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New FCA Listing Rules May Start Regulatory Shift On Diversity

By **Robert Dedman, Jules Quinn and Marcus Young**

(July 1, 2022, 10:15 AM BST)

The U.K. Financial Conduct Authority has built up a reputation as a robust regulator in recent times. Last year alone, it dished out £567.7 million (\$781 million) in fines to various parties, which is little surprise as regulators have become more rigorous following the global financial crisis, coupled with the increasing prominence of corporate governance and compliance.

So, with the FCA proudly — and rightly — embracing its role of protecting consumers and the integrity of the financial markets, it was an interesting move when the FCA floated, in July 2021, the idea of changing the Listing Rules to require the reporting of specific board diversity targets related to gender and ethnicity.

After much feedback, the FCA finalized new Listing Rules 9.8.6R(9) and 14.3.33R(1), which took effect this April and require listed companies to publicly report their board diversity on a "comply or explain" basis.

Across the Board

Diversity and inclusion has been a critical topic in corporate boardrooms for many years. The perceived lack of representation, whether that be around gender, ethnicity, sexuality, disability, etc., is a problem that companies have been attempting to understand and grapple with, mainly through internal processes, for some time, though with limited success.

You'd be hard-pressed to find a major international company without diversity officers, targets — quotas are a more sensitive subject —, affinity groups, mentoring programs and the like. There has also been growing external pressure from shareholder activists and lenders, scrutinizing firms' environmental, social, and governance credentials, and — increasingly — commenting on the lack of them.

However, few City financial regulators have gone as far as to enshrine diversity and inclusion policies into their rules.

The FCA introduction of Listing Rules 9.8.6R(9) and 14.3.33R(1) may be the beginning of changes. These



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rules apply to both U.K. and overseas issuers with equity shares, or certificates representing equity shares, admitted to the premium or standard segment of the Official List, including closed-ended investment funds and sovereign controlled companies, but excluding open-ended investment companies and shell companies as defined in 5.6.5AR.

At present, the rules do not apply to issuers of listed debt and debt-like securities, securitized derivatives or miscellaneous securities.

Affected entities are required to provide additional information in annual financial reports for financial years starting on or after April 1 as to the current make-up of the board and how it stacks up against the FCA's selected targets, which require that at least:

- 40% of the board members be women;
- One of the senior board positions, including chair, CEO senior independent director or chief financial officer, be a woman; and
- One member of the board be from a minority ethnic background.

There is also the provision for listed companies to disclose in annual financial reports a standardized numerical table on the diversity of their board and executive management by gender and ethnicity. If an entity cannot meet the targets, it is obliged to explain why.

Explain Talking

Ordinarily, a regulator asking for an explanation causes significant worry in the regulated community but, in this instance, there is no overt threat of sanctions or remedies included in the policy, though noncompliance will presumably be met with some sort of enforcement response.

In some sense, the FCA could be looking to apply indirect influence on entities rather than the full force of a regulatory clampdown, in a similar way to gender pay gap reporting.

The statutory obligation to report on the gender pay gap came into force in 2017, requiring any employer with 250 or more employees to annually report specific figures about their gender pay gap to the government.

Organizations need to publish their gender pay gap information — and written statement if applicable — in a prominent place on their public-facing website, and can provide a discretionary report and action plans to help explain any pay gap.

As with the new FCA policy, at present the main risk in gender pay gap reporting does not come via fines but from reputational damage. For example, on International Women's Day in March, a Gender Pay Gap Bot drew attention on Twitter by replying to organizations supporting International Women's Day by tweeting their gender pay gap figures.

Entities that are perceived to pay women less than men or perceived to not be diverse enough in the boardroom could come under PR pressure from clients, stakeholders or even activists.

Even so, both the new FCA policy and gender pay gap reporting are rather blunt tools that do not always

consider the nuances or the ever-evolving landscape or benchmarks. As an example, the FCA policy originally included reference to "those self-identifying as women" and "non-White ethnic minority background." While these terms were ultimately not used in the final text, it underscores the point that there are a whole host of other diversity factors excluded from consideration at present, such as sexuality, disability and socioeconomic background.

Quite how these terms are refined and defined shifts over time. Likewise, the policy seems to assume the board will be a company with a Western nexus, rather than other locations with different cultural or diversity profiles.

A Fines Line

The bigger question is just how far the FCA will go in terms of policing diversity.

Historically, fines for institutional and individual conduct have largely focused on market abuse and financial misconduct. Over recent years, as a result of the #MeToo movement, the FCA has pivoted fairly rapidly into investigating nonfinancial misconduct in the financial services industry.

This has caused the financial services industry to look increasingly carefully at issues of personal conduct — both in and outside the workplace. The FCA's move has been mirrored by some professional bodies, such as the Solicitors Regulation Authority, which moved to discipline individuals for issues not related directly to their professional work. Examples of recent SRA sanctioned behavior range from drunk driving to harassment to taking colleagues to strip clubs.

While such behavior is on a different plane to diversity targets, it does show the general trend toward regulators taking such issues of diversity, inclusion and personal behavior a great deal more seriously than before.

The FCA CEO Nikhil Rathi had some ominous words about this trend at the launch of the HM Treasury Women in Finance Charter Annual Review in March 2021. He referred to the FCA's five conduct questions, which are:

What proactive steps do you take as a firm to identify the conduct risks inherent within your business?

How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?

What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?

How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organization and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?

Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Rathi said that the five conduct questions were introduced to help focus the minds of senior managers on conduct risk, adding

I would like to see this expanded — and a sixth added — for all firms: Is your management team diverse enough to provide adequate challenge and do you create the right environment in which people of all backgrounds can speak up?

He went on to warn that, in the years ahead, if the FCA didn't see improvements in diversity at senior levels and better answers, it will also consider how to best use its powers.

"There are supervisory tools we can draw on. For example, I want to consider whether the diversity of management teams — and the inclusivity of the management culture they create — could be part of our consideration of senior manager applications," Rathi summarized.

It may well be that adding diversity targets to the Listing Rules is the first of a series of regulatory steps from the FCA — and potentially other regulators — to push the diversity agenda forward.

Those under the scrutiny of the FCA should be looking at their diversity and inclusion policies and how they comply with the existing targets. While they may only be faced with explaining any deficiencies in the initial stages, the threat of further sanctions down the road if real change isn't made, and sustained, looms large.

What is for sure is that organizations can expect to add regulatory scrutiny of their diversity and inclusion performance on top of existing internal, stakeholder and funding pressure in the future.

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