BETTER MARKETS

RACIAL ECONOMIC INEQUALITY

REPORT

How Can the SEC Address Racial Economic Inequality Through Regulation of the Securities Markets for All Americans

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INTRODUCTION

American history has been marked by racial discrimination and the mistreatment of Black Americans and other minorities for 400 years. This discrimination has been fueled by long-standing racist beliefs, laws, policies, and practices, which in turn have contributed to a deeply entrenched racial inequality in the American economic and financial systems. The legacy of this history is starkly evident today in the headlines, the social unrest, and the irrefutable data showing deep racial economic inequality particularly as it relates to Black Americans—in short, a profound racial wealth divide.

A new movement is underway in the realm of business and finance that promises some forward progress in addressing racial economic inequality and other aspects of racial injustice. Companies, and the shareholders that own and ultimately govern them, are increasingly re-examining their priorities and recognizing that they can and should do more to correct and reverse racial injustice. This perspective, often referred to as the ESG movement, espouses the view that companies should work not just to generate profits but also to promote environmental sustainability, social justice for all—including racial equity—and greater shareholder participation in corporate governance.[1] This movement is supported not only on moral and social policy grounds but also on squarely financial grounds. For example, as elucidated below, studies show that more ethnically diverse companies are more profitable than their less diverse peers. Thus, the ESG factors, and specifically racial justice, have become material to investors for both financial and non-financial reasons.[2]

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Government regulators, in turn, have an important role to play in facilitating the implementation of this potentially transformative way of thinking. The Securities and Exchange Commission is one of those regulators. The SEC, as the regulator of our capital markets, plays an important role in stewarding one of the primary wealth generating engines of our economy. And more specifically, regulating the flow of material information to investors has long been one of its responsibilities. It must therefore be centrally involved in addressing racial economic inequality. In this report, we review the economic marginalization that still creates barriers for Black Americans, the role the SEC can play in solving the problem, and some of the specific steps the SEC can and should take to help rectify the racial wealth divide.

[1] Stephen Hall & Jason Grimes, Better Markets, *White Paper: What is ESG and Why Is It So Important?* (Jul. 14, 2021), https://better-markets.org/sites/default/files/documents/Better_Markets_White_Paper_SEC_Why_Is_ESG_Important.pdf.

[2] *See also id.*

BACKGROUND: Today's racial wealth divide resulted from centuries of exploitation and discrimination.

The North American institution of slavery began 400 hundred years ago, in the early 1600s, with the slave trade and the prolonged subjugation of millions of Africans forcibly taken from their homeland. While the Civil War, the adoption of the Thirteenth Amendment in 1865, and other events were critical milestones in the societal transition away from slavery, the concentration of wealth and resources among white citizens continued and continues to this day. And it has persisted notwithstanding the civil rights movement of the 1960s and the legislative reforms of that era, including some in the financial realm.[3] Thus, racist attitudes and practices have been firmly in place for most of our country's history. Rather than aberrations in our national narrative, they have become the norm that must be changed through new policies, practices, and with respect to finance, targeted regulatory reforms.

It is no wonder, then, that today we continue to see racial economic inequality particularly for Black Americans in many areas of economic and financial prosperity. In the case of entrepreneurship, Black Americans are significantly less likely to start businesses than white Americans and Black-owned businesses are less likely to be successful.[4] There is the disparity in employment, reflecting the fact that the unemployment rate for Black Americans has persistently been higher than that for white Americans—frequently as much as twice as high.[5] There is the wealth gap, which reflects the fact that the typical Black household has just **10%** of the wealth of the typical white household, a disparity that amounts to an astonishing wealth differential of **$10.6 trillion**.[6] Moreover, a report from Citigroup found that if the U.S. had closed certain racial gaps 20 years ago, an estimated $16 trillion would have been added to the economy.[7] And it is estimated that the U.S. stands to lose $5 trillion over the next five years from the failure to close those gaps today.[8]

The lack of economic opportunity available to Black Americans and other minorities is further illustrated by the lack of diversity in top positions at major companies. In the Fortune 500, 82.5% of board seats

[3] The handful of relevant financial market reforms included the Equal Credit Opportunity Act and the Community Reinvestment Act. The latter statute depends on implementation through strong rules, and the OCC has recently proposed to rescind the weak Trump-era CRA rules and replace them with a stronger set that promotes more consistent treatment of all types of depository institutions. Press Release, *OCC Issues Proposal to Rescind its 2020 Community Reinvestment Act Rule* (Sept. 8, 2021), https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-94.html.

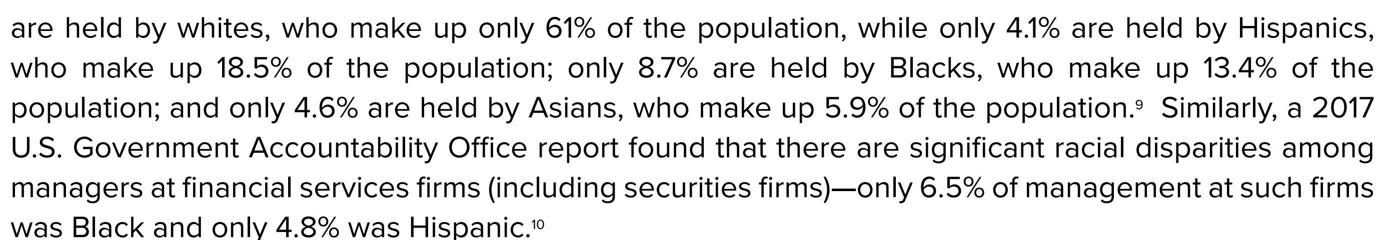
[4] Kaufmann Foundation, *Research on Race and Entrepreneurship* (Dec. 2016), https://www.kauffman.org/wp-content/uploads/2019/12/kauffman_compilation_race_entrepreneurship.pdf.

[5] Stephanie Aaronson, *et al.*, Brookings Institute, *A Hot Labor Market Won't Eliminate Racial and Ethnic Unemployment Gaps* (Sept. 2, 2021), https://www.brookings.edu/blog/up-front/2021/09/02/a-hot-labor-market-wont-eliminate-racial-and-ethnic-unemployment-gaps/.

[6] Calvin Schermerhorn, Opinion, *Why the Racial Wealth Gap Persists, More than 150 Years After Emancipation*, Wash. Post (June 19, 2019), https://www.washingtonpost.com/opinions/2021/07/30/us-wealth-gap-race/; Vanessa Williamson, Brookings Institute, *Closing the Racial Wealth Gap Requires Heavy, Progressive Taxation of Wealth* (Dec. 9, 2020), https://www.brookings.edu/research/closing-the-racial-wealth-gap-requires-heavy-progressive-taxation-of-wealth/. There is also the way all of these gaps perpetuate each other in an endless cycle. Lack of Black entrepreneurship means fewer jobs in predominantly Black communities, which means lower employment in Black communities, which means less wealth in Black communities, which means fewer people in Black communities with the capital to start a business, and so on and so forth.

[7] Citi GPS, *Closing the Racial Inequality Gaps* (Sept. 2020), https://ir.citi.com/NvIUklHPilz14Hwd3oxqZBLMn1_XPqo5FrxsZD0x6hhil84ZxaxEuJUWmak51UHvYk75VKeHCMI%3D.

[8] *Id.*



are held by whites, who make up only 61% of the population, while only 4.1% are held by Hispanics, who make up 18.5% of the population; only 8.7% are held by Blacks, who make up 13.4% of the population; and only 4.6% are held by Asians, who make up 5.9% of the population.[9] Similarly, a 2017 U.S. Government Accountability Office report found that there are significant racial disparities among managers at financial services firms (including securities firms)—only 6.5% of management at such firms was Black and only 4.8% was Hispanic.[10]

One of the most significant insights from the protests that erupted in 2020 following the murder of George Floyd is that such persistent racial economic inequalities are not simply the product of individual bad actors with reactionary views on race. Rather, as one commenter has explained, "racism is also systemic, existing in the advantages and disadvantages imprinted in cultural artifacts, ideological discourse, and institutional realities that work together with individual biases."[11] Simply put, racism is built into the structure of society, into the fabric of its institutions. Solving racial economic inequality is not just a matter of collectively agreeing that everyone is equal and that racism and bigotry are deplorable. Racial economic inequality must be attacked, in large part, at an institutional level. In other words, if the powerful people who run the powerful institutions in America do not combat institutional racial economic inequality, we will not solve the racial wealth divide.[12]

WHY THE SEC MUST FOCUS MORE ON PROMOTING RACIAL ECONOMIC EQUALITY: The Legal, Economic, and Moral Rationales.

The SEC is one of those powerful institutions that can and should help promote racial economic equality. This may not seem obvious at first glance. Indeed, there are some, including some at the SEC, who argue that addressing racial economic inequality and other social issues should not be the agency's focus.[13] After all, this argument goes, the SEC is primarily concerned with regulating the capital markets to ensure that they are fair and efficient and that this mission does not intersect with social policy challenges such as racial discrimination, at least not sufficiently to justify SEC action. In any event, they contend, the SEC lacks the institutional expertise to address these complex social issues. This point of view fails for several reasons.

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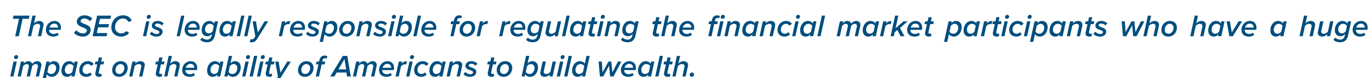
[9] Deloitte, *Missing Pieces Report: The Board Diversity Census of Women and Minorities on Fortune 500 Boards* (6th ed. 2020), https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/missing-pieces-board-diversity-census-fortune-500-sixth-edition.html; U.S. Census Bureau Website, Quick Facts (last accessed Dec. 8, 2021), https://www.census.gov/quickfacts/fact/table/US/PST045219.

[10] GAO, *Representation of Minorities and Women in Management and Practices to Promote Diversity*, 2007-2015 (2019), https://www.gao.gov/assets/gao-19-398t.pdf.

[11] Phia S. Salter, *et al.*, *Racism in the Structure of Everyday Worlds: A Cultural-Psychological Perspective,* 27 Current Directions in Psychological Science 150, 150 (2018), https://journals.sagepub.com/doi/full/10.1177/0963721417724239.

[12] *Cf.* John Stuart Mill, Inaugural Address Delivered to the University of St. Andrew's 74 (Longmans, Green, Reader, and Dyer 1867) ("Let not anyone pacify his conscience by the delusion that he can do no harm if he takes no part and forms no opinion. Bad men need nothing more to compass their ends, than that good men should look on and do nothing. He is not a good man who, without a protest, allows wrong to be committed in his name, and with the means which he helps to supply, because he will not trouble himself to use his mind on the subject."), https://play.google.com/store/books/details?id=8w8qAAAAYAAJ&rdid=book-8w8qAAAAYAAJ&rdot=1.

[13] *See, e.g.,* Remarks of SEC Commissioner Elad L. Roisman, *Can the SEC Make ESG Rules That Are Sustainable?* (June 22, 2021), https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.



The SEC is legally responsible for regulating the financial market participants who have a huge impact on the ability of Americans to build wealth.

First, it is clear that participation in the capital markets is one critical strategy for Americans striving to build wealth for important life goals such as purchasing a home, paying for a child's education, and accumulating a sufficient nest egg to afford a comfortable retirement. The SEC regulates the financial

services industry, including the brokers and investment advisers who help facilitate investor access to those markets. Second, the SEC also oversees the companies that turn to the capital markets for money to start and grow their businesses. It regulates many aspects of corporate life, from the disclosure of "material" information that ensures investors have accurate information about the companies they invest in, to the corporate governance processes through which investors elect boards of directors and vote on major corporate policies. Ultimately, the SEC's responsibilities, as a legal matter, are critical to ensuring broad economic prosperity.

Yet truly broad economic prosperity is impossible as long as Black Americans and other minorities face unjustifiable and disproportionate economic hardship. What this ultimately means is that racial economic equality is an issue that falls **within the SEC's jurisdiction and that the SEC has a clear role in helping to address the problem**. Many at the SEC agree. For example, Commissioner Allison Herren Lee delivered a speech in September 2020 outlining the importance of racial justice and the SEC's role in promoting it.[14] In addition, the SEC's Investor Advisory Committee as well as its Asset Management Advisory Committee have taken up the problem of racial inequality and issued recommendations to help the SEC address it more effectively.[15]

Corporate policies on racial justice have a direct impact on stakeholders and ultimately corporate profits, and they are clearly material to investors.

The SEC's role in addressing racial economic inequality also rests on the clear financial correlation between diversity and a company's bottom line. The notion that financial issues with a real impact on companies' profitability (and thus, investors' fortunes) are divorced from ongoing racial economic inequality represents a myopic view of how finance and economics actually work. And in particular, this view discounts how corporate policies and practices on matters of racial justice can affect the behavior of employees, shareholders, and consumers who in turn determine the strength and profitability of the company.

For example, a company's stance on racial justice also impacts its ability to attract, cultivate, and retain talent. An Edelman report also detailed this phenomenon. 41% of Americans said they would not work

[14] SEC Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More*, Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

[15] SEC Investor Advisory Committee, *Recommendations regarding Minority and Underserved Inclusion in Investment and Financial Services* (Mar. 11, 2021), https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210311-minority-and-underserved-inclusion-recommendation.pdf; SEC Asset Management Advisory Committee - Subcommittee on Diversity and Inclusion, *Recommendations for Consideration by the AMAC* on July 7, 2021, https://www.sec.gov/files/amac-recommendations-di-subcommittee-070721.pdf.

for a company that does not take a stand on racial justice issues.[16] Another 55% said that racism at their workplace had damaged their relationship with their employer.[17] This not only has a potentially destructive impact on those workers' health (which makes it a moral issue), but in turn has a potentially destructive impact on those workers' productivity (which makes it an economic and financial issue).[18] And employees who have a damaged relationship with their employer may be more likely to leave, which is costly in several ways, all impacting the bottom line.

Moreover, it has become increasingly clear in recent years—and in particular after the murder of George Floyd and the resulting protests—that consumers themselves are increasingly "voting with their dollars," *i.e.*, letting moral considerations drive their spending. The Edelman report released in May detailed precisely this phenomenon, finding that 42% of people in the U.S. either started or stopped using a brand based on how the company responded to racial justice protests, an increase of 7 percentage points year-over-year.[19] This trend is even more pronounced in younger generations: One report found that 62% of Americans under the age of 35 said they would research brands' inclusivity practices before purchasing from them.[20] This strongly suggest that this phenomenon will only become more pronounced over time. Moreover, we have seen evidence that this is not just a matter of survey respondents giving high-minded answers to survey questions that do not reflect their real-life behavior. For example, in 2018, Nike launched a campaign featuring Colin Kaepernick, the former NFL quarterback who in 2016 knelt during the national anthem to protest racism and police brutality against Black people (and who some feel was effectively blackballed by the league as a result). Although Kaepernick became a controversial figure, Nike saw "its sales increase and its stock price reach an all-time high."[21]

The upshot of all of this is that a company that does not adequately address racial justice concerns will have trouble attracting and nurturing talent, it will have trouble sustaining employee productivity, and it will likely have trouble retaining employees. In other words, a company's approach to racial justice can either shrink or enlarge its available talent pool, which in turn impacts its ability to grow, adapt, and profit. Similarly, a company that is perceived to be lagging in racial justice issues alienates consumers,

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[16] 2021 Edelman Trust Barometer Special Report, *Business and Racial Justice in America* 23 (May 2021), https://www.edelman.com/sites/g/files/aatuss191/files/2021-05/2021%20Edelman%20Trust%20Barometer%20Special%20Report_Business%20and%20Racial%20Justice%20in%20America.pdf.

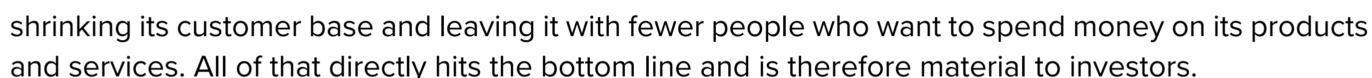
[17] *Id.* at 21.

[18] Adwoa Bagalini, *5 Ways Racism is Bad For Business—And What We Can Do About It*, World Economic Forum (Jul. 14, 2020), https://www.weforum.org/agenda/2020/07/racism-bad-for-business-equality-diversity/.

[19] 2021 Edelman Trust *Barometer Special Report, Business and Racial Justice in America* 14 (May 2021), https://www.edelman.com/sites/g/files/aatuss191/files/2021-05/2021%20Edelman%20Trust%20Barometer%20Special%20Report_Business%20and%20Racial%20Justice%20in%20America.pdf.

[20] S&P Global Ratings, *Why Corporations' Responses to George Floyd Protests Matte*r (Jul. 23, 2020), https://www.spglobal.com/ratings/en/research/articles/200723-environmental-social-and-governance-why-corporations-responses-to-george-floyd-protests-matter-11568216.

[21] *Id*.



shrinking its customer base and leaving it with fewer people who want to spend money on its products and services. All of that directly hits the bottom line and is therefore material to investors.

It should come as no surprise, then, that companies lacking in employee and management diversity experience worse financial performance than those with greater levels of diversity—and, indeed, this is exactly what the empirical evidence demonstrates. For example, a series of reports by McKinsey & Company has examined the impact of diversity on the profitability and competitiveness of companies, and those reports have consistently found that more diverse companies are more profitable than their less diverse peers. The most recent report found that "companies in the top quartile (of ethnic and cultural diversity) outperformed those in the fourth (quartile) by 36 percent in terms of profitability in 2019."[22] This is, in part, because "diverse teams have been shown to be more likely to radically innovate and anticipate shifts in consumer needs and consumption patterns—helping their companies gain a competitive edge."[23] Suffice it to say, if McKinsey & Company—a consulting firm often seen as an avatar for the pursuit of maximal corporate efficiency[24]—believes there is a strong business case for increasing diversity and promoting racial justice, then there is most certainly a strong business case for increasing diversity and promoting racial justice.

Thus, even if one assumes that all investors are unconcerned with the legal intricacies of securities regulation or the moral imperatives discussed below, such investors would still care about a company's approach to racial justice, because there is strong evidence that companies with better approaches to racial justice perform better financially and, accordingly, offer better returns to investors. While diversity may or may not have been material to a company's performance 30 years or 50 years ago, it is undoubtedly relevant today. If the conventional wisdom holds that the SEC's mission to regulate the free and fair functioning of the capital markets—which includes ensuring that investors have relevant information about the financial and economic strength of the companies they would invest in—does not implicate racial justice issues, that conventional wisdom is outdated, as racial justice issues are materially relevant to the most basic thing investors are trying to do: make money.

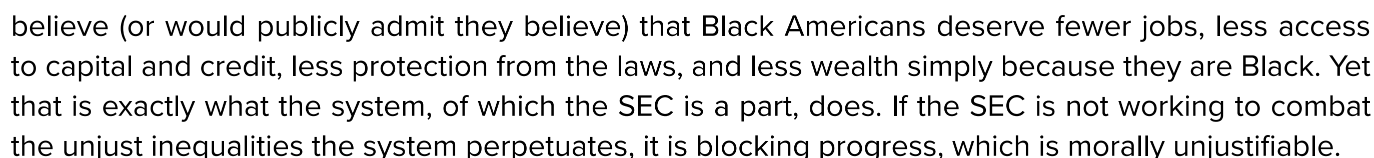
The SEC has a moral responsibility to promote an end to ongoing racial economic inequality.

Underlying all of the foregoing considerations is a profoundly important moral imperative. Those who would sideline an agency like the SEC and discourage it from doing all it can to combat economic racial inequality are engaged in a form of moral abdication. The variety of racial divides discussed in the background section of this Report are not just numbers. They represent a real human cost, *i.e.*, millions of Americans who face unnecessary hardship and foreclosed opportunities because of a system that was intentionally built up over the course of centuries to privilege white Americans at the expense of Black Americans and other Americans of color. Presumably, few people who make this argument

[22] McKinsey & Company, *Diversity Wins: How Inclusion Matters* 4 (May 2020), https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters#signin/download/%2F~%2Fmedia%2Fmckinsey%2Ffeatured%20insights%2Fdiversity%20and%20inclusion%2Fdiversity%20wins%20how%20inclusion%20matters%2Fdiversity-wins-how-inclusion-matters-vf.pdf%3FshouldIndex%3Dfalse.

[23] *Id.*

[24] Ryan Cooper, *Opinion: What McKinsey Really Suggests About Pete Buttigieg*, The Week (Dec. 12, 2019), https://theweek.com/articles/883584/what-mckinsey-really-suggests-about-pete-buttigieg.



believe (or would publicly admit they believe) that Black Americans deserve fewer jobs, less access to capital and credit, less protection from the laws, and less wealth simply because they are Black. Yet that is exactly what the system, of which the SEC is a part, does. If the SEC is not working to combat the unjust inequalities the system perpetuates, it is blocking progress, which is morally unjustifiable.

WHAT THE SEC CAN DO TO PROMOTE RACIAL ECONOMIC EQUALITY: Disclosure, Proxy Voting, and Enforcement in the ESG Arena.

The SEC has jurisdiction and influence over essentially three types of actors in the capital markets: The agency itself; the members of the financial services industry, including brokers, investment advisers, and investment companies; and the thousands of corporations, both public and private, that seek to raise capital from investors. The SEC has some key regulatory tools at its disposal to shape the policies and activities of all three groups of actors with respect to advancing racial economic equality. We start with the single most important group (the public companies) and the single most important tool (disclosure).

PUBLIC COMPANIES

Disclosure.

The SEC's primary regulatory tool is mandated disclosure.[25] This may appear to be an inadequate regulatory device for addressing patterns of behavior that reinforce the urgent, longstanding, and deeply engrained issue of racial economic inequality and the racial wealth divide. Many might prefer that the SEC impose substantive requirements regarding, for example, minimal diversity requirements for public companies[26] rather than simply requiring companies to tell us what they are doing with regard to racial justice. However, for a variety of reasons (including potential limits on the SEC's legal authority to mandate some aspects of corporate policy), disclosure requirements represent an important first step for the SEC in addressing racial economic inequality, discrimination, diversity, and inclusion, and they can even go a long way toward substantively changing company behavior.

The first advantage of disclosure regulation is that it is well-established under the law and therefore legally defensible and less likely to draw successful legal challenges that would undermine efforts to address racial economic inequality. It is commonly understood that the regulatory regime established for securities by Congress was intended to be one primarily based on full and accurate disclosure of information material to investors.[27] Essentially, disclosure can be said to be "the defining characteristic

[25] SEC Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More*, Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

[26] The Nasdaq exchange recently approved a rule requiring all listed companies to disclose the diversity composition of their boards and imposing a duty to meet minimum diversity requirements or at least explain their reasons for their failure to meet those standards. While this too is ultimately a disclosure approach, it also reflects something that some may argue is closer to a substantive diversity requirement. https://www.sec.gov/rules/sro/nasdaq/2021/34-92590.pdf. That rule has been challenged in court. *See Alliance for Fair Board Recruitment v. SEC*, No. 21-60626 (filed Aug. 10, 2021, 5th Cir.).

[27] *Sec. & Exch. Comm'n v. Cap. Gains Rsch. Bureau, Inc.*, 375 U.S. 180, 186 (1963).

of securities regulation."[28] As such, the authority of the SEC to require more disclosure is generally well-understood and well-accepted. By contrast, the SEC's authority to impose certain substantive requirements on issuers and how they conduct their business is arguably less firmly established, meaning some attempts to impose such requirements could be in greater danger of judicial nullification. However, using disclosure is not just a strategic legal strategy. Disclosure can actually be an effective tool in substantively changing company behavior. What former Supreme Court Justice Louis Brandeis said about publicity is as true today as it was in 1933:

> Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.[29]

Disclosure has widely been recognized as an effective tool not only in providing information to investors and the public, but in actually changing behavior. For example, when Congress mandated that manufacturers make detailed disclosures of their emissions of toxic pollution into the environment, some larger companies committed to reducing such pollution by as much as 90%, presumably spurred by the knowledge that the extent of their polluting activities would soon be made public; within a decade, toxic pollution releases had been reduced by half.[30] Moreover, while disclosure clearly has its limits as an investor protection tool,[31] it has also been noted that the securities markets have proven particularly well-suited for effective use of disclosure in some respects.[32]

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Disclosure can be effective at regulating behavior in a variety of ways. Most obviously, disclosure provides the public with information that it can act on, and when the public acts on that information (for example by buying the securities of companies that have demonstrated a commitment to ameliorating racial economic inequality and selling the securities of those companies that have not), the result is a "chain reaction of new incentives."[33] Disclosure influences consumer and investor behavior with direct effects on the company's bottom line.

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[28] Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. Cin. L. Rev. 1023 (2000).

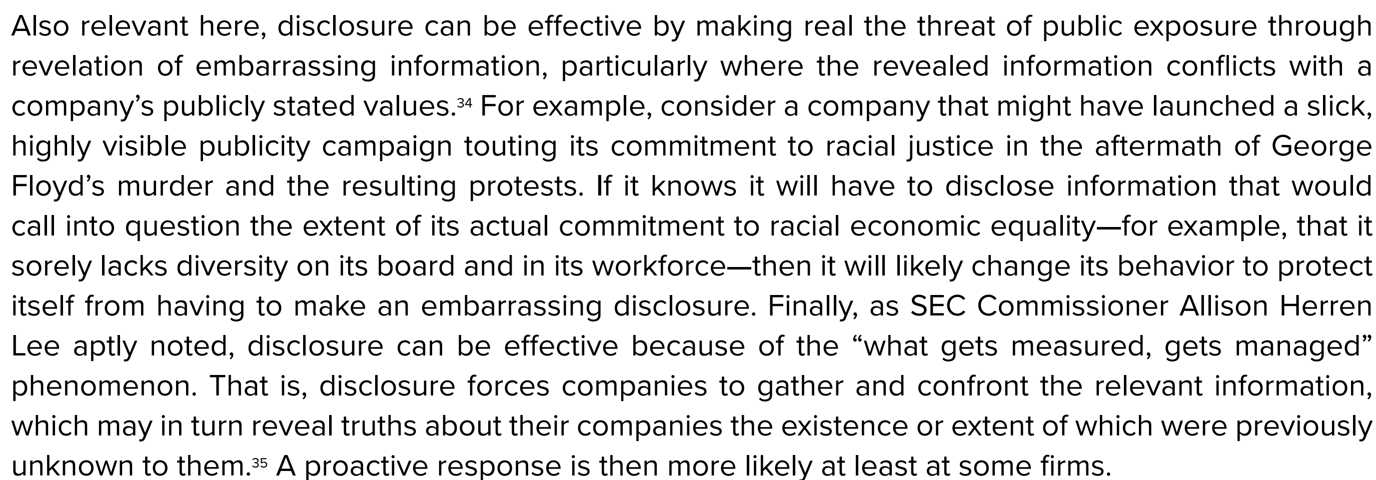
[29] Louis Brandeis, *Other People's Money* 92 (1933).

[30] Archon Fung, *et al*., *Full Disclosure: The Perils & Promise of Transparency* 29 (2007).

[31] While disclosure is of enormous value in some contexts, such as making sure investors have complete and accurate information about the companies in which they consider investing, it has proven to be a relatively weak remedy when it comes to preventing retail investor confusion and protecting investors from predatory behavior. *See* Angela Hung, *et al.*, *Effective Disclosures in Financial Decisionmaking* (2015), https://www.rand.org/pubs/research_reports/RR1270.html; George Loewenstein, *et al.*, *The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 American Economic Review: Papers and Proceedings 423 (2011); Robert Prentice, *Moral Equilibrium: Stock Brokers and the Limits of Disclosure*, 2011 Wis. L. Rev. 1059 (2011) (concluding that disclosures do not give sufficient information to investors and may even cause brokers to give more biased advice); Omri Ben-Shahar & Carl Schneider, *The Failure of Mandated Disclosure*, 159 U. Pa. L. Rev. 647 (2011) (finding that disclosure as a regulatory tool has a history of being ineffective); Daylian Cain, *et al.*, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. of Legal Studies 1 (2005).

[32] Margaret Kwoka & Bridget DuPey, *Targeted Transparency as Regulation*, 48 Fla. St. U. L. Rev. 385, 405 (2021).

[33] Archon Fung, *et al.*, *Full Disclosure: The Perils & Promise of Transparency* 2 (2007).



Also relevant here, disclosure can be effective by making real the threat of public exposure through revelation of embarrassing information, particularly where the revealed information conflicts with a company's publicly stated values.[34] For example, consider a company that might have launched a slick, highly visible publicity campaign touting its commitment to racial justice in the aftermath of George Floyd's murder and the resulting protests. If it knows it will have to disclose information that would call into question the extent of its actual commitment to racial economic equality—for example, that it sorely lacks diversity on its board and in its workforce—then it will likely change its behavior to protect itself from having to make an embarrassing disclosure. Finally, as SEC Commissioner Allison Herren Lee aptly noted, disclosure can be effective because of the "what gets measured, gets managed" phenomenon. That is, disclosure forces companies to gather and confront the relevant information, which may in turn reveal truths about their companies the existence or extent of which were previously unknown to them.[35] A proactive response is then more likely at least at some firms.

Disclosure will provide the SEC and other policymakers with relevant information to better understand the nature and scope of concerns related to racial economic equality at issuers and other companies, equipping them with the information needed to consider next steps in promoting racial economic equity.

Ultimately, whatever the mechanism, there is every reason to expect that, where both investors and issuers (not to mention issuers' customers) recognize the importance of promoting racial justice, for both economic and non-economic reasons, meaningful disclosure requirements will be effective at spurring companies to do more than pay lip service to racial economic equality. In any event, at the very least, disclosure will provide the SEC and other policymakers with relevant information to better understand the nature and scope of concerns related to racial economic equality at issuers and other companies, equipping them with the information needed to consider next steps in promoting racial economic equity.

For disclosure to be effective, of course, it has to be accurate, meaningful, comprehensive, comparable, and effective at promoting accountability. At the very least, this would mean that, with respect to racial economic equality, issuers should be required to disclose the racial and ethnic makeup of their boards of directors, the racial and ethnic makeup of senior management, the racial and ethnic makeup of the issuers' workforce overall, and the racial and ethnic make-up of suppliers. Other items of information may be relevant as well, including compensation data by race and disclosures about any accusations of racial or ethnic discrimination by employees, customers, or others. Companies could also be required to make other disclosures related to their promotion of racial economic equality. For example, the SEC might require companies to disclose whether any of their products or services implicate racial equity issues and, to the extent they contribute to racial discrimination, what the company is doing to address those concerns.

Some past experience highlights the potential value of such a requirement. For example, Amazon came under fire for its facial recognition software, which was shown to be less accurate when attempting

[34] Margaret Kwoka & Bridget DuPey, *Targeted Transparency as Regulation*, 48 Fla. St. U. L. Rev. 385, 404 (2021).

[35] SEC Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More*, Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

to recognize the faces of people of color. Criticism focused in particular on police use of its software, which exacerbates police mistreatment of Black people.[36] As a consequence of these revelations, Amazon suspended its policy of allowing law enforcement to use the software.[37] The SEC's most recent regulatory agenda indicates it intends to take up several relevant disclosure rules, including rules on board diversity and human capital disclosures.[38]

Proxy voting and shareholder governance.

One way the SEC influences corporate behavior, at least indirectly, is by establishing and enforcing the rules under which shareholders govern the companies in which they invest. By ensuring that shareholders have full and fair access to the proxy process, the SEC can ensure that the will of the shareholders over corporate governance—including the election of directors—is appropriately considered and implemented. Thus, for example, to the extent shareholders of a company want to increase minority representation on the board or seek to ensure that the company deals with suppliers that in turn perform well under various diversity metrics, the SEC can facilitate the implementation of those policies by protecting the proxy process.

One way the SEC influences corporate behavior, at least indirectly, is by establishing and enforcing the rules under which shareholders govern the companies in which they invest.

The SEC has recently re-opened the comment period on a proposal to improve the proxy process through the use of universal proxy cards, a reform that Better Markets has supported because it will eliminate an unjustifiable disparity in the voting options available to investors who attend shareholder meetings and vote in person versus those who vote by proxy.[39] Similarly, the SEC has indicated it will revisit the severely flawed proxy advisory rules issued in 2020.[40] Those rules will hurt investors by suppressing the views of proxy advisory firms, which are often the only source of independent information about how shareholders should vote their proxies. As shareholders increasingly demand action from often reluctant issuers on ESG issues, including racial economic equality, ensuring that the proxy voting process is as fair and robust as possible and that investors can access information that is independent of management will be critical.

[36] Jeffrey Dastin, *Amazon Extends Moratorium on Police Use of Facial Recognition Software*, Reuters (May 18, 2021), https://www.reuters.com/technology/exclusive-amazon-extends-moratorium-police-use-facial-recognition-software-2021-05-18/.

[37] *Id.*

[38] SEC Agency Rule List (last accessed Dec. 8, 2021), https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F.

[39] Better Markets, Comment Letter on Universal Proxy (Jun. 7, 2021), https://bettermarkets.org/wp-content/uploads/2021/07/Better_Markets_Inc_Supplemental_Comment_Letter_on_Universal_Proxy_6-7-2021.pdf.

[40] SEC Agency Rule List (last accessed Dec. 8, 2021), https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F.

Enforcement over ESG fraud.

Recognizing the growing importance of ESG issues such as racial economic inequality to investors, more and more investment advisers are trying to cater to those who seek investment options that promote ESG values. Unfortunately, as the SEC explained in a recent "risk alert," advisers are often engaging in misleading practices to attract these clients.[41] These include portfolio management practices that are inconsistent with a firm's stated approach to ESG issues, inadequate controls to prevent violations of firms' stated ESG policies, and misleading and inflated marketing materials about the nature of firms' ESG investing practices.

As a result of these deceptive practices, investors may place their money and their trust with an adviser or a particular fund because of representations the adviser or fund makes about not investing in companies that help entrench racial inequality, only to find out that the investment vehicle is indifferent to racial justice concerns or possibly even exacerbates the problem. Such practices not only take their toll in individual cases, they also threaten to dampen enthusiasm for ESG investing overall. The SEC has broad authority to police misleading representations and outright fraud by investment advisers and others, and it should make addressing ESG fraud a top enforcement priority.[42]

THE FINANCIAL SERVICES INDUSTRY

The lack of diversity in the financial services industry, including the securities industry, is striking. For example, in a report issued by the Subcommittee on Diversity and Inclusion of the SEC's Asset Management Advisory Committee highlighted some sobering statistics on the state of diversity in the asset management industry:

> Of the $70 trillion in global financial assets under management (hereinafter "AUM") across the investment universe, less than 1% are managed by minority-owned or women-owned firms. Independent from AUM, across the industry of asset management firms, percentages of ownership interests by women and people of color in asset management firms remains startlingly and disproportionately low, by any and every objective measure. Women and people of color also remain dramatically underrepresented (by all objective measures) at the board and senior management levels within asset management firms and fund complexes. This severe underrepresentation also extends to general employment within the industry.[43]

To address these serious diversity issues, the Subcommittee recommended, among other things, that the SEC impose new disclosure requirements, issue guidance for fiduciaries selecting asset managers to properly weight diversity, and establish procedures for managing reports of discriminatory practices.

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[41] SEC Division of Examinations, *Risk Alert: The Division of Examinations' Review of ESG Investing* (Apr. 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf.

[42] Naturally, enforcement is a critical tool that the SEC must use to ensure that all of its reforms aimed at promoting racial economic equality have maximal impact. So, for example, once various disclosure obligations are in place, with required and standard elements relating to racial equity, the SEC can and should use a strong exams and enforcement program to implement the rules.

[43] SEC AMAC, *Report and Recommendations on Diversity and Inclusion in the Asset Management Industry* (Jul. 7, 2021), https://www.sec.gov/files/spotlight/amac/amac-report-recommendations-diversity-inclusion-asset-management-industry.pdf.

THE SEC ITSELF

The SEC must recruit a more diverse workforce.

The SEC's role in racial justice is not limited to efforts to modify the behavior of issuers and other companies it regulates. The SEC also must ensure that it is promoting racial justice internally. One way it can do this, most obviously, is by ensuring that its own workforce, particularly at senior levels, is more diverse. As SEC Commissioner Allison Lee has noted, the diversity picture at the financial regulators, including the SEC, is filled with "grim statistics."[44] At the SEC, while progress may well be in the offing under its current Chair, the fact is that only 2% of political appointees have been Black, and less than 3% of senior staff are Black as of July 2020.[45] This lack of diversity at the SEC and other financial regulatory agencies has a ripple effect throughout the financial services industry, as regulatory agencies are often a fertile recruitment ground for often lucrative jobs in the financial services industry.

To ensure it has a diverse and representative workforce, the SEC should continue to leverage both of its internal units set up to address issues surrounding discrimination and equal opportunity. The SEC's Office of Minority and Women Inclusion[46] was established to "promote diversity, inclusion and opportunity include building and maintaining a diverse workforce, cultivating an inclusive work environment, and fostering diversity in our network of suppliers and in the regulated entities we oversee." Its Office of Equal Employment Opportunity was established "to create and apply best practices to achieve equal employment opportunity . . . in the workplace and to support compliance with anti-discrimination laws."[47] Both of these offices can make important contributions in the effort to ensure that the SEC itself is appropriately diverse, provided they receive the necessary funding and support.

The SEC must give a more prominent role to its Office of Minority and Women Inclusion.

The Office of Minority and Women Inclusion has a particularly important role to play. An important step the SEC can take to promote racial justice is to use the resources and expertise already available internally to analyze these issues. It is a common refrain that one of the reasons the SEC cannot (or should not) do more to promote ESG issues such as racial justice is that it does not have the in-house expertise to address the non-economic aspects of the issues.[48] However, that is simply not true, at least not with regard to the diversity aspect of the "S" in ESG.

As Commissioner Lee has noted, the SEC has a "tremendous resource" in its Office of Minority and Women Inclusion, which "is doing important work helping the agency to examine its own diversity

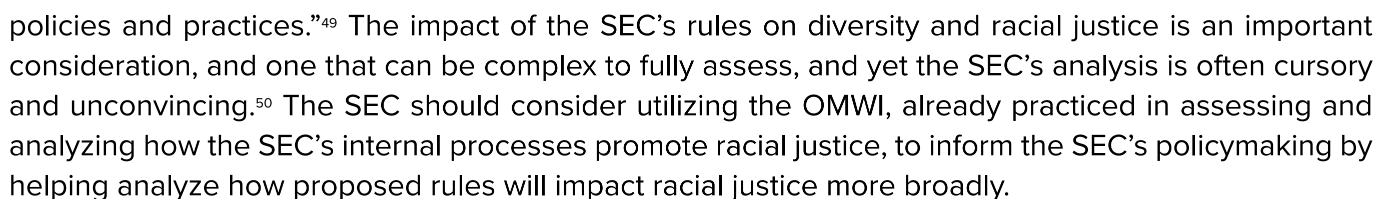
[44] SEC Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More*, Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

[45] Brummer, Christopher J., *What Do the Data Reveal About (the Absence of Black) Financial Regulators?* (July 20, 2020), SSRN: https://ssrn.com/abstract=3656772 or http://dx.doi.org/10.2139/ssrn.3656772.

[46] SEC Office of Women and Minority Inclusion (last accessed Dec. 8, 2021), https://www.sec.gov/page/omwi-section-landing.

[47] SEC Office of Equal Employment Opportunity (last accessed Dec. 8, 2021), https://www.sec.gov/page/eeosectionlanding.

[48] SEC Commissioner Elad L. Roisman, *Can the SEC Make ESG Rules That Are Sustainable?*, (June 22, 2021), https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.



policies and practices."[49] The impact of the SEC's rules on diversity and racial justice is an important consideration, and one that can be complex to fully assess, and yet the SEC's analysis is often cursory and unconvincing.[50] The SEC should consider utilizing the OMWI, already practiced in assessing and analyzing how the SEC's internal processes promote racial justice, to inform the SEC's policymaking by helping analyze how proposed rules will impact racial justice more broadly.

CONCLUSION

The legacy of slavery, segregation, Jim Crow, and racial discrimination continues to contribute to serious racial inequality in our society, manifested in part by the variety of racially-based economic divides that persist. This inequality, in addition to being a moral issue, has served as a drain on our economic prosperity, and it often has an adverse impact on investors' bottom lines. For all of these reasons, those matters are material to a reasonable investor and the SEC has a key role to play in promoting racial justice and equality.

In addition to promoting diversity among its own workforce, the SEC can promote racial justice most effectively by exercising its authority over public companies. That means requiring comprehensive and effective disclosures by issuers about how they contribute to racial equality and promote diversity, and it also entails improving the proxy voting process to ensure that investors have both the independent information they need to make informed decisions as well as the ability to actually vote as they wish. Under Chair Gary Gensler, the SEC has begun showing promising signs that it will move proactively to exercise its authority in this area, and we commend it for undertaking the initiatives it has placed on its agenda. We call upon it to do more and we will watch and advocate to ensure that the SEC does what it can to contribute to racial justice and equality.

[49] SEC Commissioner Allison Herren Lee, *Diversity Matters, Disclosure Works, and the SEC Can Do More*, Remarks at the Council of Institutional Investors Fall 2020 Conference (Sept. 22, 2020), https://www.sec.gov/news/speech/lee-cii-2020-conference-20200922.

[50] *Id.*

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

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