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Capital Markets Policy Team
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Wednesday 20 October 2021

Dear Capital Markets Policy Team,

Diversity and inclusion on company boards and executive committees

We welcome the opportunity to respond to your Consultation Paper on Diversity and inclusion on company boards and executive committees.

The Quoted Companies Alliance *Corporate Governance Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

Overall, the QCA welcomes the FCA's approach in taking the lead on encouraging greater diversity and transparency on company boards and executive committees. We have welcomed developments in this area in recent years, such as the Hampton-Alexander Review and the Parker Review. Our members, and the small and mid-sized quoted company community as a whole, recognise that it is important to take action to improve diversity. Greater diversity has the potential to produce many benefits, such as improved corporate governance practice and, arguably, corporate performance. It is important that companies are able to benefit from the positive consequences of increased diversity.

Our key concern with the proposals is in relation to the ability of smaller companies to comply with the FCA's proposed targets. While setting targets is important to encourage improvements, the targets proposed are, in effect, arbitrary figures and may not reflect genuine attempts to improve diversity within a company. We have summarised our key concerns for smaller companies below:

- Larger companies (who will typically have larger boards) will find it easier to meet the 40% target for women on the board, for instance, while smaller companies (who may have small boards with as few as four members) will struggle to reach this target as a result of there being considerably less refreshment opportunity, meaning that change takes much longer.
- Smaller companies may witness substantial fluctuations in the data they collect where as few as one or two changes in senior positions could have a disproportionate statistical impact.

- Start ups and smaller companies at an early stage in their growth and development may have needs for specific technical expertise which could have an affect on the constitution of their board members and senior management.
- There is also the concern that it is not necessarily easy to recruit diverse boards, in particular for smaller companies with smaller budgets.
- Finally, if all companies intend to comply with the new requirements at the same time, there could be a shortage of suitable candidates.

The comply or explain model proposed does provide some flexibility in this respect, although an inability to comply can often produce negative consequences for companies as a result of certain market participants paying limited attention to the explanatory part and dismissing the company due to its non-compliance. Of course, a compelling explanation for non-compliance is needed, but this can still be overlooked.

In light of this, we believe that a more proportionate approach would be for the FCA to consider removing the “comply” element for smaller companies below a certain market capitalisation threshold (such as £100 million) and not setting specific and, in some respects, arbitrary figures for compliance. Greater emphasis placed on the ‘explain’ part is beneficial as it is more important and more telling than compliance.

If this is considered undesirable, an alternative solution would be for a phased introduction of the comply or explain disclosure requirement. For instance, it could be required of all companies with a market capitalisation of over £100 million first, before extending it to all remaining companies a year or two later. This would allow smaller companies, who typically have smaller boards, to have a chance at complying with the requirements by giving them more time to be able to find suitable candidates.

Finally, we stress that it is important that the FCA manages its powers effectively so as to avoid regulatory overlap in this area. Diversity and inclusion has historically been associated with the UK Corporate Governance Code that is “owned” by the FRC, which means that this could result in potential crossovers between the powers of the two regulators. It is essential that there is communication and coordination between the FCA and FRC to avoid adding to the complexity of the regulatory regime.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,



Tim Ward
Chief Executive

Q1 Do you agree with the proposed comply or explain disclosure requirement on board diversity targets relating to gender and ethnicity?

Yes – on the whole, we consider that setting the disclosure requirements on board diversity targets relating to gender and ethnicity on a comply or explain basis will be an effective method for most companies in improving transparency and helping them to take meaningful steps to improve diversity. The comply or explain disclosure requirement allows for flexibility, which is particularly important for companies with smaller boards who may need more time to recruit diverse board members. We also do not consider that the comply or explain basis will be met with significant opposition from the majority of the company community.

However, we would stress the importance of the need for the FCA to consider the wider implications of setting a comply or explain disclosure requirement on board diversity targets relating to gender and ethnicity. Namely, that one of the biggest issues for small and mid-sized quoted companies relates to the actions of proxy voting advisers, who, in many instances, overlook the “explain” part when a company is unable to adhere to the “comply” part on the basis of their clients’ views who do not consider non-compliance an option. In most cases, proxy adviser firms adopt a box-ticking approach on behalf of their clients that is completely at odds with the comply or explain approach upon which the UK Corporate Governance Code is based, for instance. It is, therefore, entirely likely that this box-ticking approach will be adopted by proxy adviser firms on behalf of their clients in relation to this disclosure requirement on board diversity. This adds to the frustration of companies and the feeling that the conditions of the market are not overly welcoming and are too focussed on policing and enforcement with limited regard for the individual circumstances and characteristics of a company.

In light of this, we believe that a more proportionate approach would be for the FCA to consider removing the “comply” element for smaller companies and not setting specific and, in some respects, arbitrary figures for compliance. Greater emphasis placed on the ‘explain’ part is beneficial as it is more important and more telling than compliance.

If this is considered undesirable, an alternative solution would be for a phased introduction of the comply or explain disclosure requirement. For instance, it could be required of all companies with a market capitalisation of over £100 million first, before extending it to all remaining companies a year or two later. This would allow smaller companies, who typically have smaller boards, to have a chance at complying with the requirements by giving them more time to be able to find suitable candidates. There is also the concern that it is not easy to recruit diverse boards, and if all companies intend to comply with the new requirements at the same time, there could be a shortage of suitable candidates. A phased implementation would help mitigate such concerns.

Q2 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?

Yes – we agree with the policy rationale for 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. While it is likely that companies will face initial familiarisation costs and some ongoing additional administrative burdens, we consider that these would not be too substantial for most companies. In particular, reporting on gender is commonplace amongst many companies already, who often include director profiles and disclose the composition of their committees on the company website and within their

annual report. The administrative burdens will be greater for reporting against ethnicity, but we do not consider that this would be particularly high for most companies.

However, while we agree with the policy rationale, it would, perhaps, be more appropriate to place the numerical data reporting on a comply or explain basis also. This would ensure flexibility and reflects the notion that “one size does not fit all”.

Furthermore, the FCA has not provided a definition for the most senior level of executive management. A definition will need to be provided for clarity purposes before a requirement for a disclosure obligation to set out numerical data on the gender and ethnic diversity on a company’s senior executive management can be enforced. There is also potential scope for confusion given the definition of “senior manager” in S414C of the Companies Act 2006.

Q3 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

Yes – broadly, we agree with the proposed scope covering all Premium and Standard Listed companies.

However, the proposed scope will include the very smallest companies in the Premium and Standard Listing segment. These companies may have very small boards, with potentially as few as four members. The FCA must take into account these companies, and consider whether it is a realistic expectation for a board of this size to be comprised of 40% women, for instance, when there is considerably less refreshment opportunity. It is important that company boards are able to maintain the high levels of quality, experience and skills necessary to ensure their effective functioning, rather than being pressurised into making recruitment choices that are purely driven by the desire to comply with regulation, within a short timeframe. While, in the longer-term, we believe that this should be an achievable goal for most companies, in the short-term, at least, this may not be a realistic possibility for many smaller companies with small numbers of board members. Therefore, if a company is unable to reach these targets, this could result in adverse consequences, with these companies being penalised and having investment being steered away from them.

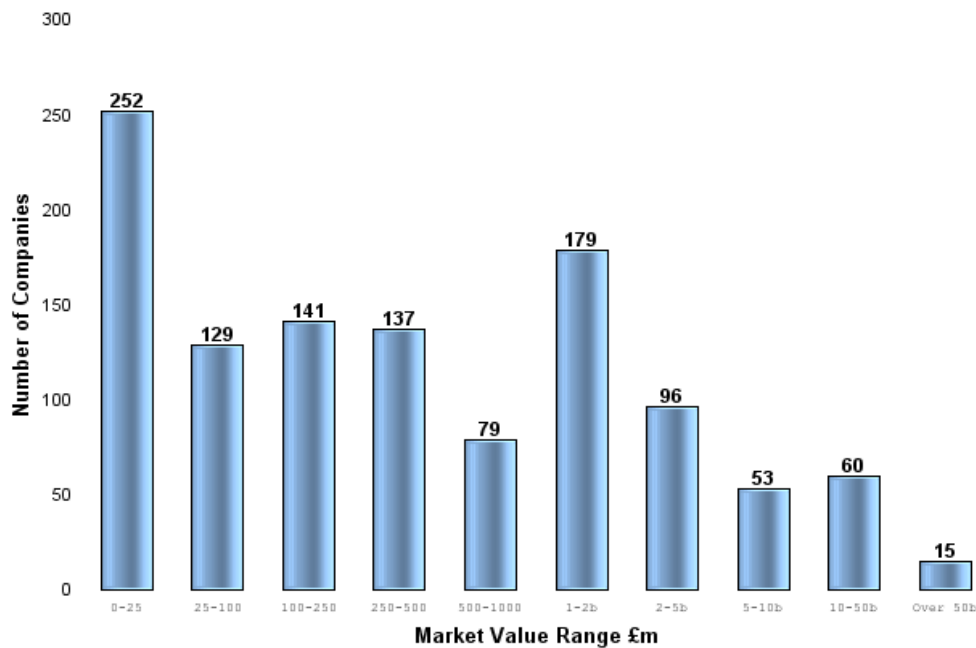
For this reason, and as articulated in our response to Question 1 above, we believe that the “comply” element should be removed for the smallest companies on the market, meaning that these companies would just have to provide an explanation for their boards’ composition, or that a phased implementation is taken forward.

Q4 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?

As per our answers to Questions 1 and 3 above, we agree with the proposal to include all companies in the Premium and Standard Listing segments, including overseas and smaller companies. However, we would advocate that the smallest companies should not have to adhere to the comply or explain approach, but rather provide an explanation for their boards’ composition only.

The table below highlights the distribution of companies by market capitalisation on the Main Market.

1



As shown in the graph, there is a significant number of companies (381) with a market capitalisation below £100 million. We would advocate for companies with a market capitalisation below £100 million being scoped out of the requirement to comply, and instead, be required to provide an explanation surrounding the nature and composition of their board only. While this market capitalisation figure is not necessarily indicative of companies with small boards, it is more likely that they will have a smaller board.

As articulated in our answer to Question 1, if this is seen as undesirable, we would suggest that a phased implementation is taken forward.

Finally, we strongly believe that the FCA must help smaller companies by issuing additional guidance to assist them in providing their explanations.

Q5 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?

In principle, we agree with the policy rationale for setting targets to increase gender and ethnic diversity representation for companies at the board-level. However, it could be argued that the targets proposed in this consultation, such as the 40% target for women on boards, are arbitrary. In addition to this, and as highlighted elsewhere in this response, it may not be possible for smaller companies to achieve these targets due to the small number of board members that they have. For example, a small company with a board of four members would effectively have to make their target 50% in order to comply with the proposed 40% target. A stratified target, in this instance, could be a more appropriate option. In addition, there is the concern that setting a single arbitrary target such as this could fail to encourage genuine diversity within companies and within their leadership pipelines. Instead, it may cause a new form of tokenism where companies seek to expand the number of their board members just to ensure they are compliant.

What is more important than setting certain numerical targets for companies to adhere to is to address diversity by embedding a culture of inclusivity and openness. This will be the key to changing thoughts and

¹ London Stock Exchange, Main Market Factsheet (as of 30 September 2021), available at: <https://www.londonstockexchange.com/reports?tab=main-market>

beliefs which are the central cause of discriminative behaviours whether they are conscious or subconscious. Setting a numerical target encourages a box ticking approach that does not necessarily do anything to tackle the embedded issues that have led to a lack of diversity on company boards. The explain approach is therefore a more thorough and thought provoking means of encouraging diversity as it would lead to companies thinking more broadly about their overall levels of inclusivity and diversity in a meaningful sense, helping to engender an improved culture and culminating in a more representative board.

We would also stress that a board may be able to demonstrate that it is operating effectively despite not necessarily being particularly diverse, but has put measures in place to improve the diversification of its board in the future through succession planning that takes into account board composition.

There are also issues evident in the marketplace that it is not necessarily easy to recruit diverse boards. It is likely that companies would have to seek external executive search and other recruitment services in order to be able to recruit more diverse board members. This will likely result in potentially significant costs for companies which will disproportionately impact smaller companies.

Finally, there also may be limitations regarding the quality and integrity of the information provided by companies assuming that certain board members will choose not to disclose their gender and/or ethnicity.

All of the abovementioned issues must be taken into consideration by the FCA before implementing the proposed targets.

Q6 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.

Yes – we agree with the format and extent of numerical data reporting proposed in the tables in Annex 2. However, as stated in our answer to Question 5 above, the FCA will first need to resolve the potential issues surrounding the quality and integrity of information if individual board members and/or senior management choose not to disclose their gender and/or ethnicity.

Q7 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.

No – we do not agree that the FCA should consider requiring similar numerical data reporting for the level below the executive management team of in-scope listed companies. While we agree that reporting on senior management composition in terms of gender and ethnicity would be useful and beneficial, companies should choose to report on this on a voluntary basis. Extending the requirement to senior management in addition to the board and most senior level of executive management increases the burdens further, which impacts disproportionately on smaller listed companies. As such, we believe that companies should be able to choose, on a voluntary basis, whether to disclose information regarding ethnicity and gender of the senior management team.

We also do not believe that the FCA should consider seeking data on representation by sexual orientation. Firstly, there are privacy issues to contend with, and, secondly, it is not overly clear what the relevance of collecting such information is. Regarding the former point, individuals may simply not wish to disclose information of such a nature. This issue may also be particularly pertinent for overseas companies whose

countries might not necessarily have sufficient legal, or other, protections for LGBTQ+ persons. For the above reasons, we do not believe that the FCA should consider seeking data on sexual orientation.

Q8 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.

Yes – we agree with the proposed amendment to DTR 7.2.8AR to add to the examples of diversity aspects insofar as they are only encouraged to take account of these wider aspects, where possible and where appropriate.

However, and as mentioned in our response to Question 7, we would object to information on sexual orientation being required due to privacy and other issues, and nor do we believe that information on disability or socio-economic background should be required. A requirement to report on these diversity aspects would create similar issues relating to privacy as individuals may not want to disclose such information. This certainly should not be required on a compulsory basis. Reporting on a voluntary and anonymous basis should, however, be encouraged.

We do consider that it would be helpful for companies to examine the composition of their governance committees in terms of gender and ethnicity. In particular, as these committees are often primarily comprised of non-executive director board members.

Q9 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

Yes – we agree with the FCA's proposed new guidance provision DTR7.2.8CG to encourage in-scope companies to consider providing numerical data to inform reporting on the results of their diversity policies.

Q10 Do you agree with the proposed implementation timing? If not, please explain why and indicate what alternative timeframe you consider appropriate

No – we do not agree with the proposed implementation timing. As articulated in our answer to Question 1 and elsewhere in this response, we propose that a phased implementation is taken forward due to the potential issues that smaller companies in particular could encounter, as well as there being a potential shortage in candidates if all companies are seeking to recruit at the same time.

We propose that the requirements apply, as proposed in the consultation, for companies with a market capitalisation of over £100 million for accounting periods starting on or after 1 January 2022, with reporting on diversity being seen in annual financial reports for these companies in spring 2023. Then the requirements should be extended to all remaining companies with a market capitalisation below £100 million for accounting periods starting on or after 1 January 2023, with reporting on diversity being seen in annual financial reports for these companies in spring 2024. Companies will still have the ability to make disclosures on a voluntary basis before these dates.

Even with an extended timeline, we still envisage that there will be practical, and other, issues for smaller listed companies in adhering to the proposals. We believe that these too need to be addressed by the FCA before taking the proposals forward.

Q11 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.

Yes – we agree that the FCA’s phased approach to improving its use of data over time. The FCA should analyse the data it captures and use this information to inform, and make adjustments to, if necessary, its proposed targets. This will not only help to improve diversity on company boards and senior executive management, but will also engender a broader culture around diversity.

Appendix A

The Quoted Companies Alliance *Corporate Governance Expert Group*

Will Pomroy (Chair)	Hermes Investment Management Limited
Tracy Gordon (Deputy Chair)	Deloitte LLP
Anthony Appleton	BDO LLP
Edward Beale	Western Selection PLC
John Beresford-Pierse	Hybridan LLP
Amanda Cantwell	Practical Law
Richie Clark	Fox Williams LLP
Kathy Cong	Prism Cosec
Louis Cooper	C/o Non-Executive Directors Association (NEDA)
Edward Craft	Wedlake Bell LLP
Ed Davies	LexisNexis
Tamsin Dow	Hogan Lovells International LLP
Peter Fitzwilliam	Mission Marketing Group PLC
David Fuller	CLS Holdings PLC
Nick Graves	Burges Salmon
Ian Greenwood	Korn Ferry
David Hicks	Charles Russell Speechlys LLP
Kate Higgins	Mishcon De Reya
Daniel Jarman	BMO Global Asset Management LLP
Colin Jones	Candid Compass
Tim Kendall	Vistra Limited
Kam Lally	Wedlake Bell LLP
Kalina Lazarova	BMO Global Asset Management LLP
Darius Lewington	LexisNexis
James Lynch	Downing LLP
Paul Norris	MM & K Limited
Laura Nuttall	One Advisory Group Ltd
Jack Shepherd	CMS
Julie Stanbrook	Slaughter and May LLP
Peter Swabey	C/o ICSA
Chris Taylor	Young & Co's Brewery Plc
Melanie Wadsworth	Faegre Baker Daniels LLP
Joan Yu	Armstrong Teasdale