

WOMAN ON BOARDS DIRECTIVE MOVING FORWARD

After a 10-year stalemate the European Council has announced that it has adopted the final text of a directive to ensure gender parity on the boards of publicly listed companies in the EU; the so called 'Women on Boards Directive'.

Although the draft Directive must now be adopted by the European Parliament, if it progresses as anticipated in scope companies will be required to achieve a target of 40% of non-executive director posts to be allocated to the under-represented sex by 30 June 2026 ('40% Target') and Member States will be required to ensure that there are effective, dissuasive, and proportionate penalties in the event of non-compliance.

WHICH FIRMS WILL THE DIRECTIVE COVER?

The Directive is applicable to all companies with a registered office in the EU and whose shares are listed on EU stock exchanges (regardless of the board structure; be it a dual ('two-tier') system in which there are separate management and supervisory boards, a unitary ('one-tier') system combining the management and supervisory functions in one single board, or a mixed system.

Micro, small and medium-sized enterprises with up to 249 employees and an annual turnover not exceeding EUR 50 million (or equivalent) or an annual balance sheet total not exceeding EUR 43 million (or equivalent), will be excluded; Member States are of course able to extend the scope of their domestic legislation should they so wish.

WHAT ARE THE NEW BOARD COMPOSITION OBLIGATIONS?

Listed companies that do not have at least 40% of the under-represented sex as non-executive directors will be obliged to make the appointments to those positions based on a comparative analysis of the qualifications of each candidate, by applying pre-established, clear, neutrally formulated, and unambiguous criteria, to attain the 40% Target by **30 June 2026**.

Alternatively, Member States can provide that in scope companies have met the obligation if they can show that members of the under-represented sex

Key issues

- The EU legislative process is progressing the Woman on Boards Directive after a 10-year hiatus
- Companies listed on EU stock exchanges will have to meet Board gender targets by 30 June 2026
- 40% of non-executive appointments must be allocated to the underrepresented sex or 33% of all board posts
- Penalties for non-compliance will be applied, including the possibility of judicial annulment of board appointments
- In scope companies will also be subject to new reporting requirements

hold at **least 33%** of all director positions, irrespective of whether they are executive or non-executive.

For these purposes the definition of 'director' includes employee representatives in Member States where a certain proportion of the non-executive directors can or must be appointed or elected by the company's workforce and/or organisations of workers.

HOW DO THE TARGETS APPLY TO "SMALLER" BOARDS?

Smaller boards of in scope companies are still subject to the 40% Target but the exact number of board positions necessary to comply with the Target should be the number closest to 40%, whether below or above that threshold, but at the same time listed companies should not be obliged to appoint members of the under-represented sex to 50% or more of the non-executive board positions.

WHAT ARE THE NEW REPORTING OBLIGATIONS?

Listed companies will be required to provide information to the competent authorities once a year about the gender representation on their boards (distinguishing between non-executive and executive directors) and about the measures taken to achieve gender balance.

If the objectives have not been met, the company must set out how it plans to attain them. This information would be published on the company's website in an easily accessible manner and included in the annual report.

Although the Directive is relatively un-prescriptive about the level of detailed information that must be provided by companies, Member States may be more prescriptive either by way of formal legislative requirement or indicative good practice guidance.

In-scope companies may elect to include additional information on an appropriate platform, for example, in their annual financial reports to provide further context, for example:

- a brief summary of any key policies, procedures, and processes;
- any wider context, that the company considers contribute to improving the diversity of its board and executive management;
- any mitigating factors or circumstances which make achieving diversity on the company's board more challenging (e.g., the size of the board or the jurisdiction where the company's main operations are located); and
- any risks the company foresees in meeting (or continuing to meet) the board diversity targets in the next reporting period, or any plans to improve the diversity of the company's board.

DOES THE REQUIREMENT TO "PREFER" CANDIDATES OF THE UNDER-REPRESENTED SEX CREATE A DISCRIMINATION RISK?

The Directive imposes a preference rule that where a company has equally qualified candidates of both sexes in terms of suitability, competence and professional performance priority shall be given to the candidate of the under-represented sex unless in exceptional cases, reasons of greater legal weight, such as the pursuit of other diversity policies, tilt the balance in favour of the

candidate of the 'over represented sex'. This might be the case for example if a company had a diversity policy that was seeking to achieve greater ethnic diversity on its board where ethnic minority representation was even less than female representation.

The principle of 'positive' action is well established in European law with case law establishing the criteria that need to be met to reconcile the two concepts of formal equality of treatment and positive action.

The criterion that the candidates are 'equally qualified' is potentially problematic. The Directive provides that Member States should ensure that the selection of the best qualified candidates for director positions is based on a comparative assessment of the qualifications of each candidate based on pre-established, clear, neutrally formulated, and unambiguous criteria established in advance of the selection process. Examples given of types of selection criteria that companies could apply include professional experience in managerial and/or supervisory tasks, international experience, multi-disciplinarity and knowledge in specific relevant areas such as finance, financial oversight, or human resources management, leadership and communication skills and networking abilities. Although it appears that both formal qualifications and or broader qualifications in terms of practical experience can be taken into account when assessing the qualifications of candidates there will inevitably be some debate about the weighting to be allocated to respective attributes.

In practice, it is highly unlikely that two candidates will be equally matched in terms of qualifications and/or experience and conceivably this may open the door to claims of direct discrimination by the unsuccessful candidate. Will this provision be unworkable because of the difficulty in testing whether the candidates are 'as qualified'. On the other hand there may not be the appetite to litigate on the part of an unsuccessful candidate?

If an individual is inclined to litigate the litigation will be facilitated by the requirement for the listed company to disclose, upon the request of an unsuccessful candidate, not only the qualification criteria upon which the selection was based, but also the objective comparative assessment of those criteria and, where relevant, the considerations tilting the balance in favour of a candidate who is not of the under-represented sex.

SEX OR GENDER IDENTITY?

The draft Directive is silent on the question of whether the 40% Target is on the basis of either biological sex or gender identity (i.e. individuals self-identifying as a particular sex). It remains to be seen whether Member States will address this question directly or simply give companies the flexibility to report against targets based on sex or gender identity.

WILL THERE BE ANY PENALTIES FOR NON-COMPLIANCE?

Member States will be required to ensure that 'effective, dissuasive, and proportionate penalties' are put in place to ensure compliance with their domestic regime that implements the Directive. Examples of specific penalty measures include fines and companies having their selection of board directors annulled by a judicial body. Member States will, however be free to determine what penalties are considered appropriate; it will not be mandatory to legislate for judicial annulment of a board appointment. Where provision for judicial annulment is mandated; the form that this will take remains to be seen.

Will it only arise upon an application by a disgruntled shareholder, unsuccessful candidate, equality body or in some other manner, for example formal registration of an appointment being rejected automatically if board composition does not meet the specified criteria?

HOW WILL THE NEW DIRECTIVE REQUIREMENTS INTERACT WITH EXISTING LOCAL GUIDELINES/RULES?

Since the original proposal for the 'Women on Boards Directive' Member States have developed various approaches to the issue of board diversity. Where national legislation has been implemented this has been diverse in approach: with different groups of companies in scope and some Member States opting for a "comply or explain" model, and others establishing specific binding legal gender balance objective with sanctions.

The revised draft text of the Directive provides that in certain circumstances Member States will be exempt from implementing the Directive's provisions. This will be the case if by the date that the Directive comes into force either:

(i) members of the underrepresented sex hold at least 30% of the total number of all nonexecutive director positions or at least 25% of the total number of all director positions in listed companies; or

(ii) the Member State's national legislation: (a) requires that members of the underrepresented sex hold at least 30% of nonexecutive director positions or at least 25% of all director positions in listed companies; (b) includes effective, proportionate, and dissuasive enforcement measures in relation to non-compliance; and (c) all listed companies not covered by such national legislation set individual quantitative objectives for all director positions.

The German Government has welcomed the Directive. Given that, by means of two recent legislative initiatives (FüPoG I (2015) and FüPoG II (2021)), Germany has already implemented binding rules on fair gender representation for supervisory boards as well as for certain executive boards of listed and co-determined companies as well as for certain state-owned companies the Federal Ministry of Justice ('BMJ') consider that the German rules are sufficient, and that Germany would accordingly fall under the Directive's implementation exception.

The Netherlands opposed the Directive for a long time, arguing that board diversity should be dealt with at a national level. This stance has now evolved; the Directive now chimes with the Dutch government's active policy against discrimination and promoting gender equality, as well as an increased level of support for relevant initiatives in society. With effect from 1 January 2022 Dutch legal entities with a listing in the Netherlands have been subject to a statutory diversity quota requirement for non-executives; this requires at least one-third of the non-executives to be of the under-represented sex. This should come within the Directive's implementation exception.

The Kingdom of Spain has also welcomed the Directive. The promotion of fair gender representation on the board of directors has been on Spain's agenda for some time. In 2007 the Organic Law 3/2007 promoted fair gender representation on the boards of both private and public companies. More recently, the 2020 Code of Good Corporate Governance required director election policies to promote gender diversity and set a target of at least 40% female representation on the board of directors in public companies.

It is evident that the effect of the soft law (code) and quota without sanctions (soft quota) adopted in Spain has increased the presence of women, but the Directive's objectives have arguably not been achieved. Accordingly, it remains to be seen whether the Spanish Government will implement the Directive or take the view that the existing arrangements are sufficient.

In 2011, France implemented binding rules on board gender representation that inspired the Directive; the "Coppé-Zimmermann" law. This introduced a requirement in relation to the gender composition of the board of directors and supervisory boards of listed companies (and unlisted companies with net sales or a balance sheet total of at least 50 million euros and an average number of at least 250 permanent employees) that there should be non-executives of each gender of at least 40% when the board is composed of more than 8 members. In addition, when the board is composed of 8 members maximum, the difference between the number of each gender cannot be more than two. Subsequently, in 2021 the "Rixain" law expanded the obligation of large corporations, with more than 1,000 employees, in terms of gender equality, by introducing an obligation to publish annually details of any gaps in the representation of women and men at senior manager level and in relation to membership of management bodies. In addition, it provides that by 1 March 2026, the proportion of people of each gender in senior management and on management bodies must not be less than 30%. This quota will increase to 40% with effect from 1 March 2029.

WHEN WILL THE RULES WILL COME INTO EFFECT?

The revised text of the Women on Boards Directive must now proceed through the formal approval process; the Directive will enter into force 20 days after it has been published in the EU's Official Journal and Member states will need to implement the directive two years after it has been adopted. It is unclear how long the approval process will take but it is anticipated that the Directive will be adopted by the European Parliament in November or December 2022. Assuming that it progresses, and Member States comply with their implementation obligations (if any) in scope companies will in principle be required to comply with these board targets by 30 June 2026.

HOW DO THESE RULES COMPARE WITH THOSE OF OTHER JURISDICTIONS?

The Directive's new requirements should also be seen in the context of a wider global movement by regulators and legislatures to increase diversity and inclusion at and below board level. In the UK, for example, for accounting periods from 1 April 2022 new disclosure requirements introduced by the Financial Conduct Authority (FCA) impose new 'comply or explain' disclosures regarding board diversity as well as enhanced data transparency (regarding both the board and the level below the board). This includes Board diversity targets of at least: (i) 40% of the board should be women; (ii) one of the senior board positions (Chair, CEO, SID or CFO) should be a woman; and (iii) one board member should be from a minority ethnic background. Some of the proposals will impact overseas as well as UK issuers. The FCA encourages firms to comply sooner if possible. A consultation on further sector-specific requirements is expected later this year for financial services firms. The UK government has however confirmed that whilst it will continue to commit to targets it has no plans to introduce mandatory board quotas.

In the United States, initial efforts in California to mandate board composition were struck down by the courts as being unconstitutional on equal protection

grounds. No similar laws are pending at the federal level, and other government-led initiatives have focused on softer targets such as studies and reporting. There have been industry-led initiatives, for example, Nasdaq requires Nasdaq-listed companies to have at least one female board member and where companies are unable to meet the requirement, they must disclose the reason(s) why.

PREPARATORY STEPS: WHAT SHOULD FIRMS /EMPLOYERS BE DOING TO PREPARE?

By way of initial preparatory steps, in-scope companies should:

- review any existing board diversity policies (and, if one is not in place, consider developing one); and
- consider their existing diversity ratios and, if these do not presently meet the proposed 40 Target, reflect on why that might be, and what organisationally appropriate steps they can take to widen succession planning and talent pools at the appropriate levels (whilst ensuring that they remain in compliance with their non-discrimination obligations under domestic legislation);
- assess how existing employee D&I data access and analysis supports future work on assessing needs for improved representation at different levels, and (if not) how this can lawfully be altered.

WHAT ARE THE POTENTIAL IMPACTS OF TARGETS ON THE CULTURE OF FIRMS AND ON THEIR INCLUSION AND DIVERSITY STRATEGIES?

The Directive's new requirements represent a significant rule change around inclusion and diversity for corporate employers. Some companies may already be in overall compliance based on existing national provisions or adherence to voluntary frameworks. For companies wishing to use them as such, the introduction of targets can be a powerful tool as part of a firm's wider inclusion programme. However, in such cases, the development and implementation of targets need to be handled with care to ensure maximum buy-in and impact. Introduction of targets can be a highly emotive issue. Strategic workforce engagement (at and below board level) will help guide how these new developments are understood and perceived by internal stakeholders. Doing so will help to avoid the potential negative pushback that can happen if the introduction and roll-out of these targets is not handled with cultural sensitivity.

The introduction of targets will likely have an impact on the discussion around inclusion and diversity within organisations. There may be a negative impact on delivery against targets and associated governance goals if the workforce perceives this as a quota that is not based on talent or merit. In such a case, it also runs the risk of having a wider negative impact on any inclusion and diversity initiatives within the company which may become seen as connected to the targets. Therefore, employers adopting targets should develop a plan and accompanying campaign on the introduction and roll-out of the targets so that they can both manage the potential impact on the culture of the company and attitudes towards inclusion and diversity.

Some key considerations could include:

- **Consultation with key internal stakeholders.** Consultation and buy-in is critical for these targets to succeed. Board (and board committee),

executive and management engagement will be key, but more 'grass roots' engagement is also likely to be important. Employee Resource Groups (ERGs) or affinity networks may be a useful group in this consultation, if established. Many companies will have a selection of ERGs including on gender, LGBT+, ethnicity, and disability. The most obvious ERG to engage with is gender parity ERGs in order to secure early support for the targets and to engage them in developing any accompanying initiatives which the targets will require. It is also important to engage the other ERGs or key population groups as the introduction of targets on gender will undoubtedly lead to questions around targets for other groups. However, they should not have the sole responsibility for focusing the organisation on the targets.

- **Develop early communications campaigns that frame the purpose of the targets.** For maximum impact, positive framing of the purpose of the targets should be clear from the very beginning from the company leadership. There can be a lot of sensitivity around the topic of targets, and they can be misconstrued as quotas that are simply a numbers game, or to the disadvantage of groups not covered by them, rather than being an initiative focussed on removing the barriers to meritocratic career opportunities. If looking to make progress towards targets, in-scope companies can use targets should help provide the focus to identify and remove artificial barriers which may have built up so that employees can have access to an equality of opportunity, ambition, and experience in the firm. Targets being perceived from the outset as such (rather than about advancing people ahead of others where they do deserve to be promoted or making members of the under-represented group having to outperform in order to 'prove' their promotion was on merit): they are about seeing who should be advanced but who has not been in the light of structural and cultural barriers.
- **Targets are only part of the solution.** Introducing targets is not the final step in an inclusion and diversity process but is part of a wider package of measures that can be used. Once the targets are announced, they can be connected into a wider inclusion and diversity campaign. Companies will need to be able to demonstrate to their workforce and stakeholders how they propose to achieve these targets; otherwise, they run the risk of undermining faith in the targets and in their wider inclusion and diversity efforts. Targets should be accompanied with specific infrastructure (ownership by relevant committees, review processes, KPIs and incentivisation) to ensure the ownership of delivering the targets is maintained.
- **Management ownership is essential.** Companies need to demonstrate that the leadership are going to be the key drivers of achieving the targets, along with counterparts in relevant internal functions (such as Co Sec, HR or People & Culture/ D&I leads). One of the other key aspects of targets is that they allow a more focussed sense of ownership across management. Some senior leaders shy away from sometimes difficult conversations around targets out of fear of "saying the wrong thing". To maximise impact, companies need to build the confidence and capacity of leaders in firms to be advocates for the targets and their wider inclusion and diversity programmes.

The implementation of this Directive will have an impact on the discussion around inclusion and diversity in the workplace and, in turn, on the culture of a

company. Developing early strategies and campaigns that are aware of the cultural issues and how best to navigate them will be beneficial for companies.

[European Parliament Press Release](#)

[European Parliament provisionally agreed text](#)

[European Council agreed text \(17 October 2022\)](#)

Clifford Chance Briefing: [Diversity and inclusion on company boards and executive management: FCA policy statement](#)

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