Late Congressman and Forest City board member Louis Stokes

At Forest City, Board Engagement Fosters Diversity and Inclusion

A commitment to a diverse and inclusive culture began 15 years ago when the late Louis Stokes was recruited to the board. By Bob O'Brien

Forest City Enterprises, a real estate management and development company, is built on values instilled by its founders and embraced by its associates every day. These values include integrity, community involvement, and entrepreneurial spirit, to name a few, and they were extended to include diversity by late Congressman and Forest City board member Louis Stokes.

As an attorney, an early leader in the civil rights movement, and the first African American to represent Ohio in Congress, Stokes' legacy of advocacy and leadership was already well established in 1999 when he accepted an invitation to serve on the company's board. Forest City grew significantly during his 15-year stewardship, expanding into new cities across the country. His leadership helped the company to grow in part by recruiting, training, and retaining our now 2,900 employees.

Fifteen years ago when Forest City reviewed its long-term strategy and plans, Stokes advocated for diversity, encouraging the board to add it as a core value. He understood that maximizing success would require all associates' experiences, perspectives, and styles in the decision-making process. He advised us that an inclusive work environment engenders acceptance, respect, engagement, and productivity.

Stokes continued to champion diversity during his tenure, both at the board level and throughout the organization. This commitment to diversity and inclusion illustrates the impact board involvement and oversight can have on the management of environmental, social, and governance (ESG) topics.

The belief that workforce diversity has a positive impact on an organization's bottom line has been substantiated by multiple studies. An interesting example, particularly for those in real estate development, shows that in an analysis of more than 700 U.S. J.C. Penney stores, having store employees mirror the racial and ethnic makeup of the communities where stores were located positively affected productivity and customer satisfaction, resulting in an increase in profits of more than $69 million. This study demonstrated a clear measure of the positive results of embracing diversity and inclusion within the workforce to our board.

A 2013 *Harvard Business Review* study determined that a team with a member who shares a client's ethnicity is 152 percent more likely than another team to understand that client. In the past three years, Forest City has increased its ethnic diversity of consumer-facing associates. From 2012 to 2014, we've seen an increase in nearly every non-white ethnicity for sales workers, a number we hope to improve in the coming years. Understanding the needs of diverse, urban populations drives innovation and improves customer service and business value.

Diversity is directly linked to our core business in urban mixed-use development. Today, 81 percent of people in the United States live in urban areas; this figure is expected to increase to 87 percent by 2050. The trend in urban neighborhood rehabilitation shows no sign of declining, particularly in areas with the potential to provide housing solutions to choice-scarce populations such as low-income families, the elderly, multi-family households, and the disabled. Our commitment to diversity prepares us to be leaders in providing timely solutions to society's housing and property needs, and better positions us to undertake projects that qualify for rapidly expanding funding assistance opportunities.

Board Proposes Allocation of Resources

By 1999, strides had been made to recruit a more diverse workforce, but we were not progressing as quickly as we desired. To reinforce our commitment to diversity and inclusion initiatives, in 2004 the first manager of diversity and outreach was hired. An internal diversity framework was created with specific action steps to ensure that compliance with government reporting and regulations related to diversity were being met or exceeded. Diversity initiatives were integrated into the hiring process with the goal of building a workforce that mirrored the communities we serve.

Our commitment to diversity was strengthened in 2006 by broadening its title to "diversity and inclusion." This addition expanded our focus beyond recruitment to the development of a culture where all associates feel welcomed and valued. This culture has resulted in increased associate retention and encourages innovation. To codify and communicate the new, strengthened value to associates, Forest City developed a diversity statement. When hiring slowed during the economic crisis in 2008, Stokes and the board reminded us to remain steadfast in our commitment to diversity and inclusion. In response, management focused on building internal diversity awareness capacities that positioned the company to attract diverse recruits once the economy rebounded.

Ethnic Diversity of Consumer-Facing FC Associates

	2012	2013	2014
White	70%	62%	58%
African American	10%	16%	15%
Hispanic / Latin American	8%	6%	10%
Asian	0%	5%	5%
Hawaiian / Asian American	3%	3%	10%
American Indian	0%	2%	0%
2 or more	8%	6%	11%

These efforts included developing and delivering business-case and education materials on ethnic, gender, and generational diversity, all of which we integrated into our new-associate orientation. Associates also participated in diversity dialogues to develop conversational skills that would engage diverse audiences. The company simultaneously cultivated external relationships with the Commission on Economic Inclusion, the Consortium of African American Organizations, and the National Black MBA Association to support our diversity outreach goals.

To collect enterprise-wide feedback from associates and measure our progress, we launched a survey called *Voices in 2012*. Administered by management and assessed by the board each year, the survey enables associates to express their opinions about workplace culture, personal and professional development, management relations, corporate communications, and personal satisfaction.

Engaging Executives and Associates

In 2011, David LaRue, the new CEO, led the company through a new strategic planning process. With diversity and inclusion a clearly articulated core value, the new plan provided us further opportunity to embed diversity and inclusion into the talent management process. The team engaged DiversityInc and the Urban League to provide benchmarking and integration strategies.

One recommendation—to create executive-sponsored Associate Resource Groups (ARGs)—was transformative. The purpose of the ARGs is to encourage an inclusive culture where diversity is celebrated and to demonstrate tangible benefit to the business by providing personal and professional development resources, education and engagement activities, and forums for collaboration and innovation between associates.

Another initiative—Women's Excellence in Leadership, Education, Advancement, and Development (WE LEAD)—was launched to develop a network of women to improve knowledge sharing, provide personal and professional development resources, and leverage experiences to achieve positive, impactful results. Since the inception of the first ARG in 2012, WE LEAD has grown to 357 members. It has provided education sessions on investor relations and retail leasing, networking events, and presentations from both internal and external female leaders on topics such as change management, life mapping, work-life balance, executive presence, and talent development.

The second ARG–African Americans Connecting & Creating

Excellence & Leadership (AACCEL)–was launched in 2013. AACCEL promotes an inclusive culture for African-American associates through cultural awareness and understanding to promote hiring, retention, and career advancement. Its programming focuses on three key concepts: professional development, corporate engagement, and community outreach.

Forest City continued to expand its ARGs in 2014 with the addition of Unidos and United Way Young Leaders, leveraging a skills-based volunteer format that encourages members across the company to serve and lead in their communities. In addition to participation in fundraising races, walks, and donation drives, members partner with organizations to provide targeted, skills-based services.

Membership in ARGs continues to grow, engage associates, develop talent, and identify opportunities to add business value across the organization. In the 2014 *Voices* survey, 78 percent of our associates reported that they felt the company creates an inclusive culture and values diversity in the workplace, a 7 percent increase since 2012. Today, we continue to work to build a culture in which all Forest City associates are accountable for diversity and inclusion.

Public Disclosure

Forest City released its first Corporate Social Responsibility report in 2013 using the Global Reporting Initiative framework, the most widely used and accepted framework for sustainability reporting. The report publicly disclosed associate gender and ethnicity demographics for the first time, and also detailed diversity metrics for its board, including age, independence, gender, and ethnicity. Reporting of this data helped generate meaningful internal awareness and dialogue, and led to the identification of opportunities to share additional information.

The report attracted attention from multiple investors, including Trillium Asset Management. Trillium commended the company for its commitment to diversity disclosure, commenting that it allows investors to track diversity efforts and assess the extent to which a company can anticipate and respond effectively to consumer demand.

Supporting a Diverse Value Chain

Our vision is to be the partner-of-choice in creating distinctive places to live, work, and shop in our core markets, and we recognize that supporting community diversity initiatives makes us a stronger partner. To this end, we have integrated diversity initiatives into both our philanthropy and procurement strategies. In 2013, we began measuring and allocating charitable donations that support diversity initiatives in our core markets. We also launched a supplier diversity program to promote, increase, and improve the participation of diverse-owned businesses in our supply chain. In 2014, Forest City spent $41.7 million with diverse-owned suppliers, exceeding our goal by $11.2 million. We also formed partnerships with various minority suppliers and business associations to identify additional diverse suppliers.

Outcomes and Next Steps

Though WE LEAD and other ARGs are in early development, the results of a 2014 annual membership survey are promising. Within the WE LEAD membership, 74 percent of associates felt the group helped their skills development, 81 percent said it expanded their network within the company, and 88 percent learned more about the business. The metric that stands out to management is that 44 percent of female associates who received promotions in 2014 were WE LEAD members. The group is fulfilling its mission to provide personal and

From left to right: Members of Forest City's women's, African-American, and Hispanic Associate Resource Groups.

professional development resources to women, enabling them to contribute more meaningfully to the business, and we are confident that all ARGs will impact long-term employee satisfaction and retention.

Executive reports on diversity and inclusion were provided to the board starting in 2014. We also welcomed Christine Detrick to our board, increasing female representation to 23 percent. The executive report encouraged leadership to re-evaluate our equal employment opportunity, anti-discrimination, and anti-harassment policies, a process that led to the protection of gender identity and expression, the addition of language on the prohibition of retaliation, and expanded reporting mechanisms. The diversity and inclusion initiative is overseen by the cross-functional Corporate Social Responsibility Advisory Council, which oversees the management of environmental, social, and governance topics including diversity and inclusion.

Our continued focus on diversity and inclusion began with Stokes' passion and interest in making diversity a core value. Through board oversight and endorsement, it has become a successful program distinguished from its industry peers.

Bob O'Brien is CFO of Forest City Enterprises. Forest City Enterprises would like to thank BrownFlynn for its ongoing support with our sustainability efforts.

Establishing a Climate-Competent Board

By Richard C. Ferlauto

Investors' expectations for boards have grown as the impact of climate change on business risks and opportunities becomes more apparent. Large institutional investors, concerned with their own portfolio risks, are increasingly calling for climate-competent boards and directors.

The California Public Employees' Retirement System (CalPERS) is one very long-term investor. Anne Simpson, the fund's director of global governance, says: "We need to be able to pay pensions for the best part of the next century, and when we're thinking about the sustainability of the fund, we're not just thinking about the financial dimension, but we're thinking about the environmental dimension, because that's important to risk and return, and we're thinking about people."

The emissions software scandal at VW is the most recent and extreme example of what appears to be a corporate governance failure related to environmental malfeasance that has cheated stockholders and stakeholders. Arguably, even the manipulation of emission tests by VW engineers has been more damaging to the environment than the BP *Deepwater Horizon* oil spill, spewing 60,000 illegal tons of nitrogen oxide into the atmosphere over the course of six years. These were sins of commission, and not just mistakes or oversights that will haunt the automaker for the foreseeable future. Charles Elson, director of the corporate governance program at the University of Delaware, describes insular and family-dominated boards like that of VW's as "a breeding ground for scandal."

Proxy season 2015 saw unprecedented collective action by institutional investors to press for expanded proxy-access rights to nominate directors as part of the effort to push for boards' climate competency. New York City Comptroller Scott Stringer launched the Boardroom Accountability Project, filing 75 proxy-access resolutions. The 34 resolutions targeted at energy companies should command director attention: 26 of the resolutions received majority votes, with most others failing by only a few percent.

The consensus proxyaccess formula—a group of three percent owners, holding the stock for three years, can nominate up to 25 percent of the board—reflects the 2009 proxy-access rule by the Securities and Exchange Commission (SEC). In the coming months, investors expect that proxy access will be implemented in good faith where it received majority approval. Institutional shareholders including the New York City Public Pension Funds, CalPERS, BlackRock, TIAA-CREF, and others that push these proposals view board accountability–rather than prescriptive, precatory climate resolutions–as the preferred approach to corporate transformation.

While robust engagement remains important to investors, the question is whether boards are competent to respond to climate and sustainability challenges. As such, investors want to be able to effectively intervene with dysfunctional boards or replace dead-wood members with more capable directors.

A usable proxy-access process emerged in 2015 as a basic building block of board competency. Large investors view the existence of proxy access as a fundamental characteristic of board competency because it makes boards more accountable to long-term shareholders. According to Stringer, "We are seeking to change the market by having more meaningful director elections through proxy access, which will make boards more responsive to shareowners. With this right in place, we expect to see better long-term performance across our portfolio."

Boards and directors, especially those facing constraints due to climate risks, need to improve their climate-related competencies. That boards need the capacity to understand and manage risk, such as those posed by climate change, is an obligation under business law as outlined in the American Bar Association's Model Business Corporation Act. Boards are protected by the business judgment rule under Delaware law, the typical rationale for not responding to shareholders' entreaties for action. Since operational and strategic judgment resides with the board, major shareholders are now increasingly focused on director accountability and board refreshment as a response to poor judgment or a lack of competency to navigate the business challenges of global warming.

The National Association of Corporate Directors' *Oversight of Sustainability Activities Handbook* asserts that: "Value creation, long-term business resiliency, strategic risk management and stewardship represent the essence of the board's role in overseeing corporate sustainability activities." Increasingly, boards are recognizing the need to hone their climate competency.

With the involvement and under the direction of the board, BHP Billiton released its *Climate Change Portfolio Analysis* report, which explains how it could continue to create shareholder value in a carbon-constrained world. "We are providing more information than ever before about how we are responding to climate change and how climate risk might affect the portfolio," said BHP Billiton's Chief Commercial Officer Dean Dalla Valle. "The opportunities and risks associated with climate change will not be spread evenly between businesses or sectors. More disclosure will allow investors, policymakers, and regulators to make more informed decisions. By sharing our analysis of BHP Billiton's portfolio in a 2° C-world, we believe investors will be able to decide how well BHP Billiton is equipped to manage climate risk."

For many companies a robust refreshment process will be necessary to aid transitioning to a climate-competent board. Enhanced strategies for identifying board candidates will have to be employed as most nominating committees will be charting new areas of skills and experience. Nomination searches need to move into new territory beyond the traditional sources. As an emerging practice, nominating committees create and disclose a matrix of current board skills, experience, and gender/ethnic composition to help highlight gaps and necessary skill sets for new candidates. Climate competency skill sets will vary by industry. Candidate selection criteria would encompass specific industry know-how, understanding risk mitigation, a background in science, new technology or regulation, and boardroom experience.

A bench of potential board candidates—highly independent directors, who understand the science of climate change—would aid boards in this process. Such a director's bench of qualified climate-competent candidates ideally would be searchable by skill set, experience, and industry sector. Boards should look at race, gender, age, and also include industry skill sets related to emerging regulatory and environmental constraints when recruiting.

Sophie L'Helias, director of global initiatives and governance at The Conference Board, believes that "director identification and selection channels use models that do not adjust to the pace of change as new risks emerge. For instance, it took major security failures before boards began asking for skill sets that include [cybersecurity]. If companies heed the market's warning as climate-related risks are priced in their shares, they will have to identify new channels to recruit directors with the requisite climate expertise."

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Nominating committees could consider giving search firms specific mandates to develop pools of director candidates with climate competency, and should support the bench concept developed in conjunction with leading experts in the field. The development of a director-support network for continuing climate education also would contribute to expanding competency.

Audit, risk, and compensation committee charters ought to require directors with climate-competency skills. Director self-assessments and third-party board evaluations might review climate competency metrics to allow for analysis of missing skill sets. Enhancing board climate competency can be achieved through director education, committee restructuring, or board refreshment. The relevant board committees might also require ongoing climate-risk education to keep up-to-date on the latest data and trends.

A standalone sustainability committee may not be necessary in all cases, but could help focus the board. On the other hand, sustainability should avoid being siloed and climate-related decisions should not be relegated to an organizational "sustainability ghetto." An effective chief sustainability officer reports to the CEO, while the board maintains oversight on risks and strategic opportunities. Board-level oversight consistent with the potential impact of climate risk on strategic, legal, reputational, and operational decisions is a best practice. A newly released report by Ceres, *View from the Top: How Corporate Boards Can Engage on Sustainability Performance*, based on case studies and interviews with dozens of directors, recommends integrating sustainability into board governance systems.

Climate-competent boards assess information regarding carbon asset risk in their company business models and incorporate risk analysis into strategic planning. The relevant committee—whether it is risk, audit, or sustainability—owns risk assessment and provides board leadership; committee charters explicitly describe the skill requirements of members as well as their scope of authority.

Climate-competent directors have the capacity to interpret scenario analysis of reduced demand, efficiency, and substitutes based on the constraints of 2° Celsius agreed upon by experts to avoid the most serious consequences of global warming. Directors need the skills to incorporate alternatives in their long-term plans regarding the nature of their products and services, particularly in the energy industry, where physical and operational risks of climate impact offshore rigs, refineries, pipelines, and the like.

Climate-competent boards provide shareholders with clear and relevant disclosures on potential company risks and vulnerabilities to regulatory and market conditions. Disclosures should reflect the spirit as well as the letter of SEC guidance on the description of material risks. Regulation S-K and staff interpretations guide boards on effective disclosure. The Sustainability Accounting Standards Board (SASB) potentially offers a framework for offering standardized material disclosures by industry. Boards can streamline comprehensive disclosures through the integration of financial and nonfinancial information.

Climate-competent directors understand how incentives motivate executives. For example, top executives in the energy sectors are among the most highly compensated of all publicly traded companies. High pay levels can maintain the status quo, even in the face of long-term threats to business stability. As financial metrics come under review, and operational metrics are adjusted, metrics that incentivize long-term sustainable growth will be needed. Operational metrics that reward increased production of carbon intensive products (including those on reserve replacement) may exacerbate the issue of stranded assets. Preferable metrics reward more-sustainable products that reduce carbon risk. Likewise, risk mitigation should include environmental and worker safety-metrics.

To mitigate a short-term focus, compensation committees should design pay plans that include rigorous holding and retention requirements for performance-based stock awards. As another best practice, long-term incentives should be decoupled from total shareholder return with a focus on no disproportionate upside due to the price of carbon. Bonuses should pay out over long-time horizons benchmarked to the Return on Invested Capital and other metrics of efficient capital. Directors should think twice before agreeing to share buybacks that may further enrich senior management with no improvement in operational performance, especially when long-term investments in research and development are needed

Effective board oversight should include metrics for risk and asset valuation compatible with standardized financial benchmarks. For example, energy companies could emphasize carbon asset risk metrics associated with capital expenditures related to exploration and production and track greenhouse gas emissions, water use, oil reserves, energy efficiency, and the like. As a best practice, climate-competent boards might consider standardized metrics on industry-level sustainability topics now being created by SASB. These standards are relevant to the industry, comparable to similar companies, and auditable by independent third parties.

Climate-competent boards enhance lobbying disclosure and philanthropic information so shareholders can evaluate business risks associated with efforts to influence the policy. Directors should be fully apprised of lobbying and nonprofit contribution policies. Governance committee charters as a best practice should have contribution guidelines that align lobbying and philanthropic policies with publicly disclosed sustainability plans. Lobbying inconsistent with company-stated sustainability policies can damage corporate branding, affect good will, and erode trust in company disclosures. Business strategies based on funding bad science will fail in the long run as faulty information is no substitute for value creation.

Directors are responsible for oversight, strategic planning, and risk management—all competencies central to the challenges of global warming and business sustainability. Shareholder calls for board accountability and increased climate competency will continue to mount as the business case for climate action becomes ever more real. D

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