

Consultation on Diversity and Inclusion proposals in the financial sector

October 12, 2023

The UK's financial regulators, the Financial Conduct Authority (**FCA**) and the Prudential Regulation Authority (**PRA**) have recently published proposals to boost diversity and inclusion (**D&I**) in the financial services sector. The proposals are aimed at supporting healthy work cultures, reducing groupthink, unlocking talent and supporting better firm governance and decision-making.

While the Regulators have released individual consultation papers (**FCA CP23/20** and **PRA CP18/23**) (the **Consultation Papers**), their proposals are broadly aligned. That said, firms which are captured under both regimes should consider both papers.

Background to the Consultation Papers

Publication of the proposals has been long anticipated following the PRA, the Bank of England and the FCA's joint 2019 Discussion Paper on accelerating change on D&I in the financial sector. The proposed rules and guidance in the Consultation Papers build on the ideas from this Discussion Paper.

The FCA has described the proposals as "not a starting point, but a next step". However, both Regulators are clear on their position that, while progress may have been made, it has not gone far enough and that D&I is a regulatory concern.

"For UK financial services to be competitive and for the companies in it to be well run with healthy work environments, it's vital they attract, retain and promote the best talent. The data suggests this isn't happening. Our proposals will encourage the largest firms to put in place plans and report against their delivery." (FCA Chief Executive, Nikhil Rathi)

To whom would the proposals apply?

All firms with a Part 4A FSMA authorisation should read the Consultation Papers. However, the Regulators have emphasised that they recognise the need for flexibility and proportionality, as not all of the proposed requirements will apply to firms in the same way. For example, the type of firm, its categorisation under the Senior Managers and Certification Regime and the number of employees will all be relevant factors.

So what are the proposals under the Consultation Papers?

A snapshot of the key proposals (which, as mentioned above, will apply differently to certain firms) from the

Regulators are:

Non-financial misconduct

- The FCA is planning to explicitly include non-financial misconduct (**NFM**) in staff fitness and propriety assessments, the Conduct Rules and the suitability criteria for firms to operate in the financial sector (known as the "Threshold Conditions"). This guidance would apply to all FSMA-authorized firms.
- This proposal is intended to help reinforce the FCA's public position that NFM is misconduct and not an additional principle.
- The PRA plans to clarify that, as part of its fitness and propriety assessments, it may take into consideration established patterns of behaviour including bullying, discrimination and harassment.

Reporting

- Firms will be required to report employee numbers to the Regulators annually. This is to help the Regulators determine which firms are within scope of the D&I requirements.
- On an annual basis, larger firms (with 251 employees or more) would be required to collect certain D&I data for board, senior leadership and all employees and report this to the Regulators. The reporting data, to be submitted on a regulatory return, would include data on demographic characteristics, inclusion metrics and targets. The proposed mandatory characteristics are age, sex or gender, ethnicity, religion, disability and sexual orientation. The Regulators are proposing that firms make publicly available the D&I data which they report to them.

D&I strategies

- Certain firms would have to put in place and maintain D&I strategies (this would apply to larger firms and dual-regulated firms subject to the CRR or Solvency II parts of the PRA Handbook).
- These D&I strategies will need to include (a) details of the firm's D&I objectives and goals; (b) a plan for meeting and measuring progress against such objectives and goals; (c) a summary of the arrangements the firm has in place to identify and manage any obstacles; and (d) details of how the firm will ensure staff have adequate knowledge of D&I.

Targets

- Larger firms would be required to set their own targets to address underrepresentation.
- The FCA expects these targets to be "stretching but realistic" and that it would normally expect a firm to set at least one target for each of the board, its senior leadership and the employee population as a whole.
- The PRA expects, if underrepresentation is identified, that as a minimum targets are set for women and ethnicity.
- Firms would be required to publicise their targets and report on their progress annually.

Risk

- The FCA plans to provide guidance for larger firms which makes clear that D&I matters should be considered as non-financial risk and that they should be treated appropriately within governance structures.

Board governance

The PRA is proposing to require firms to put in place a strategy which specifically promotes D&I on the board. It also proposes to clarify expectations on having robust succession planning in place and the D&I responsibilities for the board and board sub-committees.

What next?

Firms are invited to provide feedback on the Consultation Papers by 18 December 2023, following which the Regulators intend to review the comments provided and use them to help develop the final D&I regulatory framework for publication in policy statements by 2024. It is expected that the final rules would be brought into force in 2025.

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