

Advising the Board on **Equity, Diversity and Inclusion Risk**

Reports looking at the full range of commercial risk



Risk, Resilience
and Reputation

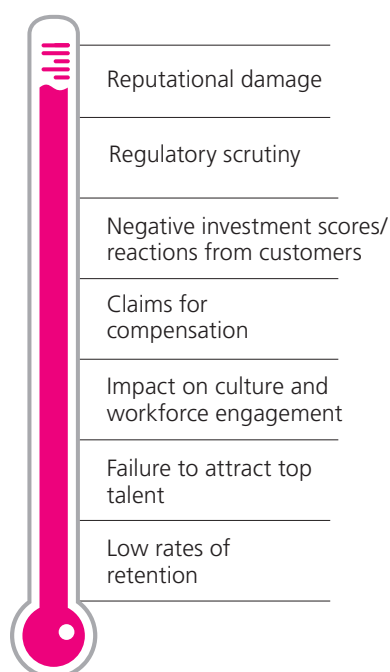
Directors' risk report

Most boards are aware these days that equity, diversity and inclusion (ED&I) should be firmly on their agenda but sometimes struggle to understand why and what they should do to address the issues. ED&I should not be seen as an “HR matter”; it’s business critical, with accountability at Board level.

Whilst ignoring ED&I is dangerous, paying lip service to ED&I may be even more problematic and certainly is not sufficient to make ED&I a reality. For example, on International Women's Day (IWD) 2022, whenever a company tweeted their support for IWD and their commitment to equality, a gender pay gap bot retweeted the size of their gender pay gap. In some cases, this exposed a potential disconnect between rhetoric and reality, highlighting the danger of paying lip service to ED&I. A poorly implemented ED&I strategy may well lead to tokenism which will be picked up by all your key stakeholders.

The board needs to have a firm grip on what ED&I is, the hard-edged legal and equally important cultural reasons why it is important. They must understand how to navigate the interplay between ED&I cultural aspiration, key business drivers and practical steps to implement a strategy (whether as part of a wider ESG strategy or otherwise).

Risk thermometer



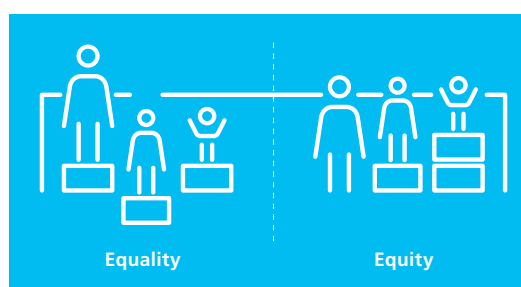
An introduction to terminology

Diversity is about all the ways that people are different. This can involve the groups of people who are protected by equality legislation, such as race or sex, but it's a much broader concept and includes the unique elements that shape a person, from their socio-economic background to their learning style.

Inclusion is about bringing diversity to life, by enabling everyone to bring their whole self to work, feeling valued, and able to voice their opinion.

Equity is a newer addition to the more established term “diversity & inclusion”. Equity is different to equality. Equity is about providing support to people based on their needs, in order to remove barriers rather than equality which is about treating everyone the same. We are seeing employers shift their attention to how they can promote equity with disadvantaged groups in their business.

Also remember ED&I is not just about race and gender, although for many businesses this is where they start their diversity journey. As we outline below, there are a number of legally protected groups but employers genuinely seeking to make progress in this area should look beyond the hard letter law and, for example, build in social mobility to their strategy.



In-house legal perspective



Heather Key

Chief Legal Counsel
Serco UK & Europe

Since I started at Serco in 2017, I have seen a step shift in talking about D&I to walking it. Although it's business sense for D&I to translate into ESG and social value policy, at Serco D&I, is not a separate workstream but is part of the fabric of the business.

Yes we have an inclusion hub which coordinates the activities for our D&I networks and we have recognition weeks and days (like national inclusion week and international Women's Day) but it is the little differences the wider Serco is making which I think has become the differentiator. We share our preferred pronouns; we talk about bias in our business decisions (and what we can do to address it); we have instigated fireside chats with a cross section of people from our senior leaders to the front line team discussing everything from our faith, our feelings on discrimination and wellbeing; and we have links to other companies to celebrate and learn. Importantly we are talking to and supporting our amazing teams who are on the ground delivering our contracts, and celebrating their successes. The energy that this movement is building really shows our values of trust, care, innovation and pride in action.

The ground up approach, the leadership involvement and the processes which have changed (our HR processes have reduced barriers to recruitment for example by encouraging inclusive adverts, and balanced interview panels) have supported this difference, although we cannot rest on our good work, there needs to be continuous action for Serco to be the place of choice where people want to work.

So how can we measure the impact of the good work? That's the hard part, you need a community of trust before colleagues will provide sensitive details. The actions our company is taking to build the trust is important and the statistics will soon show the impact our actions have made.

What do we need to do – the mandatory obligations

Legislation

The Equality Act 2010

Workplace equality law in the UK is governed by the Equality Act 2010 which prohibits discrimination, harassment and victimisation because of 'protected characteristics', which are the personal attributes that are legally protected such as race (see box below). The framework is about creating individually

enforceable statutory rights, rather than imposing specific measures on employers. The one area of ED&I where positive legal obligations do exist is in relation to the gender pay gap reporting regime.

Gender pay gap reporting

Companies in the UK with 250 or more employees must publish specific figures about their gender pay gap on an annual basis. This includes: the disclosure of mean and median gender pay gaps, mean and median gender bonus gaps, the proportion of men and women receiving bonuses and the proportion of men and women in each quartile of the company's pay structure. The obligations include a requirement to publish the gender pay gap data and a written statement which should be signed by a director or equivalent.

Although it is not currently proposed to introduce any legislation, some companies are taking steps (on a voluntary basis) to monitor and report their ethnicity pay gap.

Protected characteristics

The Equality Act 2010 contains nine categories of legal protection from discrimination and harassment.

These are:

- | | |
|----------------------|----------------------|
| — race | — pregnancy |
| — sex | and maternity |
| — disability | — religion or belief |
| — sexual orientation | — marriage and civil |
| — age | partnership |
| — gender | |
| reassignment | |

Corporate Governance

Depending on size and corporate structure, companies may have to comply with different diversity disclosures requirements as part of their corporate governance obligations. The corporate governance framework can be confusing; it is not always straightforward to determine which rules apply to each corporate structure and some of the obligations overlap. So, the starting point will be to determine which obligations apply to your company.

For example:-

- UK incorporated premium listed companies must comply with the diversity requirements in the UK **Corporate Governance Code**.
- Quoted companies must produce figures on the number of people of each sex who are directors, senior managers or employees in their **strategic report**.
- On a comply or explain basis, as part of the **Listing Rules**, certain listed companies must produce a board diversity policy on age, gender and educational backgrounds and from April 2022 this should cover ethnicity, disability and sexual orientation. In addition, in relation to financial years from 1 April 2022 the Listing Rules require targets to be set for gender and ethnic diversity at board level and these must be reported against annually on a comply or explain basis.

The consequences of a **failure to comply with a corporate governance rule** will vary depending on the source of the obligation. For example, a failure by directors to comply with the legislative requirements governing the strategic report carries different consequences to failing to comply with the UK Corporate Governance Code. The latter operates on a light touch 'comply or explain' basis, although the Financial Conduct Authority (FCA) would be entitled to impose sanctions on a listed company which fails to either comply or explain as required by the Listing Rules. In relation to the strategic report, if the directors of a company knowingly do not comply with any of the required provisions, or are *reckless* as to their compliance, they will be committing an offence.

Workforce reporting is an area where there appears to be room for improvement. According to a recent report by the Chartered Institute of Personnel & Development (CIPD) which analysed the annual reports of FTSE 100 companies, the quality of workforce reporting in the UK is "inadequate". The CIPD noted that very few companies provided information on pay and reward and that gaps existed

in relation to disclosures around temporary or contract workers. We suspect that many companies are reluctant to disclose figures which could reflect poorly on the organisation. The reality, however, is that increased transparency is a trend which is here to stay and it's better to get comfortable with this approach. Where the data being disclosed does not tell a positive tale, companies need to face in to this and ensure they provide appropriate context as well as devise a clear strategy and action plan for moving in the right direction.

Regulatory landscape

Many regulators, The Pensions Regulator, the SRA (Solicitors Regulation Authority) and the GMC (General Medical Council) to name but a few - are taking an increasingly active interest in relation to ED&I in their sectors. For example, one of the aims of the The Pensions Regulator's equality strategy is to promote high standards of ED&I among their regulated community. The SRA also makes it clear that equality legislation is the baseline of standards, and that regulatory obligations go beyond strict compliance with the law.

In the financial services sector diversity and inclusion is a core part of how the FCA and the PRA (Prudential Regulation Authority) assess culture in firms. The handling of non-financial misconduct (such as bullying and harassment, particularly sexual harassment) is a regulatory priority. In 2021, the FCA, the PRA and the Bank of England issued a discussion paper considering the future of D&I in the sector with proposals which, if implemented, would be far reaching. The cost of getting this wrong can be high. For example, Lloyds of London issued an underwriting company with a £1m penalty due to "serious failures" by the firm involving how it had handled a bullying and harassment case, and also on the basis that it sanctioned and tolerated an annual "Boys' Night Out" which according to press reports featured extremely inappropriate behaviour.

What are the opportunities?

Research has shown that there are significant returns on investment to be made for organisations that take ED&I seriously. More importantly, investors, customers, suppliers, potential recruits and your workforce expect it. There are numerous pieces of research which support the positive impact of leadership that embraces inclusive behaviours in its business. Some key points to consider:

- Being able to demonstrate strong ED&I credentials is an increasingly important way to attract and retain investors as part of the social pillar of the **ESG agenda**. Until recently, the

Expert perspective



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Equity, Diversity and Inclusion have become more prominent but for a number of people they remain buzz words and many organisations still have a long way to go to have ED&I fully integrated into their business.

To progress this agenda within your organisation you must understand the level of maturity of your approach. Is ED&I solely looked after by employee resource groups? Is it led by HR in isolation? Or is it embedded into all your processes and owned by leadership and every single individual, from the Board all the way down to the most junior members of staff?

Whatever stage you may be at, your ED&I strategy should be clearly linked to the business' goals and central in the way you operate otherwise it will always be seen as a separate issue and less of a priority.

To be successful, a ED&I approach must be 'top down – bottom up', with every single individual taking personal responsibility and the business creating accountability, especially for people in management positions.

As the Board, be genuine and transparent – nobody's cracked it and everybody sees through tokenism. In being open and honest you will create the right ecosystem to enable everyone in your organisation, including employees who are not part of a historically underrepresented group, to be a part of the solution.

That being said, ED&I cannot operate without proper resourcing – both financial and in terms of head count. Too many ED&I teams in isolation with one single individual responsible for driving critical operational and cultural change across all areas of the business.

If you are truly committed to ED&I then you must put your money where your mouth is and invest in it.

Once you get buy-in, appropriate resources and a strategy, it is important to manage everybody's expectations; constructive disruption and structural change take time – ED&I is a marathon, not a sprint.

Environmental pillar has been the dominant ESG concern of investors but attention is turning to the S. There is a lack of consistency around the variables that make up the S in ESG but there is a clear consensus that diversity and inclusion are a core sustainability indicator. On ED&I specifically, the Investment Association (the group that represents asset managers in the UK) expects companies to explain their approach on gender and ethnic diversity and FTSE 350 companies risk being 'red-topped' if women represent 33% or less of the board.

- In a challenging job market the **pool for talent** and **ability to recruit** depends a great deal on the perception of a company in the marketplace. Many studies show that a strong reputation on ED&I will attract candidates.

- Conversely companies that are known as having a **poor working culture** may struggle to recruit in an already constrained marketplace. In a recent study looking at the Great Resignation in the US, a toxic working culture was 10 times more likely to contribute towards attrition than salary.
- ED&I can also affect attendance. In one study looking at inclusion, a 10% increase in the perception of inclusion increased **attendance** per employee by almost one day each year.
- Studies are now examining how **consumers** respond to the sustainability and purpose of a business. In one global study it reported that customers are four times more likely to purchase from a brand with a strong purpose.

Risks to the business

Apart from missing out on the potential opportunities outlined above, getting it wrong when it comes to ED&I may create risk and costs in your business:

- The **reputational damage** following a negative media story should not be underestimated, especially given the power of social media. The #MeToo and BLM movements lifted the lid on organisations where poor behaviour had gone unchecked, resulting in a significant shift in the risk profile of harassment and bullying. How an organisation responds to allegations is also critical. The way in which Yorkshire Cricket Club responded to the investigation report into allegations of racism was highly criticised and only served to intensify the media scrutiny.
- **High profile shareholder rebellions** can result from a failure to set or meet expected ESG criteria. We saw this in 2021 over executive pay

but from a ED&I perspective, lack of diversity on boards, especially from a gender and race perspective, is a key example of this. Other reported examples include shareholder pressure around disclosure of gender and ethnicity pay data.

- Defending **costly legal claims** is another factor. Inappropriate and unethical working cultures will be fertile territory for legal claims including harassment, discrimination and whistleblowing. These claims are uncapped and, depending on the salary and future loss of earnings, awards can reach six figure sum, not to mention incurring significant legal fees.
- **Increased regulator scrutiny** can result from negative PR or a negative decision relating to ED&I matters but equally may result if an employee decides to blow the whistle direct to the regulator.

Where to start?

Organisations will be at different stages of their ED&I journey but some key steps to consider are covered below:

Collate your diversity data

The old adage applies: what gets measured, gets done. Organisations without good quality, up to date diversity data will not be able to plan an effective ED&I strategy or chart their progress. Whilst the initial concerns about data protection issues in relation to collating data can be managed, the key to a successful approach to this is creating an environment where employees feel comfortable self-declaring their ethnic background, sexual orientation and/or disability. High engagement with your data collection initiatives shows you are on the right path, whereas low engagement indicates you have a way to go.

Develop a long term strategy

- **Consider all stages of your relationship with your employees**
Build ED&I into your recruitment process, career progression, promotions and leaver management. Work with HR and management to consider ED&I at every stage. Start with the Board – what steps can you take to make it visibly diverse and keep it diverse?

- **Setting targets and objectives**

Unless you have collected data this will be difficult. Targets are not quotas, and they should provide a meaningful and measurable outcome which everyone can work towards. Figures should be aspirational but also achievable in order to maintain momentum and achieve staff buy in. They should also aim to cover the lifecycle of employment from recruitment, retention and career progression to exit.

- **Agree responsibility for delivery**

A successful ED&I strategy needs to be seen as a priority for your entire company and not just HR. Visible and active support at a Board level is critical to success.

- **Building into reward**

Consider whether ED&I should be part of your reward structures. By making it so, it will be firmly on your workforce's agenda.

- **Training**

All staff should be trained on ED&I matters starting with the Board. Training should reflect individuals' roles and seniority; in particular managers need to understand their importance as role models. Training also needs to touch on more subtle forms of behaviour such as "microaggressions": everyday behaviours which undermine people and negatively impact culture.

Listen to staff

Regular pulse checks or surveys can help companies to understand employee engagement and whether there are any issues lurking. This is an ongoing exercise where results should be monitored for progress. Diversity networks and exit interviews can all help build the picture of the health of ED&I within your organisation.

Be authentic in communications with employees

Not only should senior leaders lead by example when it comes to ED&I, any communications must be transparent, authentic and credible. Senior leaders should for example engage with diversity networks and ensure that they don't oversimplify an issue or (with the best of intentions) adopt a patronising approach.

Summary

Practical risk management for directors



Plan ahead and focus on the culture and values the board wants to create, and then identify what needs to happen in the ED&I strategy to achieve that. Don't wait for an HR crisis to happen.



When something goes wrong, don't try to bury a problem; deal with it in line with your values and be open and transparent. It doesn't matter how advanced your ED&I strategy is, there is always scope for people to behave badly. How an employer responds to an allegation of wrongdoing is crucial. Brushing bad behaviour under the carpet can undo years of good work on your ED&I strategy and risks being exposed further down the line in any event.



Don't be complacent – acknowledge and celebrate progress and achievements but recognise that organisations can always do better.



The messaging is important. Do not keep moving meetings on ED&I or repeatedly put the issue at the end of meeting agendas and run out of time: this sends a message that there is no genuine commitment.



This is a long term investment. Do not only communicate on ED&I matters on milestone dates like International Women's Day or PRIDE month. It risks looking like tokenism.

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