

FCA AND PRA CONSULTATION ON DIVERSITY AND INCLUSION IN THE FINANCIAL SERVICES SECTOR: D&I STRATEGIES, DATA REPORTING, DATA DISCLOSURE

The FCA and PRA (the 'regulators') have published their much anticipated consultation papers ([PRA CP 18/23](#) and [FCA CP23/20](#)) on a package of measures to promote diversity and inclusion (D&I) in the financial services sector with a view to achieving healthier firm cultures, reducing groupthink, unlocking new talent and addressing consumer needs. The regulators clearly regard some of the proposed steps as significant interventions.

The regulators' July 2021 discussion paper ([DP21/2](#)) made it clear that they wanted firms to think about how they can advance D&I through improvements to their policies, governance arrangements, accountability, remuneration arrangements and disclosure. To help inform their proposals, a one-off voluntary pilot data survey was carried out in late 2021 culminating in the December 2022 FCA review paper: [Understanding approaches to D&I in financial services](#).

These consultations mark the regulators' next step towards the achievement of greater D&I in financial services and importantly also provide greater clarity on the regulators' expectations around non-financial misconduct (the regulators are seeking to clamp down in particular on bullying and sexual harassment as part of their D&I strategy).

The final regulatory requirements will be set out in a Policy Statement (PS) in 2024. In-scope firms will be subject to the new rules 12 months after the publication of the PS subject to some limited transitional provisions.

The regulators have worked closely together to produce consistent and coordinated proposals for consultation albeit that their respective proposals are necessarily driven by the regulators' underlying statutory objectives resulting in some subtle differences. In broad terms, the following policy areas are addressed by the regulators: non-financial misconduct, [D&I Strategies](#), [Data Reporting](#), [D&I Disclosure obligations](#) and setting [D&I Targets](#). This Briefing is a spotlight on the proposals in relation to [D&I Strategies](#), [Data Reporting](#), [D&I Disclosure obligations](#) and setting [D&I Targets](#) and the proposals in relation to risk and board governance and the PRA proposals in relation to individual accountability under the Senior Managers and Certification Regime (SM&CR). We have prepared separate Briefings providing an overview of the proposals and a focus on non-financial misconduct.

Key proposals

- The integration of non-financial misconduct considerations into the regulators' rules on conduct and fitness and propriety assessments and the guidance on the suitability threshold conditions;
- An annual obligation to report employee numbers;
- A requirement to set targets to address underrepresentation at Board, senior leadership and general workforce level;
- An annual D&I reporting obligation;
- A requirement to publish D&I strategies;
- Individual accountability under the SM&CR and remuneration alignment (PRA only).

The regulators have not pursued some of the interventions addressed in DP21/2 (such as allocating D&I prescribed responsibility to an individual senior manager). However, given the regulators are painting D&I as a risk issue, formalising rules and guidance, and introducing evidence-based granularity into certain data and reporting requirements, it is clear that if the changes are introduced firms and employees must regard D&I as a systemic regulatory issue.

WHAT FIRMS ARE IN SCOPE?

In keeping with the regulators' approach to proportionality, firms will be subject to different proposals depending on the number of employees, their SM&CR categorisation and whether they are dual-regulated. Smaller firms with fewer than 251 employees will be exempt from many of the requirements.

FCA CP 23/20 provides that a minimum standard will apply to all FSMA firms with a part 4A permission in relation to the proposals on: 'non-financial misconduct' and 'Data Reporting' and additional rules on D&I Strategies, Data Disclosure, Setting Targets and Risk and Governance (see further below) will apply to firms with 251 or more employees (so called 'large firms').

The PRA's CP18/23 proposals apply only to Capital Requirements Regulation (CRR) firms and Solvency II firms (which includes third country bank and insurance branches) with a similar proportionality approach being taken in respect of smaller firms. No proposals apply to non-CRR and non-Solvency II firms (e.g. credit unions and friendly societies).

KEY POLICY PROPOSALS BY FIRM TYPE

Policy areas	Which firms the proposals apply to
Non-Financial Misconduct	All FSMA Firms with a Part4A permission and where relevant Threshold Conditions and existing chapters of the Handbook apply (including COCON and FIT)
	All CRR and Solvency II firms with respect to their establishment in the UK, including third country branches
D&I Strategies	All CRR and Solvency II firms of any size with respect to their establishment in the UK, including third country branches
	All FSMA firms with a Part 4A permission who have 251 or more employees, excluding all Limited Scope SM&CR firms (' Large FCA Firms ')
Risk & Governance	All FSMA firms with a Part 4A permission with 251 or more employees, excluding all Limited Scope SM&CR firms (' Large FCA Firms ')
	All CRR and Solvency II firms with respect to their establishment in the UK, excluding third country branches
Data Reporting D&I Disclosure Setting D&I Targets	All FSMA firms with a Part 4A permission need to report their number of employees annually, excluding all Limited Scope SM&CR firms.
	All FSMA firms with a Part 4A permission with 251 or more employees have additional reporting obligations, excluding all Limited Scope SM&CR firms (' Large FCA Firms ')
	Only those CRR and Solvency II firms (including third country branches) with 251 or more employees who are predominantly carrying out activities from an establishment in the UK All FSMA firms with a Part 4A permission with 251 or more employees have additional reporting obligations, excluding all Limited Scope SM&CR firms (' Large FCA Firms ')

DIVERSITY AND INCLUSION STRATEGIES

Large FCA Firms and dual-regulated CRR and Solvency II firms of any size will be required to develop an evidence-based D&I strategy the maintenance and oversight for which would be the Board's responsibility. The strategy as a minimum must contain:

- the firm's D&I objectives and goals;
- a plan for meeting those objectives and goals and measuring progress;
- a summary of the arrangements in place to identify and manage any obstacles to meeting the objectives and goals;
- ways to ensure adequate knowledge of the D&I strategy amongst staff.

The firm's board would be responsible for the maintenance and oversight of the firm's D&I strategy.

Firms will be required to make their strategy easily accessible and free to obtain; the FCA suggests a firm's website is likely to be an ideal platform to meet this requirement.

The regulators have opted for a light touch giving firms the flexibility to devise a strategy that takes account of their needs and operating environment and do not mandate a timeframe for the frequency of the D&I strategy review subject always to the requirement that the strategy remains fit for purpose. The FCA, as part of its supervisory approach, may review D&I strategies to assess how firms are identifying, monitoring and taking steps to address issues they or the FCA have identified.

Firms will have the flexibility to determine whether board and firm-wide strategies will be adopted, or a single strategy applied. Third country branches falling within the D&I strategy at international group level will need to consider how the regulators' expectations can be addressed.

FIRM TARGETS

The FCA proposes that firms would be required to set targets to address underrepresentation in their firms. Firms would normally be expected to set at least 1 target for demographic characteristics identified by the firm, as appropriate for their circumstances, for each of the board, its senior leadership, and the employee population as a whole (which includes the board and senior leadership). The firm's board would oversee the targets set and would be expected to be able to explain the rationale for the targets chosen.

The FCA will not mandate which demographic characteristics the targets must cover nor what those targets should be, which is a variation in its approach to targets for listed firms set out in 'Diversity and inclusion on company boards and executive management' (PS 22/3). The PRA, however, stipulates that '*Firms would be expected to set targets for women and ethnicity at a minimum, if the firm identifies underrepresentation in these areas.*'

Firms will be required to disclose their D&I targets (alongside the rationale for them and the progress made) as part of their new data reporting obligations (see below).

Territorial scope: Firms based overseas that carry out activities in the UK would be in scope but may not have a board or senior leadership in the UK. In

Territorial and Group Application

Apart from the proposed rules on non-financial misconduct and the application of Threshold Conditions the FCA and PRA proposals apply only to employees that carry out their activities predominantly from an establishment in the UK. For overseas firms, the FCA proposals apply only to activities of the firm that are carried out from an establishment in the UK.

The proposals apply on a solo entity basis.

What is a large firm?

As mentioned above a firm with 251 or more employees will be 'a large firm' for the purposes of the proposed additional requirements. The average number of employees over a rolling 3-year period as at a specified annual reference date will determine whether the employee threshold is met. For these purposes firms must have regard to the regulators' wider definition of employee that may require contractors, individuals seconded to the firm and non-executive members of the board to be considered.

this case, firms would not have to set a target for the areas of the firm that are based overseas, i.e., the board or the senior leadership.

D&I DATA REPORTING: WHAT IT WILL LOOK LIKE

Large FCA Firms and CRR and Solvency II firms (including third country branches) with 251 or more employees will be required to annually collect and report to the regulators in numerical figures, data across a range of demographic characteristics, inclusion metrics and targets via a single regulatory return to the FCA and PRA on the RegData platform. Failure to submit the D&I Data Report in time could lead to supervisory and enforcement action (in addition to an administrative fine).

Many firms are likely to collect much of the mandatory data that will have to be reported (see table below); less readily available may be data that can be provided on a voluntary basis (gender identity, parental responsibilities, carer responsibilities, socio-economic background).

Timeframe: The first regulatory reporting would be due during a three-month window following the rules coming into effect, with a reference date to be confirmed upon publication of the final policy.

The first regulatory reporting would be on a 'comply or explain' basis, if firms are unable to gather all the required data for reporting in the first year. The next time the reporting is due, firms would be required to report the full suite of mandatory data requested in the regulatory reporting return.

Mandatory demographic characteristics	
Age	Ethnicity
Sex or Gender (firms are required to report on either Sex or Gender. Firms may choose to report on both Sex and Gender on a voluntary basis.)	Religion
Disability or long-term health condition(s)	Sexual orientation
Voluntary demographic characteristics	
Sex or Gender (firms are required to report on either Sex or Gender. Firms may choose to report on both Sex and Gender on a voluntary basis.)	Parental responsibilities
Gender identity	Carer responsibilities
Socio-economic background	

The regulators will use the data to produce and publish an aggregated benchmarking report in relation to regulated firms.

DATA REPORTING - CULTURE AND INCLUSION: PSYCHOLOGICAL SAFETY/ SPEAKING UP

In addition to reporting demographic data, firms will be required to report to the regulators on a selection of inclusion metrics. This is because 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.

Firms will be required to report annually in the 3 layers of the board, senior leadership and all employees on whether employees feel:

- safe to speak up if they observe inappropriate behaviour or misconduct;
- safe to express disagreement with or challenge the dominant opinion or decision without fear of negative consequences;
- their contributions are valued and meaningfully considered;

- they are subject to treatment (for example actions or remarks) that had made them feel insulted or badly treated because of their personal characteristics;
- safe to make an honest mistake;
- that their manager cultivates an inclusive environment at work.

This data will have to be reported on a 5-point scale of 'strongly agree' to 'strongly disagree', including a neutral option and captured on an anonymous and voluntary basis.

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 wrongdoing can be called out, supporting objectives including 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 formal or informal channels to raise issues of concern. Firms that wish to collect and report Inclusion data on a voluntary basis will need to consider how they capture it. The PRA proposes to provide a voluntary data collection template (addressing both the mandatory and voluntary data sets), for a firm's internal use, which would be entirely separate from the regulatory reporting return and firms could make use of this possibly in conjunction with staff engagement surveys.

The surveys align the focus that the regulators have had for a number of years on psychological safety that the regulators and wanting to obtain whistleblowing data, and so in that respect are not a surprise. However, they are very prescriptive presumably with a view to providing the regulators with consistent and meaningful data. The requirement on firms to ask very specific and hard-hitting questions of employees is likely to mean that firms must take the topics raised and the risk of enforcement action even more seriously.

DATA REPORTING: ON TARGET SETTING AND PROGRESS

Firms will be required to provide information in the 3 layers of the board, senior leadership, and all employees on:

- the demographic characteristics they have set targets for as well as their inclusion targets if any;
- the percentage at which each target has been set;
- the year each target was originally set;
- the year the firm is aiming to meet the target;
- the firm's current level of representation against each target (%);
- the rationale for the targets set;

- any further information the firm would like the regulator(s) to consider about targets they have set.

DATA DISCLOSURE

It is proposed that firms make annual public disclosures on the same D&I data disclosed to the regulators in accordance with the new Reporting Requirements (see the table above) to increase transparency and scrutiny, as well as facilitate comparisons between firms on D&I performance. The data disclosure would be in percentages rather than whole numbers.

Timing: The first mandatory disclosures would be required to be made at the same time as the publication of the firms' annual reports and accounts or for firms that do not publish annual reports and accounts, within 6 months of the end of their financial year.

The rules on disclosure will come into force 12 months after the regulators publish their final rules. In the first year of the rules being in force, firms can make their disclosures on a voluntary basis. From the following year onwards, disclosures are mandatory for firms in scope. Accordingly, all firms will be required to have published their first disclosures within 3 years of the publication of the final rules.

Firms will be free to choose where to publish their disclosure data: obvious candidates are annual reports, in a dedicated diversity and inclusion report, or on their website.

What to disclose	Levels for disclosure
Sex or* Gender	1. Board 2. Senior leadership 3. All employees
Ethnicity	
*It is proposed that firms only have to disclose either sex or gender in order to remain consistent with the Listing Rule and reduce any additional burden.	
Age	1. Board + Senior leadership [as a combined category] 2. All employees
Disability or long-term health condition/s	
Religion	
Sexual orientation	
Gender identity**	
Socio-economic background**	
Parental responsibilities (child or children under 18) **	
Carer responsibilities (health conditions/old age) **	
**In line with the FCA/PRA reporting requirements, disclosure of these demographic characteristics is voluntary.	
Inclusion metrics (See above)	1. Board 2. Senior leadership 3. All employees
Targets	4. Board

When each target was set, when the firm is aiming to meet the target, and firm's current level of representation.	5. Senior leadership 6. All employees • Any other sub-sets of employees
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DATA PROTECTION/PRIVACY CONSIDERATIONS

The regulators acknowledges that firms may face reluctance from staff to disclose their 'diversity' data so each category in their proposed Data Reporting return would allow for employees either to choose not to respond or to indicate that they prefer not to say.

Equally it is acknowledged that firms must collect data within the prevailing data protection regime (UKGDPR and potentially in some cases, other jurisdiction's data protection regimes). Accordingly, in relation to the D&I Disclosure, obligation safeguards have been built into the proposals to address concerns around identifiability so that firms will be permitted to combine levels of data (e.g., combining the board and senior leadership data) in order to prevent disclosure of information about an individual.

Firms will need to address whether their data privacy notices require updating to reflect the new Reporting Requirements and Disclosure Obligations.

RISK AND BOARD GOVERNANCE

CRR and Solvency II firms have an existing requirement to consider a broad set of qualities and competences when recruiting to the board, and to put in place a policy to promote board diversity. They are also required to explain on their website how they comply with these requirements. For banks, these requirements also apply to holding companies on a consolidated or sub-consolidated basis. The PRA proposes to:

- change the rules referring to 'a policy promoting diversity' on the board, to 'a strategy promoting diversity and inclusion';
- update SS5/16 to expect firms to apply board D&I strategies to board sub-committees;
- require the board D&I strategy to be published on a firm's website (rather than only a statement of how a firm complies with the requirement), alongside the firm-wide D&I strategy;
- clarify that when considering succession planning, upcoming appointments should also be considered in the context of diversity;
- clarify that incentives (including remuneration) are also appropriate tools for driving progress on D&I, in particular among responsible Senior Managers.

The FCA proposes to:

- amend SYSC to require common platform firms with a nomination committee to require the committee to:
 - put in place a strategy promoting D&I;
 - recommend targets for the representation of underrepresented 'demographic characteristics' in the management body; and
 - prepare a strategy to meet those targets.

- introduce new guidance for Large FCA Firms to make clear that matters relating to D&I are to be considered as a non-financial risk and treated appropriately within the firm's governance structures (which could include for example risk functions, internal audit, and support functions such as HR and conduct specialists).

SM&CR: INDIVIDUAL SENIOR MANAGER ACCOUNTABILITY FOR D&I

For firms that are in scope of culture Prescribed Responsibilities (PRs) (i.e., CRR firms with assets greater than £250 million and Solvency II firms, but not third country branches) the PRA proposes to clarify in the respective Supervisory Statements (SSs) that these PRs include responsibility for the development and implementation of D&I strategies.

The SMF holding PR I (responsibility for leading the development of the firm's culture by the governing body as a whole) would be responsible for ensuring the board sets, approves, and adopts an appropriate diversity and inclusion strategy.

The SMF holding PR H (responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm) would be responsible for ensuring that the strategy set by the board is implemented across the firm. The PRA expects that the SMF holding PR H would have their responsibility for D&I appropriately reflected in their performance objectives and remuneration scorecard, and their performance against these reflected in their remuneration decisions, via the application of risk adjustments (where these apply). The PRA stresses that its CP is intended to clarify that SMFs will not be held to account for a failure to meet diversity targets; however it has expectations that SMFs should understand, and be able to discuss with the PRA, the reasons that firms set certain targets (and if they are not going to be met, the reasons why) and of tying D&I to remuneration – which is surely an indirect means of achieving accountability?

For firms that are not in scope of culture PRs, the PRA proposes that at least one SMF should have responsibility for the implementation of the firm's D&I strategy reflected in their Statement of Responsibility (SoR).

In practice firms may elect to link remuneration of all Senior Managers (and other cohorts) to D&I metrics as part of non-financial performance assessment as a potentially effective way of driving progress.

By contrast the FCA has decided not to require an individual within each firm to be assigned a prescribed responsibility for D&I. Firms are already required to record SMF responsibilities in their SoRs. Nor are they making any changes in respect of their remuneration rules to link attainment of D&I targets with remuneration outcomes (albeit that for many firms this is an emerging practice). The FCA has indicated however that it may consider a wider review of its remuneration regime subject to strategic priorities.

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

The regulators' new requirements will represent a significant rule change for D&I for some financial services firms; others will have had D&I on their business agenda for some time and will have well-developed D&I strategies

ranging from inclusion programmes to variable remuneration metrics and some may already be in overall compliance.

For firms that need to make changes to comply with the proposed new rules, 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. Structured workforce engagement (at and below board level) will help guide how these new developments are received 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 is likely to have an impact on the discussion around D&I 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 firm which may become seen as connected to the targets. Therefore, firms 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 firm and attitudes towards inclusion and diversity.

Some key considerations could include:

- Consulting with key internal stakeholders;
- Developing early communications campaigns that frame the purpose of the targets;
- Putting in place specific infrastructure and governance (ownership by relevant committees, review processes, KPIs and incentivisation);
- Obtaining essential management ownership (such as designated Senior Managers, HR or People & Culture/ D&I leads).

PREPARATORY STEPS

- Firms would be advised to consider:
 - what their current D&I data collection, practices and policies look like and what current difficulties they encounter;
 - what the practical and legal implications of the proposals outlined might mean for, amongst other things, their:
 - policy, governance, specific infrastructure (ownership by relevant committees, review processes, KPIs and incentivisation);
 - remuneration arrangements;
 - annual review and certification and related HR systems (including the extent to which non-financial misconduct is considered);
 - employee engagement surveys and training;
 - operational and senior manager oversight (of for example D&I strategy, implementation and workplace culture); and
 - data collection processes.

TIMETABLE/NEXT STEPS

- Responses to the consultation paper can be submitted until **18 December 2023**
- The FCA/PRA Policy Statement will be published in 2024 and the implementation date for changes will be 12 months after publication of the Policy Statement to give firms time to prepare.

- what areas of the firm currently 'own' matters relating to D&I and non-financial misconduct (such as designated Senior Managers, HR or People & Culture/ D&I leads) and whether that may need to be expanded to include, for example risk and audit;
- what consultation may be needed with key internal stakeholders when the changes are finalised (and making senior managers and relevant operational areas aware changes are in the pipeline);
- developing early communications campaigns that frame the purpose of the D&I strategy and any targets.

Once the final Policy Statement is published firms will want to carry out a deep dive to ensure that they have the frameworks, culture, training and processes in place across the firm to ensure that they can comply with this regulatory 'intervention'.

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

[FCA Understanding approaches to D&I in financial services](#)

[FCA CP 23/20 Diversity and inclusion in the financial sector – working together to drive change](#)

[PRA CP 18/23 Diversity and inclusion in PRA-regulated firms](#)

[Briefing: FCA and PRA Consultation on Diversity and Inclusion in the financial services sector: an Overview](#)

[Briefing: FCA and PRA Consultation on Diversity and Inclusion in the financial services sector: Non-Financial Misconduct](#)

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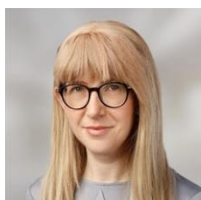
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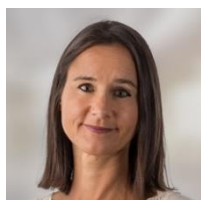
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