

THE FCA, PRA AND BANK OF ENGLAND HAVE PUBLISHED A DISCUSSION PAPER SEEKING VIEWS ON PROPOSED REGULATORY PLANS TO IMPROVE DIVERSITY AND INCLUSION IN REGULATED FIRMS

The discussion paper (DP21/2) makes it clear that the FCA, PRA and Bank of England (the 'regulators') expect to see diversity and inclusion become part of how they regulate and part of how the UK financial sector does business. They want firms to think about how they can advance diversity and inclusion through improving their policies, governance arrangements, accountability, remuneration arrangements and disclosure. The regulators' engagement on diversity and inclusion will be an important part of its wider engagement on Environmental, Social and Governance (ESG).

WHAT FIRMS ARE IN SCOPE?

DP 21/2 is addressed to all UK regulated financial entities i.e. firms authorised under the Financial Services and Markets Act (FSMA) and regulated jointly by the PRA and FCA (banks, building societies, designated investment firms, credit unions and insurance firms) or solely by the FCA; payment services and e-money firms regulated by the FCA; credit rating agencies and recognised investment exchanges regulated by the FCA; and FMIs regulated by the Bank of England.

Views are sought in the DP21/2 on bringing overseas firms that provide services in the UK into scope.

DP 21/2 does not cover listed firms that are not regulated by one or more of the regulators.

WHAT IS MEANT BY DIVERSITY AND INCLUSION?

DP21/2 focusses on 'diversity of thought' also called 'cognitive diversity'. This is broader than the nine characteristics protected under the Equality Act 2010 (EQA) (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation), and is considered by the regulators to include other factors, such as socio economic diversity, gender (including where it does not coincide with sex), and cultural background.

Key proposals

DP 21/2 sets out a number of policy options including:

- the use of targets for representation;
- measures to make senior leaders directly accountable for diversity and inclusion (D&I) in their firms and other SMCR changes;
- linking remuneration to D&I metrics;
- D&I reporting obligations;
- training obligations; and
- publication of D&I policies;
- the regulators' approach to considering D&I in non-financial misconduct.

Inclusion, in addition to diversity, is a key focus of DP21/2. This is defined in the paper as the practice or policy of providing equal access to opportunities and resources for people who might otherwise be excluded or marginalised, for example due to demographic characteristics.

PSYCHOLOGICAL SAFETY/ SPEAKING UP: WHAT IS IT AND HOW DOES IT INTERACT WITH DIVERSITY AND INCLUSION?

The regulators place importance on firms having a culture of psychological safety without which they consider that staff may be unwilling to speak up and raise concerns. By 'psychological safety' the regulators mean an environment where employees feel safe to share ideas and speak up where they see issues results in more productive and innovative businesses. The regulators' view is that diverse and inclusive environments allow all individuals to speak up freely without fear - therefore pursuing diversity and inclusion aligns with the regulators' wider desire for a speak up culture so that potential wrong doing can be called out, supporting the objective of safety and soundness in firms.

Although most firms will have internal whistleblowing (some in accordance with their regulatory whistleblowing regime obligations and others as a matter of good practice) and grievance procedures the culture within a firm will not necessarily be such that staff will make use of them, or indeed of other informal channels to raise issues of concern. In the example D&I metrics set out in Appendix 2 of DP 21/2 it is suggested that firms when measuring staff 'Engagement' should assess survey results on employees' well-being and personal resilience including psychological safety.

NEW DATA REPORTING OBLIGATION: WHAT IT MIGHT LOOK LIKE?

DP21/2 anticipates that when the proposed D&I regulatory regime is consulted on in 2022 it will include a requirement to report to the regulators:

- on the EQA protected characteristics plus socio economic background for different categories of staff, such as Board members and the executive committees, senior managers, and their direct reports, and all other staff;
- whether there are any internal diversity targets for the Board and senior managers;
- the firm's progress in relation to any identified D&I targets; and
- high level firm wide data on demographic diversity characteristics and inclusion practices.

Prior to that the regulators will conduct a one off pilot survey of a representative sample of solo regulated firms, all firms jointly regulated by the PRA and FCA, and selected FMI to test how firms' can provide data with a view to considering regular reporting in the future.

The regulators have set out some initial thoughts on what metrics might be included in any future D&I data collection exercise to prompt discussion. It is suggested that most metrics can be divided into: recruitment, retention, advancement, representation and pay. DP21/2 then suggests steps towards developing metrics including:

- Defining and reviewing periodically which diversity dimensions (e.g. protected characteristics and nationality, educational attainment, age, disability, sexual orientation, family status, carer and parental status, employment status (full time, part-time, flexible working) to monitor;
- Defining and reviewing periodically which inclusion initiatives to monitor;
- Reviewing data policies to address data protection and privacy issues; and
- Selecting and reviewing periodically what metrics should be used for the purposes of: (i) diagnosis; (ii) tracking progress; and (iii) measuring return on investment, so as to track the impact of diversity and inclusion initiatives.

In due course the regulators aim to use the data collected to monitor progress and enable benchmarking across the financial services industry.

It is also likely that firms will be required to make additional disclosures including data on pay gaps (going beyond gender to include other characteristics). Views are invited on whether a regulatory disclosure template would be appropriate. It remains to be seen whether the Government will introduce a requirement on employers more generally to publish ethnicity and/or disability pay gap data as part of the promised Employment Bill (or otherwise). If so it is not yet clear whether the regulators would deviate from such a regime, potentially adding to the administrative burden for some firms.

DATA PROTECTION/PRIVACY CONSIDERATIONS

DP21/2 acknowledges that firms may face reluctance from staff to disclose their 'diversity' data and suggest that an open dialogue with staff about the policy intent may help to overcome this.

Equally DP21/1 acknowledges that firms must collect data within the prevailing data protection regime (UKGDPR and potentially in some cases, other jurisdiction's data protection regimes). Some diversity data is 'special category' personal data and subject to additional restrictions DP21/2 suggests firms "can manage this through surveys seeking voluntary disclosure of sensitive information". It remains to be seen what the regulators approach will be if firms cannot secure the requisite data.

BOARD SUCCESSION PLANNING

The DP seeks views on the best approach to achieve diversity at Board level (and below) and mandating areas of responsibility for D&I at Board level. It flags that the regulators could make it explicit in their rules or guidance that, when giving attention to succession planning and accounting for the future collective suitability of the Board, upcoming appointments should also be considered in the context of diverse representation. Overall, the paper discusses approaches to developing diverse talent for the future.

INDIVIDUAL SENIOR MANAGER ACCOUNTABILITY FOR DIVERSITY AND INCLUSION (D&I)

DP21/2 explores various options for imposing individual responsibility on senior managers according to the nature of the SMCR firm (solo/dual regulated etc). What is clear is that there is likely to be a clear senior management accountability for D&I and this is almost certainly going to have to be reflected in individual statements of responsibility.

REMUNERATION

Linking remuneration to D&I metrics as part of non-financial performance assessment is mooted as a potentially effective way of driving progress. For SMCR firms it is proposed that all Senior Managers who have responsibility for managing employees, including the accountable executive who holds the prescribed responsibility for culture in dual regulated firms, should expect their performance against these objectives to be reflected in their variable remuneration, including the use of risk adjustments.

SMCR: FITNESS AND PROPRIETY ASSESSMENT

To date the FCA has, in some cases, taken into account non-financial misconduct when assessing an individual's fitness and propriety for the purposes of the SMCR regime. There is however no guidance as to what constitutes 'non-financial misconduct'. The regulators' suggestion that they can develop guidance on this topic to include evidence of sexual harassment, bullying and discrimination on the basis of someone's protected (or otherwise) characteristics as factors to take into account is to be welcomed. This would provide firms with much needed clarity on whether they need to assess whether evidence of such behaviour constitutes a breach of the Conduct Rules, and as such requiring disclosure under the regulatory reference regime and lead to a more consistent approach in practice.

SMF APPROVAL

The FCA and PRA are considering whether to collect diversity data about the individual as part of the information provided for Senior Management Function applications in order to facilitate their understanding of how the firm has considered the proposed appointment and how it will contribute to diversity in a way that supports the collective suitability of the Board and senior management. If either regulator forms the view that the proposed appointment would worsen or not address risks arising from a lack of diversity and groupthink this could provide grounds for withholding approval.

TARGETS

DP 21/2 considers the use of targets in a way that avoids a 'tick box' compliance exercise. It seeks views on :

- the merits, or otherwise, of setting regulatory requirements or expectation for firms to have targets for: (i) some or all of their boards; (ii) senior management population (and how this should be defined); and (iii) the wider firm; and
- whether targets should be set by firms or by the regulators.

Whatever approach is ultimately adopted in relation to targets, the potentially problematic issue of ensuring that accurate data is available to measure attainment (or otherwise) remains. Full and accurate data collection is arguably going to be one of the greatest challenges for firms.

FIRM WIDE POLICIES

The regulators are keen on requiring all firms to have a D&I policy that is published on their website. The content would not be prescribed but the expectation is that the following areas would ideally be addressed: clear objectives, realistic goals, a plan for meeting those goals and ways for

Alongside DP21/2 the FCA has also published a review of academic research and other literature on the impact of diversity and inclusion (D&I) in the workplace that seeks to explore the business performance, risk management and conduct outcomes of diverse and inclusive companies.

[FCA Paper: Review of research literature that provides evidence of the impact of diversity and inclusion in the workplace](#)

The Bank of England has also published a Staff Working Paper Gender, age and nationality diversity in UK banks in which it reports that the evidence is that gender diversity has increased steadily over the last two decades, albeit from a very low base and to only 20% by the end of 2020 that there is evidence of a 'glass ceiling', with the proportion of females increasing more slowly in the most influential roles.

[Bank of England published a Staff Working Paper Gender, age and nationality diversity](#)

measuring progress and as a minimum policies should promote diversity on the Board.

PROPORTIONALITY

A one size fits all regime is not proposed; instead views are sought on how any changes could be tailored to specific categories of firms to ensure that any new regime is proportionate. Options for determining the thresholds for application of the new D&I rules include:

- using the existing categorisation applied to the solo firms SMCR regime (i.e. Enhanced, Core and Limited Scope firms); or
- using the definitions of company size used by the Companies Act 2006 for accounting and reporting (i.e. micro entity, small, medium sized and large).

TIMETABLE/NEXT STEPS

- Responses to the discussion paper can be submitted until 30 September
- One off pilot survey of a representative sample of firms will be conducted Q3/4 2021
- The FCA and PRA will issue a joint consultation in Q1 2022
- The FCA/PRA Policy Statement will be published in Q3 2022
- The FCA will communicate about its 'diversity' proposals for listed firms in the 'coming months' (2021?)

The direction of travel is clear for financial services firms, albeit no definitive approach has been set out by the regulators. Firms would be advised to consider what their current D&I practices and policies look like, what current difficulties they encounter and what the practical and legal implications of the proposals outlined in DP 21/2 would mean for them.

[Diversity and inclusion in the financial sector DP21/2](#)

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