



DIVERSITY AND INCLUSION ON COMPANY BOARDS AND EXECUTIVE COMMITTEES

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The Institute of Chartered Accountants in England and Wales (ICAEW) welcomes the opportunity to comment on *Diversity and inclusion on company boards and executive committees* (the Paper) published by the Financial Conduct Authority (FCA) in July 2021 as FCA Consultation Paper 21/24 on 28 July 2021.

This response of 20 October 2021 has been prepared by the ICAEW Financial Services Faculty with input from across the organisation, including our Corporate Governance Committee, comprising of leading practitioners in best practice corporate governance and stewardship, including non-executive directors of listed companies. As a leading centre for thought leadership on financial services, the faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

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EXECUTIVE SUMMARY

ICAEW supports measures taken to promote Diversity and Inclusion (D&I). D&I is a theme of our strategy to 2030.

For companies to continue to work well, and to meet the needs of the society they serve, every sector must remove barriers, discrimination, and groupthink, and promote advancement on merit. Greater diversity and inclusion will ensure that each sector gets access to the widest possible talent pool. Companies will need to evolve to meet the needs of the market (where there is a particular demand for information on environmental, social and governance (ESG)) factors, employees and society. To do so, their staffing models will need to adapt and evolve too, and better reflect the societies they seek to serve.

Our positive view of D&I is based on experience of collecting data on D&I since 2015. We have seen benefits of an increasingly diverse and inclusive profession, though acknowledge there is still much work to do. Continued monitoring and tracking of D&I metrics will build improved decision-making, help to restore trust of society in business, lead to better products and services for UK and international customers and culminate in stronger companies attuned to the needs and demands of society.

This response highlights two key items:

1. Business-led inclusion is the real goal - without genuine inclusion, diversity targets alone risk becoming a tick-box exercise. A gender balanced board would be meaningless if one gender is not heard or if that gender is remunerated very differently.
2. Nevertheless, metrics have an important role on the road to supporting and building towards change and greater inclusion, and providing investors with information for improved decision-making. Metrics also enable comparison, including with international public markets to enable investors and other key stakeholders to assess and evaluate rates of progress. We support their use in the way the Consultation Paper promotes.

Answers to the detailed questions include practical insight based on ICAEW's experience of collecting diversity information. We would be happy to discuss this formally or informally with the regulator.

MAJOR POINTS

BUSINESS-LED INCLUSION IS THE REAL GOAL

1. There is general acceptance that greater diversity on company boards helps reduce groupthink and ensures that companies better reflect the composition of society. This in turn helps restore trust in business. Board diversity targets alone might risk being purely a metric without genuine inclusion: people must be allowed a voice and the freedom, confidence and support to use it. Consider a board which has hit its diversity targets to achieve key goals or metrics – and possibly to ensure that senior managers hit remuneration targets - but which does not allow all members the chance to express views or to provide challenge.
2. Inclusion is harder to measure and achieve, compared to diversity. Board composition (and metrics) is not the end of the story. Boards need to be diverse in substance, not just in appearance, to realise their potential and to provide leadership on inclusion. Meaningful cognitive diversity is therefore vital. We cannot expect a diverse board automatically to allow diverse viewpoints to shape its behaviour and decisions. Inclusivity needs to be business-led to enable different views to be expressed, heard and considered. The board still needs to work as a team, serving the interests of the company and sharing the responsibility for its decisions. It takes effort and commitment from the chair and the board members to develop mutual respect and recognise that an open exchange of diverse views can help the board reach better shared conclusions¹.

METRICS ARE IMPORTANT BUT ‘GOOD’ DATA IS VITAL

3. ICAEW supports using metrics to measure and work towards better D&I, based on experience of collecting data on D&I since 2015 as a regulator for legal services. There are notable benefits, but these benefits did not emerge immediately and only after an ‘education cycle’. Some respondents were initially unhappy to answer questions regarding characteristics. Recently, ‘prefer not to say’ responses have increasingly been replaced with defined responses.
4. Continued monitoring and tracking of D&I metrics may build better decision-making, stronger companies and lead to better products and services for customers. The disclosure of metrics proposed will help in setting reinforcing mechanisms to move in the right direction. The desire for change is evidenced by signals from investors that progress in this area is important to them.
5. For in-scope companies, the data or metrics may help to inform business policy decisions across a number of areas which may not in themselves be diversity related. The impact of Covid for example, and home working has been illustrated through statistics on maternity/paternity, caring responsibilities and disability (See Challenges of a Covid environment – pg. 5). It can inform companies on the structures of their benefits packages and the location of their offices and resources.
6. The data itself does not change diversity within a company. It however strengthens business leadership on D&I, informs progress on diversity initiatives and aspirations and creates awareness of the subject at management and staff level.
7. The significance of ‘good’ data should not be underestimated. Through the disclosure of metrics, the FCA aims to increase transparency for investors on the diversity of boards and executive management of in-scope companies, and to incentivise companies towards greater diversity. The level of confidence in metrics depends on the integrity of the underlying data, and on the systems, skills and basis of preparation involved in producing the metrics. Although the proposed disclosures build on some existing reporting requirements, not all in-scope companies will be equally familiar with, or already subject to, recommended gender or

¹ *Information overload: EFFECTIVE BOARDS AND COMMITTEES IN FINANCIAL SERVICES* ICAEW (2019)

ethnicity targets for boards such as those in the Davies, Hampton Alexander and Parker Reviews.

8. There is a case for commentary and guidance on data collection, stratification and presentation policies and skills needed in a company, and to support the basis of preparation, and process for documentation, review and presentation of metrics. Such guidance might usefully refer to common difficulties faced in the collection of data, and to other common data-gathering requirements where there could be synergies. For example, FCA guidance might set out how the proposed gender disclosures would interact with those required by the Companies Act 2006.

REGULATOR'S GOALS

9. There needs to also be an acknowledgement that achieving target D&I (however those metrics may be defined) is reliant on promotion of equal opportunities at grass roots level; many professions currently recruit from a limited talent pool as a result of candidates being whittled down before application. Whilst ostensibly based on objective criteria, this may result from those individuals not being sufficiently supported in education or through being told from an early age that certain professions do not look at candidates from certain groups.
10. While improved D&I can help make a positive impact for the future, it may not show immediate results. It will be important to define which objectives are short-term, and which require a greater mind-set change that may be beyond the power of regulatory requirements to achieve.
11. The regulator should provide greater clarity on where they see their D&I remit, how they intend to measure success, and over what timescale they expect lasting change to occur.

COORDINATION OF REFORMS AND UK COMPETITIVENESS

12. There are proposed (and further expected) reforms to the regulatory landscape for UK plc. The FCA and HM Treasury are promoting changes to the UK's listing and prospectus regime in order to encourage and facilitate a wider range of companies to raise capital on the UK's equity markets. These reforms are expected to improve the international competitiveness of UK markets for certain companies that need finance to grow, and for investors seeking attractive opportunities.
13. Expected reforms from BEIS are set to enhance the audit and governance requirements of many in-scope companies. Moreover, the proposed changes in CP 21/24 will, if adopted, add to ongoing obligations for public quoted companies. Government and regulators must act in a coordinated way on implementation and timing of reforms.
14. As far as possible, legislators and regulators should aim to be consistent with each other, including on terminology. While company law reporting requirements (s414C(8)(c)) refer to 'sex', the FCA's proposals focus on 'gender' and it is not clear if they are the same thing. This places the onus on business to interpret whether to use company law or FCA terminology and risks disclosures being based on different firms making different interpretations. (See our response to Q6).

RESPONSES TO SPECIFIC QUESTIONS**Question 1*****Do you agree with the proposed comply or explain disclosure requirement on board diversity targets relating to gender and ethnicity?***

15. We agree with the 'comply or explain' approach to disclosure, subject to our comments on implementation in response to Q10.
16. The basis of 'target' must be clear at the outset as a benchmarking measure rather than something deliberately aimed at within a short period of time. We do not agree there is a case for the 40% target for female representation on boards to be a listing rule. If D&I is to be business-led it would be better for the business to determine an aspiration, taking into account investor demand and customer preferences.
17. A target of 40% may be realistic for a minority of in-scope companies, such as FTSE 350, that have followed the Hampton Alexander and Parker recommendations since 2015 and 2017 respectively. The remainder of in-scope companies will not be starting on the same data collection and recruitment footing, even if the proposals are adopted for accounting years beginning after 1 January 2022. As such, ICAEW welcomes the need for proportionality. Part of this is a realisation that boards cannot be fully representative of the underlying demographic of the UK simply because it is so diverse and the competency of the board would be compromised by having too many individuals. Any targeting measures should aim for an appropriate mix without quotas of each characteristic.

Question 2***Do you agree with the proposed disclosure obligation to set out numerical data on the gender and ethnic diversity on a company's board and its most senior level of executive management?***

18. Realistic targets are helpful at every level. It is important to foster a diverse pipeline to ensure there is enough diverse talent ready to take over senior leadership positions. Targets will potentially be more effective at levels below board level, as talent has not been lost throughout the pipeline at this stage.
19. One of the arguments for diversity is 'representing diverse customers' or mirroring the society that you seek to serve. Often, it is junior employees, rather than senior leaders, who deal with customers, and hence diversity at this level is as relevant as diversity at board level.
20. The effectiveness and practicability of targets for board members has already been demonstrated by progress made through voluntary initiatives, such as those referred to above. Therefore, any objection to extending targets to other employees, say to senior managers or employees in customer-facing roles, must be carefully considered.
21. To achieve diversity at board level, a company must have the right policies in place when it comes to junior hiring and staff retention. Evidencing recruitment policies which promote D&I throughout the ranks, rather than focusing on the senior ranks, indicates a genuine commitment. This will also feed through to provide a greater pool of C-suite talent with sufficient diversity for the future, where arguably there is currently a dearth of diversified talent as companies have not been sufficiently proactive to date in encouraging such diversity.
22. The regulator needs to consider that while board diversity can be achieved in the short-term through recruitment of staff which provides socio economic/ethnic diversity, this may not provide the necessary change to the cognitive diversity where required to promote better outcomes for customers through empathy and innovation.
23. The focus and targets might be more on awareness rather than characteristics. A key challenge for diversity in the workplace is less on recruitment but rather more on retention and progression. The barriers here tend to be in middle management and the metrics they use to recruit and progress their staff. A focus on training of these individuals both with mind

sets and the intended culture of the organisation may be better objectives to enable better progression and consequent better diversity at senior level.

24. As noted in paragraph 14, consistency is helpful to businesses and users of the information. The levels of disclosure for sex set out in section 414C of the Companies Act 2006 cover the board and senior management. The proposal would allow for consistency with this provision.
25. As is the case in the Companies Act there may be some challenges, not least around definitions of what 'senior management' should include. If it is intended to secure cross-industry comparatives then some sort of guidance will be necessary to determine who 'senior management' are. If the outcome sought is merely for corporates to aim for diversity balance within their relevant levels of management then the reach should really be down to them with a minimum reporting requirement of top tier.

Question 3

Do you agree with the proposed scope of who would be required to report under the new Listing Rules proposals, and those we have excluded (eg, issuers of listed debt)? If you disagree, please explain why.

26. We agree, subject to our comments on implementation in response to Q10.

Question 4

Do you agree with our proposal to include overseas and smaller issuers in the new Listing Rules proposals? If not, please explain whether you would propose further flexibility within the rules, or would exclude such companies from scope?

27. We agree they should be included but consider that there should be flexibility or phasing-in that take into account factors such as existing application of reporting requirements, size of board etc. Our earlier point questioning the appropriateness of targets also applies.
28. No companies should be exempt completely from understanding and promoting D&I within the organisation, but smaller companies might not be able to report on D&I data due to confidentiality concerns, or might not be able to achieve D&I targets as quickly due to lower staff turnover. Smaller companies may have very different D&I targets to larger companies, reflecting their ethos and background.
29. Where a company is small and has few employees, it has limited options in its employee choice and the demographic is inevitably skewed. In ICAEW's experience smaller practitioners also tends to have built up a sustainable income from existing contacts meaning there may be little need to seek wider, which limits the scope of enhancing through diversity.
30. Depending on the ultimate objective of the regulators the application of proportionality may change. One of the objectives required by the Legal Services Board is to measure what is happening within the profession as a whole. A significant number of firms in the sector are sole practitioner and this is also the case for ICAEW firms registered for probate. However, the sole practitioner is as much an element of the diversity in the profession itself as well as the major firms. The LSB therefore encourage data collection from firms large and small in order to build this picture.
31. The consumer interest and diversity objectives in the Legal Services Act also put an effective obligation on the licensed individual be they sole trader or large firm to reach out to under-served markets. The diversity data collection is a methodology and template for the smaller firms to make progress against those specific objectives from a fresh perspective.
32. In ICAEW's experience once firms (including smaller firms) have got used to the methodology and are assured of confidentiality (for example through using a trusted outsourcer for data collection) they provide the data more readily and address diversity policy at the proportionate level within their websites and marketing literature.
33. The disclosure requirements of firms within their business and on their websites needs to be addressed practically to balance GDPR, privacy and diversity requirements. ICAEW as a standard requires firms to publish on their websites the results of their diversity monitoring

alongside a policy statement but provides exemptions from the data disclosure where it is too transparent, and individuals can be identified. In such circumstances generic sentences outlining the dynamics without specifically disclosing ratios is permitted.

34. Some organisations may be reticent to certain types of monitoring or pursuing certain diversity policies, and in some jurisdictions doing so is illegal, which may impact how the UK branch or subsidiary of a non-UK headquartered company, is able to respond. For example, religious based organisations might find conflict in dealing with other faiths or sexual orientations. Whilst some recognition is required on the constraints of policy ICAEW would still suggest the monitoring questions are asked, as the 'prefer not to answer' or 'no' answers are in themselves useful evidence base for the wider market.
35. We have concerns in the conclusion reached in the paper that consistency and monitoring capacity should be an override in moving away from the flexible approach of NASDAQ and applying the Listing Rule requirements across the board for overseas issuers. It gives the impression of one size fits all when clearly it does not in the global context. The comply and explain approach permits some degree of flexibility, but really the question should be based on what the intended outcome is meant to be.
36. The introduction to the consultation appears to be driving in the direction of an outcome of better governance within the UK context, and therefore the overseas aspect may not be critical. Alternatively, the outcome may ambition on a global scale to effect change, but there is a danger that the approach is then seen as political interference in the conduct of individual state morals and interferes with the economic returns. We are not convinced the outcomes and overseas aspects are fully reconciled in these proposals.

Question 5

Do you agree with proposed targets on gender and ethnic diversity representation at board-level of companies? Should we consider any additional or different targets?

37. As we have noted above 'targets' should be regarded as benchmarking measures rather than something being deliberately aimed at within a short period of time. Any variance can be addressed through the comply or explain process.
38. It will be appreciated that the smaller the board, the more difficult it is to accommodate these targets. If the quoted group are engaged in niche areas where there is not diverse expertise in the market it would be counter-productive just to appoint individuals to tick the diversity box. Any measures as the paper rightly points out need to be proportionate and commercially sensible for the businesses falling under these targets.
39. Our experience as a regulator has demonstrated that businesses being asked to supply diversity data and their staff are initially hesitant; requests for simple and contained when the concept is first rolled out. Once the stakeholder groups and those canvassed are familiar with the process and purpose, then wider data can be extracted. We would suggest that better progress will be made at this stage through keeping the demand simple. In the longer term there may be a business case for more of the protected characteristics or other attributes relevant to the business.

Question 6

Do you agree with the format and extent of numerical data reporting proposed in the tables in Annex 2? If not, please explain any changes you would suggest or where further clarity is needed.

41. Yes. The layout proposed is clear and should be understood both by those supplying the data and those then reading and interpreting it.
42. ICAEW would however draw attention to the use of 'gender' in the table rather than 'sex' as is specified under section 414C(8)(c) of the Companies Act 2006. We have found that this divergence has created some adverse responses in our own monitoring of characteristics as we have preferred to use gender as the measure rather than 'sex'. This reflects the UK

Government's distinctions between definitions of the two terms, in which 'sex' is defined as the biological aspects of an individual and something usually assigned at birth; whereas 'gender' is a social construct based upon a personal internal perception of oneself. It is important that the reasoning for using the term 'gender' is made clear and that the objective in the reporting is other than simply ticking the boxes in the legislation. In ICAEW's case the importance lies in how the individual presents themselves in current day life rather than attributes at birth, as societal attitudes are directed by presentation. ICAEW therefore supports the FCA in using 'gender' as the metric but would add a note of caution in how the information is obtained and presented.

43. Linked to this aspect is the approach of the FRC which could seek to apply section 414C(8)(c) literally in its guidance. There will need to be consistency between the two regulators to prevent confusion and adverse press comment detracting from the key messages that the data should be conveying.
44. The use of ONS data categories for the ethnicity information is sensible, and an approach that ICAEW applies in its own reporting. The synergy then allows direct comparison of the company information with the UK demographic.

Question 7

Should we consider requiring similar numerical data reporting for the level below the executive management team of in-scope listed companies and / or seek data on representation by sexual orientation? If so, we welcome any drafting suggestions and views on any impact this may have for the CBA and scope of our proposals.

45. As noted above, the requirement should be set at the existing statutory level, but companies should have the option to disclose the data further down the employment chain. They may choose to do this for example to monitor progression of minorities through grades within their business as pipeline for the senior appointments, but this is best achieved through gradual adoption rather than forced intervention. Factors that could affect the degree of cooperation would include the diversity culture within the business and the comfortability of employees to engage with a monitoring process.
46. Unless there is a specific clear outcome being sought, ICAEW questions the request for orientation data at board and senior management level. The ratios would in any case be small, but there is a wider message around the characteristic and indeed many of the other characteristics that the key objective is not to artificially promote, but rather to ensure there is equal opportunity and no discrimination. This is likely to be better conveyed by company policies as stated in the company's annual report rather than numbers.

Question 8

Do you agree with proposed amendment to DTR 7.2.8AR to add to the examples of diversity aspects included in DTR 7.2.8AR which issuers could disclose in their reporting on their diversity policy, and to extend consideration to key board committees? If not, please explain why.

47. A challenge in diversity strategies generally at this time is one of measurement of social mobility and progression. It is recognised that barriers include remuneration policy, task allocation and promotion. These generally apply lower down an organisation but can feature at board level where remuneration and appointments committees may be critical in opening up a diverse dynamic in the boardroom. As membership of these committees tend to be small in number it is difficult to see how diversity itself can be represented at all times in them, but alternatives include training on areas such as unconscious bias so that the members of those committees are at least aware of the diversity issues that may be relevant and affect their own decision making.

Question 9

Do you agree with our proposed new guidance provision DTR7.2.8CG encouraging in-scope issuers to consider providing numerical data to further inform reporting on the results of their diversity policies? If not, please explain why.

48. The reasoning for any data collection must be clear to those it relates to as well as investors in terms of its purpose, what is being measured and what is expected to change and why. The data then has to be collected sensitively with regard to data protection requirements and assured in its integrity. This is best applied as a second step once a board has determined its strategy and addressed the first three actions set out in 7.2.8CG(2)(a)-(c). But it also has to be considered in the context of the Hampton principles and be relevant to the reporting and the shareholder.
49. Whilst the proposed requirement is set out in annex C of the consultation, the accompanying guidance is not. It would be appropriate that the guidance has full regard to the privacy of the individuals and requires context for any disclosures.

Question 10

Do you agree with the proposed implementation timing? If not, please explain why and indicate what alternative timeframe you consider appropriate

50. We suggest a phased implementation for in-scope companies that are outside FTSE 350. In addition, as suggested in paragraph 14 we recommend the FCA and Government coordinate implementation and timing of proposed and expected reforms, to enable practical synergies where changes include data gathering and publication.
51. There are a number of factors that affect timing. The first is the competency and capacity of quoted companies to put this information together with some integrity. This cannot happen overnight and a start date of accounting periods commencing 1 January 2022 therefore looks highly ambitious.
52. A second factor is that many of the metrics take time to develop. In ICAEW's case, metrics are collected every two years as annual figures tended to show little change as staff turnover levels are not significant enough. And it is only with the 4th collection of data in year 8 that some trends are now starting to be identified. Unless corporates have a significant change in their staffing arrangements change will come in small increments.
53. This in part is a reflection of the time it takes for staff with certain diverse characteristics to build competence and progress within an organisation which previously may not have supported them. Cultural change is not achieved overnight.

Question 11

Do you agree with our phased approach to improve our use of data over time? Should we consider other approaches? If so, please suggest these.

54. We are pleased to note that the further development steps would include consultation with the FRC as consistency between the two bodies is fundamental for the reporting to be a success for both regulators.
55. We also agree that the possibility of extending the characteristics should be part of Phase 2 and not something addressed in Phase 1.
56. In Q4 above we expressed concern around extending the requirements to overseas listed entities. The consumer outcome evaluation in Phase 2 is a further area of inconsistency as the consumer outcomes in third countries are not matters that companies can necessarily influence or be politically permitted to do so. Also if customer outcome is deemed to be a key policy objective, this should be articulated in the earlier phase as a justification for the reporting and data collection, and not tagged on at the end.