Expect growing pressure for enhanced diversity and inclusion in the financial sector, from regulators, customers and broader stakeholders.

In a nutshell:
- In the UK, regulators and the regulated are embarking on a journey to accelerate the pace of meaningful change on diversity and inclusion in the financial sector.
- Financial regulators in other jurisdictions are taking more tentative steps, although cross-sectoral policies and initiatives are also providing some impetus.
- Given the global ESG agenda, pressure from customers and broader stakeholders is likely to drive greater change in the coming year even if regulators do not.

Regulators and the regulated are on a journey together in relation to Diversity and Inclusion (D&I) in the UK, but is it clear what the destination actually is? Is this just a UK excursion, or the beginning of a global adventure?

In July this year, the UK financial services regulators published a discussion paper on D&I entitled "Working together to drive change". Their objectives are clearly stated: the paper refers to diversity "making business sense", and says diverse workforces drive better outcomes by enhancing diversity of opinion and preventing potentially damaging "group think".
This journey of course takes place against the backdrop of the Environmental, Social and Governance (ESG) agenda, which is undoubtedly gaining traction worldwide. As the FCA says: "Diversity and inclusion is a key component of ESG – both in its own right, and as an enabler of creative solutions to other environmental and social challenges."

The UK Regulators' D&I discussion paper is supported and complemented by the FCA's 'strategy for positive change: our ESG priorities'. This features a set of target D&I outcomes including ensuring that:

- regulated firms and listed companies have more diverse representation at all levels;
- regulated firms and listed companies foster cultures that are inclusive so that staff can share their diverse experiences and backgrounds; and
- firms design and deliver products that reflect the diverse needs of consumers, offer fair value and deliver such products in a fair and accessible way.

This all sounds well and good, but what does this mean for firms in practice?

The discussion paper sets out several concrete proposals. Many are not unexpected and should be relatively straightforward for firms to implement, if they aren’t in place already: for example, requiring firms to:

- have D&I policies (and publish them);
- provide D&I training;
- link remuneration to progress on D&I; and
- report diversity data.

Some aspects are already in place in the UK (for example gender pay gap reporting for employers who employ a headcount of greater than 250). Many of these more predictable proposals make a lot of sense, both from a business perspective, but also in a society with a heightened focus on good culture.
The UK Regulators acknowledge that gender has historically been the primary focus in diversity discussions. The UK is not alone. For example in Hong Kong, since 2019, the Hong Kong Stock Exchange (HKSE) Listing Rules have required listing applicants with single gender boards to explain the measures put in place to achieve gender diversity after listing. And in Spain, the Code of Good Corporate Governance enacted by the National Securities and Market Commission in June 2020 recommends that Boards of Directors comprise at least 40% female directors by 2022.

Other aspects of diversity have however lagged behind. And where different diversity characteristics interact, the disadvantages experienced by the individuals at that intersection are magnified; firms need to acknowledge this and respond proactively, collaboratively and sensitively.

Outside the UK, financial services regulators don't yet seem to be pushing regulated firms to do more in relation to D&I, or at least not to the same degree. However, the growing ESG agenda may change that dynamic and prompt others to come along for the ride.

Regulators in other jurisdictions may also be influenced by existing general policies or even legal requirements. In South Africa, for example, one of the key drivers for financial institutions to deliver on diversity and inclusion is South Africa's policy of Broad-Based Black Economic Empowerment (BEE) which sets out the transformation objectives of the country. Under the Companies Act financial institutions are required to have a Social and Ethics Committee which is seized with a number of responsibilities, including monitoring BEE compliance and the implementation of the Employment Equity Act. While progress has been made in transforming diversity in the industry, the issue remains high on the agenda of financial services companies and regulators. This is evident from the position taken by the regulators with the yet to be enacted Conduct of Financial Institutions Bill (2020) which contains provisions that will require financial institutions to develop transformation plans and commitments aligning with South Africa's BEE legislation and objectives.

In Australia, although the Australian Prudential Regulation Authority (APRA) has indicated that its focus remains on risk culture, it has shown some interest in D&I. In a 2018 report on one of Australia’s biggest banks, APRA said that:

- a well-functioning executive committee would generally encourage “a diversity of thinking styles with topics viewed from different perspectives – a strategic and operational perspective; a task-focused and relationship-focused perspective; and an inside and outside the industry perspective”; and

- positive elements of a program proposed by the bank included “an ambition to source more diverse talent to provide expertise and capability that [the bank] may not currently have”. 

More recently, in May 2021, the Executive Director of APRA's Superannuation Division said that "an organisation's attitude to inclusion and diversity can be a key factor in creating a culture where everyone feels safe to speak up."

In the United States, the Financial Industry Regulatory Authority sought comments earlier this year on “any aspects of our rules, operations and administrative processes that may create unintended barriers to greater diversity and inclusion in the broker-dealer industry.” The U.S. Securities and Exchange Commission ("SEC") has announced and undertaken similar efforts in 2021 and it will also consider ways to increase D&I specifically in the asset management industry. It is currently considering rule changes requiring public companies to reveal more diversity information about their employees.

Some of the UK Regulators' proposals for financial institutions already apply, or are being consulted on, in other jurisdictions. The HKSE has issued a consultation paper on proposed further changes to the listing rules to promote diversity. These proposals include:

- introducing a mandatory disclosure requirement requiring all listed companies to set numerical targets and timelines for achieving diversity at both the board level, and across the workforce (including senior management); and
- requiring the boards to review the implementation and effectiveness of its board diversity policy annually.

Some jurisdictions have "comply or explain" principles or industry recommendations for best practice, including D&I considerations. For example, the Spanish Code of Good Corporate Governance, referenced above, and the ASX Corporate Governance Council of Australia's Principles and Recommendations, which apply to listed companies in those countries. In Australia this includes a recommendation for a listed entity to have and disclose a diversity policy and set measurable objectives for achieving gender diversity in the composition of its board, senior executives, and workforce generally, amongst other requirements. The Nasdaq Stock Market LLC's board diversity rule adopted by the SEC in the US also establishes a disclosure framework based on a minimum diversity objective.

The UK Regulators are confidently taking a lead in this journey and, having expressed concern that the "rate of change has been slow" to date, will most definitely keep their foot on the gas in 2022. The evidence suggests that financial services regulators in other jurisdictions may well join them, with the surge in global focus on ESG issues acting as a catalyst. Even if regulators do not, there is a good chance that customers and other stakeholders will press firms to chart a better D&I course.
KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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