that “the defect have a significant propensity to affect the voting process.” The standard does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.<sup>11</sup>

Moreover, in *Basic Inc. et al. v. Levinson*, the Court stated that:

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<sup>10</sup> H. Rep. 73-85 (1933), at 2-3.

<sup>11</sup> 426 U.S. 438 (1976).

The Court also explicitly has defined a standard of materiality under the securities laws, see *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), concluding in the proxy solicitation context that “an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” *Id.*, at 449, 96 S.Ct., at 2132...The court further explained that to fulfill the materiality requirement “there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Id.*, at 449, 96 S.Ct., at 2132. We now expressly adopt the TSC Industries standard of materiality for the § 10(b) and Rule 10b-5 context.<sup>12</sup>

Thus, materiality is in the eye of the reasonable investor. As discussed in this testimony, there is significant research demonstrating that a corporation’s approach to diversity, at the board level and within its workforce, meaningfully affects its performance. Investors, particularly investors who have a long-term horizon, such as CalPERS, find this information to be material, as a result.

Incoming SEC Chairman Gary Gensler recently testified before the Senate Committee on Banking, Housing and Urban Affairs about the meaning of materiality. During the hearing, he alluded to these cases, stating that “materiality is defined, [as] what reasonable investors are seeking to have to make their decisions either to invest or not to invest or to vote yes or vote no” and materiality is “about investors making a choice as to what's significant, or what's material, to be more accurate, what's material for those investors.”<sup>13</sup>

To Mr. Gensler’s point, shareholders like CalPERS have actively engaged with corporations about diversity, which evinces the materiality of such information to these investors. Back in March 2015, CalPERS along with other public fund fiduciaries representing over \$1.12 trillion in assets submitted a petition<sup>14</sup> to the SEC for a rulemaking requiring new disclosures related to nominees for corporate board seats in order to provide investors with necessary information to evaluate the nominees’ gender, racial, and ethnic diversity, as well as their mix of skills, experiences, and attributes needed to fulfill the corporation’s mission.

In July 2020, BlackRock issued a note to clients entitled “Our Approach to Sustainability. The note stated that its “stewardship also includes topics that have been central to many companies’ license to operate, particularly over the past few months, such as human capital management and diversity and inclusion.”<sup>15</sup> Moreover, the note stated that “We also will continue to emphasize the importance of diversity in the board room and will consider race, ethnicity, and gender as we

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<sup>12</sup> 485 U.S. 224 (1988).

<sup>13</sup> Nominations Hearing, Senate Committee on Banking, Housing and Urban Affairs (Mar. 2, 2021).

<sup>14</sup> <https://www.sec.gov/rules/petitions/2015/petn4-682.pdf> (dated March 31, 2015)

<sup>15</sup> Our Approach to Sustainability, BlackRock Investment Stewardship, <https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf>.

review a company’s directors” and as part of that focus, they supported at least one shareholder proposal for “greater disclosure around” a company’s diversity and inclusion efforts.”<sup>16</sup> Vanguard too has emphasized that diversity is part of a board’s responsibility to overseeing long-term value.<sup>17</sup>

Additionally, CalPERS has developed a three-part strategy for investment based on research into the positive correlation of human capital to value creation. This involves:

- advocating for public policies and reporting sustainability disclosures in a consistent, comparable and reliable manner;
- engaging companies and our external managers; and
- integrating human capital management across the portfolio to better identify, measure and assess long-term risk and opportunity.

This strategy ensures that we capture diverse talent and counter unconscious bias in our investment decisions. It is founded on partnerships with initiatives such as the Human Capital Management Coalition, which we co-founded to provide a platform for research, knowledge sharing and co-operation in company engagement and regulatory advocacy. The results are notable as we have seen a significant increase in companies appointing diverse candidates to their boards, although progress is still too slow and diversity too often viewed in only one dimension – typically gender.<sup>18</sup>

### **Mandatory Diversity Disclosures are Necessary to Help Investors Allocate Capital Efficiently**

Investors need more transparency into board diversity so they can make more informed decisions and allocate our capital to the investments that will provide the most long-term value. In Section B of our Principles, we emphasize the importance of board quality, including the need for board diversity:

The board [of directors] should facilitate a process that ensures a thorough understanding of the diverse characteristics necessary to effectively oversee management's execution of a long-term business strategy. Board diversity should be thought of in terms of skill sets, gender, age, nationality, race, sexual orientation, gender identity, disability, and historically under-represented groups. Consideration should go beyond the traditional notion of diversity to include a broader range of experience,

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<sup>16</sup> Id.

<sup>17</sup> Vanguard 2020 Investment Stewardship Annual Report (2020), [https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2020\\_investment\\_stewardship\\_annual\\_report.pdf](https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2020_investment_stewardship_annual_report.pdf).

<sup>18</sup> Tamara Sells and Anne Simpson, *Investment for Sustainable Value Creation*, Official Monetary and Financial Institutions Forum.

thoughts, perspectives, and competencies to help enable effective board leadership.

Moreover, our Principles state that board should play an active role in “efforts to promote diversity, inclusion and innovation” and the board itself should “disclose a diverse mix of director attributes” so that the board has “a range of skills and experience which provide a diverse and dynamic team.”

Unfortunately, there is a substantial lack of diversity at U.S. companies, especially outside of the S&P 500. ISS estimates that underrepresented ethnic groups constitute only 12.5 percent of board directors” whereas 90 percent of “director positions with the most influence over the direction of the company and the board are white.”<sup>19</sup> Furthermore, only 29 percent of the 3000 largest U.S. companies have two or more ethnically diverse directors and 84 percent of these companies have no ethnically or racially diverse employees among their top five executives.<sup>20</sup> Nasdaq has stated that the U.S. currently ranks 53<sup>rd</sup> in board gender diversity, according to the World Economic Forum.<sup>21</sup> Given the lack of disclosures about board diversity, it is hard to get very good data on racial diversity on boards, but third party analysis appears to show that as many as 70 percent of Nasdaq companies’ boards are not diverse at all.<sup>22</sup>

According to ISS, there are many challenges to obtaining decision-useful information on corporations’ diversity metrics, among other metrics. These include the lack of standardized of disclosures, and inadequate and/or inaccurate information disclosed, among others.<sup>23</sup> Without more comprehensive disclosures of board diversity, we and other investors are less able to evaluate the competitive advantages between companies.

Voluntary disclosures, quite simply, are insufficient to enable investors to obtain the information necessary to evaluate diversity data. There is a need for comparability and consistency of disclosures, which help manage expectations and evaluate management. There would be major problems if a company began to selectively disclose particular information. Investors would have to use the only means available to address the problem which would be through votes in board of directors’ elections or through litigation. Mandatory disclosures would bypass these issues. We appreciate the need to balance a variety of considerations in determining the scope of disclosures,

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<sup>19</sup> ISS-ESG at 12.

<sup>20</sup> Id.

<sup>21</sup> Self-regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Listing Rules Related to Board Diversity [Release No. 34-90574; File No. SR-NASDAQ-2020-081].

<sup>22</sup> Andrew Ross Sorkin, Jason Karaian, Michael J. de la Merced, Lauren Hirsch and Ephrat Livni, *Nasdaq Pushes for Diversity in the Boardroom*. <https://www.nytimes.com/2020/12/01/business/dealbook/nasdaq-diversity-boards.html>.

<sup>23</sup> Maura Saunders, *Survey Analysis: ESG Investing Pre- and Post-Pandemic*, at 12, ISS ESG.



particularly ESG disclosures, and we are glad that the SEC is focusing on these issues in this context.<sup>24</sup>

Accordingly, to remedy this information asymmetry and the inadequacy of voluntary disclosures, boards should annually disclose their demographic information including race, ethnicity, and gender, as advocated in our Principles. Ideally, companies should disclose their Employer Information Report, known as the EEO-1 report, or similar workforce demographic data to enable shareowners to assess the board's diversity relative to its workforce and compare companies in similar industries.

Fundamentally, mandatory disclosures will improve transparency, accountability, and efficient capital allocation by enabling investors to make informed decisions based on material information. Such disclosures will help investors monitor their portfolio companies' progress and commitment to a diverse workforce. Investors need to be able to compare between companies' efforts to draw talent from as wide a pool as possible and to invest in the company whose efforts will promote the best long-term value for their portfolio. CalPERS has long taken the view that companies need to adopt progressive human capital management practices, including with respect diversity, accompanied by fair, accurate, timely, and integrated reporting on how they mitigate human capital risks and generate sustainable returns.

## **Conclusion**

CalPERS is a fiduciary whose primary goal is making good investments to fulfill our responsibility to our members. We believe companies' long-term value creation requires a real commitment to diversity and inclusion. In other words, we have a long history of focusing on diversity and inclusion within our portfolio companies because of the potential effects on our returns. It is investors like CalPERS who ultimately bear the costs when companies do not seek talent from the widest available pools and thus reduce their long-term value.

Policy-makers have an important role to play in creating a regulatory framework that incentivizes the companies we invest in to take diversity seriously while generating returns that meet public pension funds' needs. Policies that encourage businesses to be diverse and inclusive and require disclosures demonstrating their commitment help investors identify companies that are able to both deliver the returns we need and have measurable positive human capital impacts. Such policies are useful in strengthening investor confidence and encouraging capital to flow toward a more sustainable economy.

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<sup>24</sup> John Coates, ESG Disclosure - Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets (Mar. 11, 2021), [https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121?utm_medium=email&utm_source=govdelivery).

We look forward to working with the Subcommittee and Committee to discuss these issues, as well as the policy proposals set forth in today's hearing, and hopefully more proposals in the future. Thank you, Chair Beatty and Ranking Member Wagner for inviting me to participate in this hearing, and I look forward to your questions.