Securities Regulation Daily Wrap Up, TOP STORY—Illinois' new board diversity law favors disclosure over quotas, (Aug. 27, 2019)

Securities Regulation Daily Wrap Up

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The law scraps a requirement that boards include women and minorities in favor of disclosure and a third-party scorecard.

Illinois' governor signed legislation requiring public companies headquartered in the state to disclose information about gender and minority representation on their boards. The enacted law completely replaces the draft as introduced, which would have required each corporation to have at least one female and one African American director by the end of next year. Representative Chris Welch, who introduced the bill, said that he is also looking into similar legislation for "private companies that do public business."

Illinois is the corporate home of 36 Fortune 500 companies. A Crain's study of the largest Chicago-based corporations found that female and minority representation on boards—24 and 16 percent, respectively—is about even with national averages for large companies. Only 12 of the largest 40 Chicago-area companies would have satisfied a version of the Illinois law requiring female, African American, and Hispanic representation.

Requirements. Under HB 3394, no later than January 1, 2021, all public companies with their executive office in Illinois, whether incorporated in the state or elsewhere, must include diversity information in their annual reports. The disclosure must include the self-identified gender of each board member and state whether each member self-identifies as a minority person. If a director self-identifies as a member of a minority group, the corporation must also disclose the director's race or ethnicity.

The law also requires certain process-based disclosures. A company must provide data on the specific qualifications, skills, and experience it considers for its directors, director nominees, and executive officers. The report must also describe the company's process for identifying and evaluating director nominees and for identifying and appointing executive officers, including in both cases whether and how demographic diversity is considered. Finally, the company must describe its policies and practices for promoting diversity, equity, and inclusion among its board of directors and executive officers.

Each year, the University of Illinois will review the disclosures and publish on its website a report that aggregates the demographic data provided. The university must also establish a rating system for assessing female and minority representation on the reporting companies' boards and publish an individualized rating for each corporation. This rating will take into account the corporation's compliance with the law's reporting requirements, its diversity policies and practices, and the demographic diversity of its leadership. The university's report will also identify strategies for promoting diversity and inclusion among directors and officers.

Legislative efforts towards diversity. As introduced, the bill would have required at least one female and one African American director on each corporation's board and would have imposed penalties for violations modeled after California's law requiring gender diversity on boards. Enacted in 2018, that law requires that each public company headquartered in California have between one and three female directors, depending on the size of the company's board. The California law has faced criticism, including from SEC Commissioner Hester Peirce, who said that the requirements amount to "an improper federalization of corporate governance," increase costs to public companies, and may unintentionally signal that corporations will not recruit female directors unless required to do so. Institutional Shareholder Services, however, predicted that California's law could lead to a 22 percent increase of female directorships nationwide.

Illinois Governor J. B. Pritzker praised the effects of diverse leadership on business: "reduced turnover, increased growth and improved market share." Senator Christopher Belt said that the law will help "pinpoint the corporations who aren't diversifying. Illinois is a very diverse state, and boards should reflect the diversity of its employees, consumers and community."

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