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Diversity and inclusion in the financial sector – working together to drive change

Discussion Paper

DP21/2

July 2021

How to respond

We are asking for comments on this Discussion Paper (DP) by **30th September 2021**.

You can reply in writing to:

Bank of England
Threadneedle Street
London
EC2R 8AH

Telephone:
020 3461 4695

Email:
dp2_21@bankofengland.co.uk

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Foreword

Serious inequalities and lack of inclusion between different groups have been present in in our society for many years and extend far beyond the financial sector. Nonetheless, it is important that we, as financial regulators, play our part in addressing the negative impact this has within financial services, including by prompting the firms we regulate to do more – more quickly – to improve diversity and inclusion within their own workforces. Tackling these issues will advance the objectives set for us by Parliament.

Research shows evidence of correlations between diversity and inclusion and positive outcomes in risk management, good conduct, healthy working cultures, and innovation. These outcomes directly contribute to the stability, fairness and effectiveness of the firms, markets and infrastructure that together make up the financial sector. Financial services firms and regulators therefore have a strong shared interest in moving towards a more diverse and inclusive industry. Other regulators are also taking increased interest in diversity and inclusion for similar reasons.

To date, industry and sector-based initiatives, such as the Women in Finance Charter, the Race at Work Charter and the Social Mobility Task Force, have largely taken a targets, transparency and accountability focused approach to exerting peer pressure for change. These initiatives have led to some progress and also create spaces for firms and employers to share challenges and successes.

Nonetheless, despite years of discussion and many research studies, the conversation about diversity and inclusion in many ways is still in its infancy. Most effort to date has focused on gender and we are a long way from bringing discussions about other aspects of diversity to the table in the same way, let alone talking about the challenges experienced where different diversity characteristics interact. Conversations tend to be about diversity rather than inclusion (because diversity is easier to achieve and measure). Limited data inhibits high quality research on diversity across the board. And we still rely on members of disadvantaged groups to articulate the problem and design the solutions for us.

It is clear that we still have a very long way to go. Large gender and ethnicity pay gaps still exist in the financial sector, there are parts of the industry which lack diversity at senior levels, and the products offered to customers still do not always meet the needs of disadvantaged groups. In addition, staff at both firms and regulators do not often have the vocabulary or skills to conduct open and constructive conversations about sensitive subjects such as race.

There is clear momentum for change, which is building around the world. Social movements and increasing investor focus have led to global conversations, in particular about gender and race. These have engaged the attention of regulators globally.

Environmental, Social and Governance (ESG) issues are rising to the top of the agenda for corporates, investors and wider society. This will helpfully serve to keep diversity and inclusion at the forefront of the minds of boards, executives and staff. Against this background, we as regulators need to make our expectations of firms clearer and to root them in our statutory objectives, supported by the Public Sector Equality Duty introduced by the 2010 Equality Act. This Discussion Paper is an important step towards making rapid and more substantive progress across the financial sector.

Diversity and inclusion are critical to our work on culture and governance, particularly for boards and senior management. For the FCA, it will also be based in existing work around the treatment of consumers, including vulnerability and the proposed new Consumer Duty. We expect to see diversity and inclusion become part of how we regulate and part of how the UK financial sector does business. For the Bank of England and the PRA, the key consideration is about the linkage between insufficient diversity and inclusion and groupthink, which can present a serious risk to safety and soundness. Our goal is to see increased diversity and inclusion in financial services translate into safer and sounder firms with better internal governance and risk management, a more innovative industry, and financial products and services that meet the diverse needs of consumers.

To achieve this, we do not intend to prescribe a "one size fits all" approach to diversity and inclusion but we do believe that policy has an essential part to play in driving change and we want to work with a wide range of stakeholders, within and outside the financial services sector, to understand the best approaches to take.

This is a journey that we, regulators and regulated, are on together. As employers, we have very similar challenges to those facing many firms and we recognize that we have significant work to do to improve our own diversity and inclusion. Despite this we think it is important that we lead by example in terms of ambition, accountability and transparency. We will recognise those firms that make good progress and will not hesitate to take action where we see shortcomings, particularly where those impact on consumers and market outcomes.

By working together on these issues we think we can drive real change. We encourage all interested stakeholders to respond to the questions set out in this paper.

Nikhil Rathi (Chief Executive, Financial Conduct Authority)

Jon Cunliffe (Deputy Governor, Financial Stability, Bank of England)

Sam Woods (Deputy Governor, Prudential Regulation and Chief Executive Officer of the Prudential Regulatory Authority)

1 Introduction

This discussion paper (DP) is issued by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) as well as the Bank of England (the Bank) in its capacity of supervising financial market infrastructure firms (FMI). We refer to ourselves collectively as 'the regulators' in this paper.

A resilient industry that reflects those it serves

1.1 Our joint ambition is to ensure the financial system is better able to support the economy through well-run firms and sound financial markets that can meet the diverse needs of their consumers. We want a resilient financial services sector, which brings together and responds to different views and perspectives, so that concerns can be raised and decisions are challenged effectively. Having firms that represent the society they serve would support the design of financial services and products that improve consumer outcomes. An inclusive culture in which all staff can speak up allows the benefits of diversity to flourish. Together, diversity and inclusion can reduce groupthink, encourage debate and innovation and thereby improve outcomes for consumers and across markets, supporting financial stability.

1.2 We are publishing this DP to engage financial firms and other stakeholders in a discussion on how we can accelerate the pace of meaningful change and what role we can most usefully play to support this change. We reiterate why diversity and inclusion is important for our objectives. And we explore how to build on existing requirements to support and monitor progress in the UK financial sector. The regulators are working together to clarify our regulatory approach to diversity and inclusion in pursuit of our statutory objectives (see **Box 3**) and having due regard to our Public Sector Equality Duty. This discussion will support our engagement with stakeholders and policy development, helping to determine which interventions could have the greatest impact.

A collective commitment to faster change

1.3 We recognise that the financial sector has taken steps forward on diversity and inclusion. However, there is much more that needs to be done to create truly diverse and inclusive organisations that meet the diverse needs of those we serve. Likewise, we recognise that we have more work to do ourselves to improve the diversity and inclusion of our own institutions. We believe that, in parallel, it is important and timely to open a discussion on how we can use our central roles in industry to drive wider change across UK financial services markets.

1.4 Further progress is necessary and will require collective commitment across the industry and other stakeholders to bring the full benefits of diversity and inclusion to the financial services sector and to the full range of individuals and businesses it serves. We expect the leadership of many firms to recognise the need for action and to rise to the challenge. However, it will be important that we develop robust policy that sets clear minimum expectations. We set out our thinking on this in this Discussion

Paper and invite comment. We intend to propose rules and guidance based on this discussion. Ultimately, where firms fail to meet our minimum expectations, we will be prepared to use our regulatory powers, and take action where appropriate.

1.5 To meet the regulators' expectations around the standard of care that firms should provide to consumers, for example the expectations recently articulated by the FCA in its Guidance for firms on the fair treatment of vulnerable customers and consultation on a new Consumer Duty (CP 21/13), firms will need to be able to recognise and respond to the diverse needs of their customers and potential customers. We believe that increased diversity and inclusion will support them to do this.

1.6 The FCA is also considering its approach to diversity in listed firms and will share more in the coming months.

1.7 The regulators are collaborating with regulators from other industries, including through the UK Regulators' Network Diversity & Inclusion network, to help improve diversity and inclusion across UK regulated industries.

Who this discussion affects

1.8 Our work and ambitions on diversity and inclusion apply to all firms, as it is important across the whole financial services sector. This includes 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. While we believe the issues covered in this DP are also relevant to small firms (e.g. credit unions, small intermediaries, small payments firms, small insurers and other small firms) and overseas firms operating in the UK (e.g. through branches), any future policy development will consider the nature of their business models (see Chapter 5 for more detail on policy scope). The FCA will discuss this approach with the Payment Systems Regulator in the context of their work on diversity and inclusion.

1.9 In this DP, we use 'firms' to refer to all UK regulated financial entities listed above, including FMIs and organisations not authorised under FSMA. The term 'solo regulated firms' refers to those regulated only by the FCA, rather than jointly by the PRA and FCA or solely by the Bank (which regulates FMIs). This DP does not cover listed firms that are not regulated by one or more regulators.

We want to know what you think

1.10 We welcome contributions from all parts of the financial sector, and parties with an interest in this issue. This includes:

- firms
- industry groups/trade bodies
- consumer groups and individual consumers
- policy makers and other regulatory bodies
- industry experts and commentators
- academics and think tanks
- organisations representing the interests of groups of people

1.11 Firms may be particularly interested in responding, as any future policy may directly apply to them. But we welcome the views of organisations and individuals beyond these firms and their employees, who have an interest in responding. Stakeholders are also encouraged to provide examples of positive industry practices that we can learn from.

Understanding diversity and inclusion – the terms we use

1.12 To be able to discuss diversity and inclusion consistently, we think it is useful to set out what we mean when using these terms throughout this document.

1.13 With respect to diversity, we focus on 'diversity of thought', also called 'cognitive diversity', which we consider to be important for furthering our regulatory objectives. We propose to define diversity of thought as:

> bringing together a range of different styles of thinking among members of a group. Factors that could lead to diverse thinking could include, but not limited, to different perspectives, abilities, knowledge, attitudes, information styles, and demographic characteristics, or any combination of these.

1.14 Diversity of thought is required to tackle the complex and evolving issues across the financial sector and wider society. Diversity of thought is about recognising how our different perspectives, skills, abilities, knowledge, attitudes, and information styles, or a combination of these, inform our approach to solving problems.

1.15 Diversity of thought can be influenced by many factors which, as mentioned above, also includes demographic characteristics which may affect viewpoints and life outcomes. These characteristics can be visible and measured, such as gender, age and ethnicity, or non-visible, such as disability, sexual orientation and education. They do not only include the nine protected characteristics defined in the Equality Act 2010 (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation), but can also include other factors, such as socio-economic diversity, gender (including where it does not coincide with sex), and cultural background.

1.16 It is also helpful to recognise that individuals can have a combination of different diversity factors. This means they may be able to contribute a combination of different perspectives or experience more discrimination. It is also important to recognise that the interconnected nature of social categorisations such as race, class or gender as they apply to a given individual or group can create overlapping and interdependent systems of discrimination or disadvantage. This is often referred to as 'intersectionality'.

1.17 Diversity alone is not enough. Inclusion means that everyone feels involved, valued, respected, treated fairly, and that these elements are embedded into a firm's culture. An inclusive culture is therefore necessary to enable the benefits of diversity of thought to flourish in practice. It not only encourages every person to be able to be themselves at work, but also to make a contribution and feel empowered to provide challenge, raise concerns and perform at their best. A culture of psychological safety is important for fostering inclusion.

1.18 Inclusion can be defined 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. Our view is that this would mean that all individuals are able to participate fully, including being able to speak freely without fear. Their views and contributions should be valued and fully considered regardless of differences due to demographic characteristics or background. They should be able to freely show diversity of thought without the expectation that they will conform to arbitrary cultural conventions.

Question

Q1: **What are your views on the terms we have used, how we have defined them, and whether they are sufficiently broad and useful, now and in the future?**

The importance of diversity and inclusion – why we care

1.19 Recognition of the importance of diversity and inclusion has grown over recent years, and events across the world have highlighted existing disparities, inequalities and the need for further progress. The coronavirus (Covid-19) pandemic has had a disproportionate impact on certain consumer groups, placing them at greater risk of financial harm and further entrenching existing inequalities. For example, ethnic minorities are disproportionately represented among the growing number of consumers with characteristics of vulnerability (FCA Financial Lives 2020 survey) and a higher proportion of individuals within this group reported that their financial situation had worsened since the pandemic began, suffering a larger decline in average earnings. There is also evidence of ethnic minorities are twice as likely to have left employment as white adults (Understanding Society Covid-19 survey).

1.20 The financial services industry touches the lives of virtually every citizen of the UK in some way. Together, we regulate nearly 60,000 firms and there were 1.1 million financial services jobs in 2020. The industry contributed £132 billion to the economy – 6.9% of the total – in 2019 (House of Commons Library). We believe that taking action to promote a more diverse and inclusive financial services industry will have a substantial positive effect on the UK's economy and wider society.

1.21 There is growing evidence that diversity of thought, when part of an inclusive culture, supports better decision making by firms. Diversity makes business sense – from both a financial and a consumer perspective. It can lead to better outcomes for firms, support their safety and soundness, and promote financial stability. We believe that more diverse and truly inclusive firms will benefit from better risk management, as individuals will feel more empowered to have open discussions and debates, without fear of having their views shut down. It should mean that concerns about imprudent practices are more likely to be raised and acted upon. We also note research on the relationship between diversity at senior levels and firm outcomes. For example, Geyfman et al. (2018) find that gender diversity on US bank Boards positively influences performance outcomes without affecting bank risk, which, the authors say, 'reinforces the notion that diverse banks are not assuming greater financial risk to generate higher returns'. (Please see the literature review, published alongside this Discussion Paper, on the impacts of diversity and inclusion).

1.22 For retail customers (including policy holders), firms need to be sufficiently diverse and inclusive to be able to understand and meet the needs of their diverse customer bases; otherwise their customers are at more risk of harm. For example, customers may not be offered suitable options for their circumstances, they may have difficulty in accessing products and services, or there may not be products and services that meet their needs. This can lead to disengaged consumers, and potential exclusion from financial services.

1.23 Diversity and inclusion are also important for firms that do not deal directly with retail customers. Many are involved in managing money that belongs to individual investors, and this impacts the stability of the whole financial system. And there are significant issues around funding for businesses led by women and indications that this extends to people from ethnic minorities and lower socio-economic groups (for example, see Brush et al (2014), Shaw et al (2009) and data collected by the OECD). This raises the question of whether the market is operating efficiently, to take advantage of the full range of opportunities available.

1.24 This context helps to understand why we, in our role as regulators, want to see improvements across the financial services sector. We want to see firms taking meaningful steps to achieve greater representation at all levels, in particular at Board and senior management levels. We see diversity and inclusion as an important driver of healthy cultures, so this should be embedded throughout firms – from the Board and senior management to developing diversity in managerial, technical and professional staff, making it part of 'business as usual' through all of a firm's activities.

Progress across the sector so far

1.25 While there has been progress over the past decade, the rate of change has been slow, and direction of travel polarised across organisations. For example, Suss et al. (2021) show that the proportion of women working in authorised positions in the UK banking sector rose from 9% in 2001 to 20% at the end of 2020. For CEOs, the proportion of women rose from 1.7% in 2001 to 9.7% by the end of 2020.

1.26 There have been a number of initiatives to improve and increase diversity (as set out in **Box 1**). Increasingly, investors are also placing pressure on firms to have more diverse Boards. There have been positive trends reported in the proportion of female directorships and the global financial services sector does perform above average in terms of gender diversity. McKinsey (2020) reported financial and professional services to be the fastest growing sectors in terms of female representation at executive level.

1.27 However, the Board Monitor Europe (2019), which has a clearer focus on the UK, reported that financial services was below average for new directorship appointments. 39% of new directors appointed to FTSE250 financial company Boards in the UK in 2019 were female, compared with 42% of all new appointments in the UK FTSE250 that year. Despite efforts, this has not culminated in an increase in the representation of women at the very top of the FTSE350 as noted by The Pipeline *WomenCount* report.

1.28 While the trends are promising for gender, the overall figures are still low, based on the information available. The same report also stated that in 2020 only 13 of FTSE350 CEOs were women (5%). The 2021 Women in Finance Charter Annual Review also reports that in 2020 there was, on average, 32% female representation in senior management amongst charter participants, showing an increase of less than 1 percentage point each year from 2017. (See also **Box 2**).

1.29 The situation for ethnic minorities shows signs of going into reverse. Early findings from the Green Park Business Leaders Index (2021) show a decline in the number of black leaders and the 'black pipeline' to senior management for FTSE 100 companies. A wealth of evidence suggests that ethnic minority individuals struggle to achieve the same progression opportunities as their counterparts in the UK (McGregor Smith review (2017). Fewer than 1 in 10 management roles in financial services are held by black, Asian or other ethnic minority people (see Randstad Paying Attention).

1.30 There is also limited progress on social mobility. A deep dive study of 8 financial firms (including regulators) found that 89% of senior roles are held by people from higher socio-economic backgrounds (City of London Corporation/Bridge Group (2020)).

1.31 Although good practice at some firms may not be represented in these studies, the financial sector as a whole has a long way to go. Data on many aspects of diversity are poor in the financial services sector, making it challenging to assess the full extent of the problem. Studies on the impact of diversity and inclusion have mixed findings against some firm outcomes (e.g. share price performance) and are hampered by incomplete data. However, there is substantial evidence that makes clear the benefits that different backgrounds and perspectives can bring to an organisation. For example, there is a strong consensus within academic research that a more balanced Board improves performance on corporate governance metrics, for example effective managerial decision-making in research and development and risk management (See Chen, Ni and Tong (2015) and Wilson and Altanlar (2009)).

1.32 Most data collected through academic and other research are on gender, with some on ethnicity, and very little on other protected or diversity characteristics. This perhaps reflects where the focus has historically been when considering diversity and inclusion, although there is increased awareness and consideration of other diversity characteristics. We want to explore how data collection, regular reporting and disclosure could help monitor and drive progress.

1.33 There are increasingly more open and important conversations. For example, major UK banks, insurers and asset managers are taking part in a landmark survey to understand the impact of menopause on people working in the financial services sector. A new taskforce was launched last November to improve socio-economic diversity at senior levels in financial and professional services across the UK (see **Box 1** below). Having a better understanding of the different experiences people can have and how to support these differences is essential to make meaningful change.

Box 1: Existing initiatives helping to drive change in firms

Several government, industry and not-for-profit initiatives are helping to drive change on different demographic factors of diversity.

The Women in Finance Charter is a commitment by HM Treasury and signatory firms to work together to build a more gender-balanced financial sector. There are several progress points on gender diversity that can be demonstrated through this Charter (see **Box 2** below). New Financial publish annually a report on the sector's progress against the 4 Charter principles.

The fifth and final report from Hampton-Alexander Review was published in 2021. This was a business-led initiative supported by the Government to increase the representation of women in senior roles in FTSE350 firms, from 2016-2020. This targeted the Board and two leadership levels below, bringing initiatives to improve female representation to the top of the table.

An independent taskforce on socio-economic diversity, commissioned by the Treasury and Department of Business, Energy and Industrial Strategy and run by City of London Corporation, was launched in November 2020. New research was launched alongside this – commissioned by the City of London Corporation and authored by the Bridge Group.

The Social Mobility Employer Index is an important bench-marking initiative that ranks Britain's employers on the actions they are taking to ensure they are open to accessing and progressing talent from all backgrounds and it showcases progress towards improving social mobility.

The recommendation of the independent Parker Review was that the Boards of FTSE100 companies should have at least one 'director of colour' by December 2021 and for the FTSE250 to do the same by 2024. The results of its latest survey of FTSE100 companies, published in March 2021, showed that 74 FTSE100 companies had ethnic minority representation on their company Boards as of 2 November 2020. Legal & General announced that they will vote against re-election of the Chair of the Nomination Committee if the firms fail to meet the end-2021 deadline further endorsed the Parker Review recommendation.

The McGregor Smith review found that greater progress and positive outcomes were needed to ensure all organisations benefit from the wealth of diverse talent on offer. Following this, in 2018, Business in the Community published the Race at Work Charter which includes five calls to action to ensure workplaces are taking practical steps to tackle barriers in recruitment and progression for ethnic minority groups. Many financial firms are signatories to the charter.

The Valuable 500 campaign has successfully influenced 500 global businesses to commit to putting disability on their Board agendas. Launched at the World Economic Forum's Annual Summit in Davos in January in 2019, the campaign looks to hold global business leaders accountable for disability inclusion in their businesses by ensuring it is discussed at Board level.

Business Disability Forum is a not-for-profit organisation bringing business leaders, disabled people and Government together to understand what needs to change to improve opportunities and experiences for disabled people – with over 400 members and partners across UK business.

Stonewall Workplace Equality Index aims to promote the power of inclusive workplaces. Participating employers demonstrate their organisation's achievements and progress on LGBT equality, which includes input from staff. Organisations receive their scores, enabling them to better understand the current picture and where to focus efforts. The 100 best performing firms, and those winning Gold, Silver and Bronze Employer Awards, are celebrated publicly. Stonewall Diversity Champions (which include the Bank and FCA) benefit from in-depth, tailored feedback on their submissions.

Box 2: Indicators of progress in firms on supporting gender diversity

The Women in Finance Charter Annual Review 2020 found some positive indicators of progress in supporting gender diversity. Some highlights include the following:

- 53% of its signatories collect additional data within their female senior management population, with ethnicity, sexual orientation and disability being the most commonly collected data points.
- Other signatories reported expanding their data collection to cover new data points for the first time. These are positive developments in considering intersectionality.
- Some signatories were able to demonstrate how they are ensuring that their actions to achieve targets are inclusive to women across diversity strands, also recognising the importance of intersectionality, this time in reaching targets. Examples include supplementing data on gender, ethnicity and disability with more granular data tracking internal promotions, lateral moves, and proportions of women across diversity strands within sponsorship and mentoring programmes.
- There have been improvements to initiatives and practices amongst firms such as diverse shortlists (mentioned by a third of signatories) and diverse panels (one in six firms ensure that underrepresented groups sit on interview panels), more inclusive language on job adverts such as highlighting flexible working opportunities, and rejecting non-diverse shortlists put forward by head-hunters.
- Some firms also prioritise encouraging women to apply for stretch opportunities and are now turning their attention to building a pipeline of talent by focusing on those within the firms that are at a lower level than senior management.
- Some firms have demonstrated how they have embedded diversity and inclusion into their day to day business, and how this has impacted increased accountability placed upon senior leaders (i.e. objectives and key performance indicators linking clearly to end of year appraisal and pay).

Outcomes we want to achieve and measuring success

1.34 The thinking in this DP is intended to begin a discussion with industry on the ways we can clarify our expectations and set higher standards on diversity and inclusion. Greater diversity should support having a range of views across an organisation, while inclusion should create the necessary environment for individuals to be able to express these views, speak up and raise concerns. Combined, this should reduce the risk of group-think, which would improve decision-making within firms, consumer outcomes and standards of market conduct.

1.35 We want firms to think about how they can advance diversity and inclusion through improving their policies, governance arrangements, accountability, remuneration arrangements and disclosure. However, we recognise that these improvements will only deliver real change when they are embedded in culture.

1.36 We want firms serving retail customers to consider that customers within their target markets will have diverse needs. We want firms to understand this and take it into account in the design and delivery of products and services, and communications, so that they meet the needs of the consumers their products are sold to, and offer fair value.

1.37 We want to improve our understanding of the state of diversity and inclusion in the industry by collecting data from firms. And we want data collection in firms to improve.

1.38 In this DP, we are seeking feedback on how we should define success measures for these outcomes, in particular we welcome feedback on Chapters 4 and 5 where we discuss data and other levers, such as accountability, that we believe are essential to be able to support change and monitor progress.

How we break down the discussion

1.39 **Chapter 2** sets out **the role of the regulators**, including how improving diversity and inclusion links to our objectives and our Public Sector Equality Duty. It also covers the steps we have taken to improve diversity and inclusion internally within the regulators, recognising that we are on this journey alongside industry.

1.40 We summarise **current expectations and requirements on diversity for UK-regulated firms in Chapter 3**. Many of the existing policies have been driven by sector-specific developments. This has resulted in fragmented requirements for different types of firms.

1.41 In **Chapter 4**, we explain why good data are critical and discuss the importance of **measuring progress** and reporting in order to improve progress on diversity and inclusion. The chapter also sets out suggestions for developing metrics to monitor progress.

1.42 We outline different policy initiatives that we think could be effective for **driving and supporting** change in **Chapter 5**. These generally build on existing requirements, and the regulators' wider policy and supervisory frameworks. Some of these proposals are better suited to larger firms and we are very conscious of the need for proportionality, as well as taking into account the differences in the existing legal and regulatory framework for different categories of firm, as we develop future policy.

1.43 You can find a complete list of the questions raised in the DP in Appendix 1.

Equality and diversity considerations

1.44 For all policy work, we must consider the impact on equality and diversity with respect to the protected characteristics under the Equality Act 2010.

1.45 We have taken an initial assessment of the potential impact of this work and believe this will generate positive outcomes across those with diverse characteristics specified as protected characteristics under the Equality Act, and beyond. Feedback to this DP and parallel dialogue with industry and other stakeholders will serve as sound evidential basis for potential future policy changes and help to break down the potential impact further.

Next steps

1.46 We welcome feedback on the topics discussed. After publishing this DP, we plan to continue engaging on this subject with firms, other regulators and interested stakeholders. We also plan to gather further data through a one-off survey to provide a benchmark to monitor future progress.

1.47 Taking into account your feedback to this DP, the PRA and FCA intend to consult on more detailed proposals in Q1 2022 followed by a Policy Statement in Q3 2022. Given the different legal and supervisory frameworks for FMIs, the Bank of England will separately consider how to develop proposals to promote diversity and inclusion for these firms.

What do you need to do next?

1.48 We welcome feedback on the initiatives under discussion. We ask for views, including responses to our questions, by 30 September 2021. Details on how to respond are at the beginning of this paper.

2 The role of the regulators

This chapter sets out the role of the regulators, including how improving diversity and inclusion advances our objectives and our obligations to have due regard to the Public Sector Equality Duty. It also covers the steps we have taken to improve diversity and inclusion internally within the regulators, recognising that we are on this journey alongside industry.

Considerations of diversity and inclusion

2.1 Diversity and inclusion are central to our roles as regulators, as employers and as public bodies. In recent years, we have been taking increasing steps to enhance diversity and inclusion, for example through a more assertive supervisory focus on non-financial misconduct under the Senior Managers and Certification Regime (SM&CR) and the integration last year of gender neutral pay polices in the dual-regulated firms Remuneration Code.

2.2 There is clear momentum for change. In recent years, social movements in the U.K. and around the world as well as increasing investor focus have led to global conversations, in particular about gender and race issues. Regulators too have been challenged to reconsider their approaches. In May 2021, the Chair of the US Securities and Exchange Commission (SEC) commented that, "investors increasingly want to understand information about...one of the most critical components of companies, their workforce", and indicated that a focus on improving understanding of "human capital" issues would be a priority under his tenure. There are similar developments in other major financial services jurisdictions.

Furthering our objectives

2.3 We believe improving diversity and inclusion within financial services will advance our objectives, summarised in **Box 3** below. We believe that a diverse and inclusive firm can make the most of the skills, experience and competencies of all its people. This in turn helps individuals and firms to:

- provide effective challenge to enable prudent decision-making that supports safety and soundness in firms (including FMI's) and financial stability more broadly
- create an environment where firms are able to recruit from the widest talent pool and retain their best people, making the UK market an attractive place to do business
- improve standards of conduct within firms in relation to their customers and markets that they serve and
- understand the markets they operate in and the customers they serve, supporting innovation and emerging markets.

Box 3 – the regulators' objectives

The Bank has an objective to protect and enhance the stability of the financial system of the United Kingdom. This includes supervising FMIs to ensure they are designed and operated in a safe way that promotes continuity of service, and they contribute to reducing systemic risks in the vital payment, settlement and clearing arrangements centred upon them. The PRA's and FCA's objectives are defined in the Financial Services and Markets Act 2000 (FSMA). The PRA has a general objective to promote the safety and soundness of the firms it regulates and an objective specific to insurance firms, to contribute to the securing of an appropriate degree of protection for those who are or may become insurance policyholders. The PRA also has a secondary competition objective.

The FCA's strategic objective is to ensure that relevant markets work well. To advance its strategic objective, it has three operational objectives: to secure an appropriate degree of protection for consumers, to protect and enhance the integrity of the UK financial system, and to promote effective competition in the interests of consumers.

Well-functioning markets, integrity of financial system and safety and soundness of firms

2.4 Prudent decision-making is fundamental to promoting the safety and soundness of firms, well-functioning markets and the protection of consumers, including policyholders. Shared assumptions and cultural biases can undermine the quality of discussions, and the robustness of decisions made, because views and practices go unchallenged. Increased diversity, in particular at senior levels, helps reduce the risk of such groupthink.

2.5 Lack of diversity has been highlighted as a factor in the 2008 financial crisis. Looking at risk management outcomes, studies that compare the outcomes between diverse and non-diverse Boards following the crisis, find that businesses with more diverse and risk averse Boards had better outcomes. Arnaboldi et al (2020) examined the fines received by EU banks from US regulators. They found that greater female representation on the Board significantly reduced the frequency of misconduct fines, with female directors more influential once they reach a 'critical mass'. Wilson and Altanlar, in a wide-ranging study of mainly SMEs, found compelling evidence that more gender diverse Boards reduce insolvency risk.

2.6 There is evidence that firm cultures that are inclusive and receptive to employees are likely to generate better judgements and decision-making and reduce the risk of groupthink. Firm cultures are also likely to shape their long-term viability and the conduct outcomes for consumers and markets. We believe that this can support financial stability as well as reduce harm and improve outcomes for consumers and markets.

2.7 Our view is that there is a human cost for employees of firms that fail to deliver diversity and inclusion, with likely impact on mental health. In addition, it can affect career progression of employees into senior management roles. Poor diversity and inclusion may create an environment where there is a higher risk of bullying or sexual harassment. Not only does this have an adverse impact on employees, it can have a significant reputational impact and cause a loss of consumer and market confidence.

Investors, consumers and employees are all increasingly concerned about a range of environmental, social and governance issues. Firms that fail to meet this challenge risk being less attractive to talented staff, brand damage and investor activism.

Consumer and policyholder protection

2.8 We believe that increasing diversity and inclusion will enable firms serving retail consumers to draw on a wider range of perspectives. This will support them to meet the regulators' expectations for the standard of care that firms provide to consumers, for example the expectations recently articulated by the FCA in its Guidance for firms on the fair treatment for vulnerable customers and consultation on a new Consumer Duty, resulting in better protection of consumers (including policyholders) and better consumer outcomes. And, as set out above, diversity within firms contributes to their safety and soundness, thereby ensuring firms are able to meet their obligations to consumers and policyholders.

2.9 Different customers have diverse needs, which may change over time. If products and services (including supporting information) are not fit for purpose, or are not appropriate for or understandable by the target consumers, they may buy products and services that are inappropriate for their needs, of inadequate quality or poor value, or too risky or otherwise harmful. This can lead to both financial and non-financial harm for consumers. In addition, a poor level of customer service may hinder consumers from being able to realise the benefits of the products and services they buy.

2.10 We think that improving diversity and inclusion within firms should contribute to a better understanding of customer needs through more informed decision making, avoidance of groupthink and more innovation. This should help firms meet the diverse needs of their customers and potential customers putting customers in a position where they can better act and make decisions in their interests and enabling them to pursue their financial objectives.

Promote effective competition

2.11 The FCA has an operational objective to promote competition in consumers' interests and the PRA has a secondary objective to act, so far as is reasonably possible, in a way that facilitates effective competition amongst firms the PRA regulates, when making policy to advance its primary objective. Promoting diversity and inclusion advances these competition objectives in three ways. First, there is some evidence to suggest that more diversity among employees can help support greater innovation, enabling all firms, and in particular new entrants, to be more competitive.

2.12 Secondly, greater investment into businesses led by more diverse entrepreneurs, including FinTech, should increase beneficial competition in financial services as well as the wider economy.

2.13 Finally, competition benefits arise as customers are more likely to choose firms that can offer services that meet their various needs. These needs are likely to be better understood where the make-up of firms at all levels, better reflects the society they serve. This in turn will help make the UK a more attractive place to do business and help to attract and retain the best talent.

Public Sector Equality Duty

2.14 As public bodies, in exercise of our respective functions to advance our objectives (see **Box 3**), the regulators are subject to the Public Sector Equality Duty under the Equality Act 2010. The regulators must have 'due regard' to the need to:

- eliminate unlawful discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act
- advance equality of opportunity between people who share a protected characteristic and those who do not share it and,
- foster good relations between people who share a protected characteristic and those who do not share it.

2.15 The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex, and sexual orientation. Public authorities also need to have due regard to the need to eliminate unlawful discrimination against someone because of their marriage or civil partnership status. Public authorities are required to have due regard to the aims of the general equality duty when making decisions and when setting policies.

What the regulators are doing

2.16 We know that we have some way to go ourselves to achieve the desired outcomes we set out for industry in chapter 1. Many of these outcomes apply to us, both internally and through the functions we exercise with respect to the financial sector and the wider economy.

2.17 In this section we have set out some of the steps taken to promote diversity and inclusion. However, we are under no illusion. We know we have more to do. We intend to learn from the response to this DP to move further along this journey and make real change to better reflect the society we serve.

The Bank of England (including the PRA)

2.18 The mission of the Bank of England is to promote the good of the people of the UK by maintaining monetary and financial stability. Diversity in its many forms is an important part of delivering our mission.

2.19 Promoting diversity and inclusion is a top strategic priority for our executive team and Court of Directors. As a public institution we seek broadly to reflect the diversity of the public we serve, which helps to build the trust needed to deliver our remit. While still on a journey, we have made considerable efforts in recent years to enhance diversity and inclusion in all of its forms, including through the work of our employee networks. In particular, we have taken steps to improve diversity at the different stages of employee lifecycle, including:

- **Name-anonymised recruitment:** upon sifting applications, managers are only presented with data relevant to the job application (e.g. qualifications, previous work experience and answers to application form questions); names, personal data, and all but the most recent piece of education are not visible. Interviewers must also undertake inclusive recruitment training.

- **Career Returners programme:** in partnership with Women Returners, a specialist return-to-work organisation, we launched this programme with the aim of attracting and supporting professionals returning to the workforce after a career break.
- **Sponsorship programme:** sponsorship often happens organically, but typically between similar individuals. To support progression into senior roles, this programme aims to match colleagues from underrepresented groups with members of our executive team, broadening the range of colleagues who benefit from sponsorship.
- **Pooled recruitment:** after a successful pilot since 2018, we consistently coordinate decision-making on senior management appointments. Pooled recruitment aims to encourage a deeper pool of applicants by appointing a cohort of colleagues to open vacancies – rather than looking at each appointment in isolation – which helps increase the diversity of applicant pools.

2.20 We have also undertaken other initiatives over recent years including: scholarships for Black African and African Caribbean students, a reciprocal mentoring programme for ethnic minority colleagues and senior management, participation in the Bridge Group work on social mobility, and the 2020 launch by the Court of the Bank of England of an internal review of Ethnic Diversity and Inclusion. There is also a focus on momentum and awareness-driven activities at local levels such as 'is it ok' sessions and training programme on diversity and inclusion. In 2021, we introduced an Executive Accountability scorecard to increase the accountability and visibility of the actions that our Senior Leadership Team is taking to improve diversity and inclusion.

2.21 As part of our commitment to inclusion, we are a signatory to four charters: Women in Finance, Race at Work, Valuable500 and the Tech Challenge Charter. In 2019, we launched our Out and Proud Charter, a public commitment to creating a more LGBT+ inclusive workplace, and in 2020, our Go4Gold Disability Action Plan.

2.22 The combined efforts have contributed to some progress, albeit we recognise we have further to go, particularly at senior management level, where female and ethnic minority representation as at February 2021 is 32% and 8% respectively. Below senior management level we have representation at 46% and 21%, with greater diversity levels among new joiners, as at February 2021, 41% of experienced hires were female and 31% were from ethnic minority backgrounds. This representation is to be slightly higher for those joining our 2021 graduate scheme. We are also taking steps to further improve our own data collection with respect to diversity and inclusion, particularly in relation to other diversity characteristics. In the meantime, we have engaged with the Stonewall Workplace Equality Index, rising 18 places to 160th in 2020, and ranking 32nd in the Social Mobility Employer Index, up from 41st in 2017.

2.23 Our work on diversity and inclusion extends to our role in creating an inclusive financial sector. A lack of diverse thinking may have contributed to a culture in financial markets which allowed instances of misconduct that emerged in the wake of the Global Financial Crisis, such as cases of FX market abuse. In April 2021, we launched our 'Meeting Varied People' initiative to ensure the Bank's market intelligence work captures views from the fullest range of people (see the Bank's Market Intelligence Charter) to enhance our understanding of international and domestic financial markets. During 2021, we are also launching an Alternative Liquidity Facility, which has been designed with input from the Islamic finance community. Please note that more information on the Bank's work on inclusion is included in the Inclusion and Sustainability section of its Annual Report and Accounts 2020/21.

FCA

2.24 Diversity and inclusion are central to the FCA's ethos and approach – as an employer, as a public body, and as a regulator. We strive to reflect the society that we serve, to have and uphold an inclusive culture, to continually consider the impact of our work on different consumers, and to lead by example in the financial services sector, highlighting diversity and inclusion as an integral element of good conduct.

2.25 To make the FCA more diverse and ensure that everyone has fair opportunities to work, to develop and to progress here, we have focused on:

- **Transparency and data to hold us to account:** we collect granular data on gender and ethnicity across all divisions and at all grades in our diversity and inclusion dashboard, which allows us to target focussed positive action. Alongside our gender pay gap, we've published a breakdown of our ethnicity pay gap and the intersectional ethnicity-gender pay gap, as well as our disability pay and bonus gaps. We have targets for ethnicity and gender for senior leadership and will be introducing targets to our pipeline roles.
- **Talent pipeline and progression:** we have introduced more objective, transparent and inclusive talent reviews and have a robust diversity and inclusion resourcing strategy. We also have a Sponsorship programme which offers support to talented ethnically diverse colleagues to accelerate their career progression.
- **Training and support:** we've rolled out inclusion workshops for our SLT (Senior Leadership Team, consisting of all Heads of Department and above) and people managers, to support colleagues to feel safe to speak up when they see bias at play, to ask questions and to challenge, in a way that encourages conversation and supports positive change. And we've delivered a variety of interventions to support effective allyship at the FCA.
- **Accountability:** ensuring we hold our Executive, SLT and managers to account for progress.

2.26 More details can be found in our Ethnicity Action Plan and in our Annual Diversity Report which will be published later in July 2021.

2.27 We have engaged and active network groups that work collaboratively and provide subject matter expertise, insights around lived experiences, as well as providing a platform for engagement. We are signatories to several charters: Women in Finance, Race at Work, and the Social Mobility Pledge and participated in the Bridge Group research into advancing socio-economic diversity and inclusion in financial services and hold positions on the Social Mobility Taskforce to boost socio-economic diversity at senior levels in UK financial and professional services.

2.28 We are continuing to make progress and still have more to do: we've increased our SLT female representation from 40 to 43% in the last year and our ethnic minority SLT representation from 10% to 13%; our overall representation and promotion rates on ethnicity have improved; our diversity and inclusion scores in our employee engagement survey are one of our highest scoring metrics; and we've ranked well in the benchmarks we participate in, for example ranking 27th in the Social Mobility Employer Index and 59th in the 2020 Stonewall Workplace Equality Index.

2.29 We have a long way to go and our efforts have not yet translated into the outcomes we need to see – including meaningful reductions to our pay gaps, and improvement to some of our inclusion metrics, particularly around ethnicity. This is why we are refreshing our diversity and inclusion strategy and prioritising it as part of our transformation programme. We need to continue to focus on how we broaden our talent pipeline, leading to more diverse representation at senior levels and reduced pay gaps. To achieve this, we must have a culture where different views, backgrounds and experiences are truly valued. We need to become more outcome focused and set ourselves clearer time-bound measures for progress.

Inclusive language in our rules and guidance

2.30 Since the end of 2017, the PRA has taken steps to make language in the PRA Rulebook more inclusive by removing certain terms (e.g. chairman and other gendered terms). The FCA has also taken steps more recently to start identifying and removing non-inclusive language in legal instruments when creating new rules or amending existing ones. For example, the FCA has identified some language in its Handbook that it considers non-inclusive (e.g. 'Chinese walls'). These terms and expressions are typically found in older parts of the FCA Handbook.

2.31 However, we think there is more we could do. We plan to carry out work to explore the language in existing, and in some cases potentially long-standing, provisions in our rules to assess how they can be made more inclusive. We have begun identifying terms and expressions that could be usefully replaced with more inclusive language or alternative expressions. The replacements are not intended to alter what is required under any of the rules, so this exercise should not have cost implications for industry.

Question

Q2: **Are there any terms in the FCA Handbook, PRA Rulebook or Supervisory Statements or other regulatory policies (for any type of firm) that could be made more inclusive?**

3 Existing requirements and expectations of firms

This chapter summarises current expectations and requirements on diversity for UK-regulated firms. Many of the existing policies have been driven by sector-specific developments. This has resulted in fragmented requirements for different types of financial firms.

3.1 The regulators already have some diversity requirements in place for banks, building societies, investment firms, insurers and Central Securities Depositories (CSDs). These have mostly been created by sector-specific legal and regulatory developments, resulting in a fragmented approach. These apply in addition to any other legal obligations firms may have such as those stemming from the Equality Act. Listed firms are also expected to comply with relevant principles in the FRC Corporate Governance Code.

3.2 This chapter explains the main diversity requirements that already apply to some of the firms we regulate, not all firms are currently in scope. Chapter 5 builds on this to cover other areas of the regulatory framework that could be used to encourage firms to improve diversity and inclusion.

Credit institutions and investment firms

3.3 UK banks, building societies and investment firms must meet the requirements on the diversity of their Board, which are contained in Chapter 6 of the General Organisational Requirements Part of the PRA Rulebook and SYSC 4.3A9R to 4.3A.11R of the FCA Handbook. These firms are required to 'engage a broad set of qualities and competences when recruiting members of the management body [Board] and for that purpose put in place a policy promoting diversity of the management body [Board]'.

3.4 Firms with a Nominations Committee are also required to set a target for the underrepresented gender on the Board and prepare a policy in order to meet this target. Nominations Committees must also periodically review the skills and experience of Board members and of the Board collectively, as well as on an ongoing basis ensure that decisions made by the Board are not dominated by a small group of individuals. All firms must then explain on their website how they meet these requirements.

3.5 These requirements stem from EU legislation, which has been transposed in the UK. The joint ESMA and EBA Guidelines on the assessment of the suitability of members of the Board and key function holders under Directive 2013/36/EU and Directive 2014/65/EU (the Guidelines), which remain relevant to firms authorised in the UK, provides further guidance on how firms should promote diversity within the Board.

3.6 Under the current Guidelines diversity should 'be taken into account when selecting and assessing members of management bodies [Boards], recognising that diversity leads to a broader range of experience, knowledge, skills and values,' that will help to enhance the functioning of the Board and reduce risks from groupthink, facilitating constructive challenge and sound decision-making. Policies promoting diversity of the Board should also refer to at least the following aspects: education and professional background, gender, age and geographical provenance where relevant.

3.7 Further, the Guidelines indicate that for firms that set targets for the underrepresented gender, a timeframe to meet the target should be specified. For all other firms, including where the Board consists of fewer than 5 members, the target can be expressed in a qualitative way. All firms should also implement a diversity policy for staff, including career planning, to support a pipeline of diverse candidates for Board positions in the future.

3.8 As part of our implementation of CRD V, the FCA has introduced requirements for firms to have gender neutral remuneration policies and practices. These were transposed into the FCA's Dual-regulated Firms Remuneration Code in December 2020 and included references to the UK Equality Act 2010. The Government Equalities Office and Equality and Human Rights Commission are responsible for monitoring compliance with, publishing inquires on and enforcing relevant legislation concerning gender pay gap issues for firms including those in the financial sector.

3.9 The EU Investment Firms Directive created two relevant requirements for investment firms, that:

- remuneration committees are 'gender-balanced'
- non-SNI firms (MiFID firms that are not small and non-interconnected) report gender-pay gaps

3.10 The FCA considered implementing these requirements as part of the Investment Firms Prudential Regime but decided to consider these more broadly as part of the much wider policy thinking on diversity and inclusion that was planned for this Discussion Paper (see Chapter 5 for more details).

Insurance firms

3.11 Similar to credit institutions, insurance firms must also engage a broad set of qualities and competencies when recruiting members of the Board, and put a policy in place for this purpose (see Chapter 2, Conditions Governing Business Part of the PRA Rulebook for Solvency II Insurance firms, see Chapter 3 Non-Directive Firms – General Governance Part of the PRA Rulebook for large-non directive firms). Firms must explain on their website how they meet these requirements.

Board responsibilities - dual-regulated firms

3.12 The PRA Supervisory Statement on Corporate Governance applies to all dual-regulated firms. It sets out that to be effective, Boards need to include individuals with a diverse mix of skills and experience (see Chapter 7). The point is to have capacity to provide effective challenge across the full range of the firm's business and the opportunity to explore key business issues rigorously.

FMIs

3.13 FMIs regulated by the Bank are subject to specific regulatory requirements regarding their internal governance arrangements, including the composition and expertise of their Boards. These requirements ultimately aim to encourage prudent decision making by FMIs, for example by ensuring that different stakeholders' interests and perspectives are properly considered. Although these requirements do not generally refer explicitly to diversity, the Central Securities Depositories Regulation requires UK regulated CSDs to define a target for the representation of the under-represented gender in the Board of the CSD and prepare a policy on how to meet this target.

FRC Corporate Governance Code

3.14 The Corporate Governance Code applies on a 'comply or explain' basis to firms with a premium listing in the UK. The Code sets out some principles that are relevant to diversity and inclusion:

- Principle J says: 'Both appointments and succession plans should be based on merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.'
- Principle L says: 'Annual evaluation of the Board should consider its composition, diversity and how effectively members work together to achieve objectives.'
- The Code also states that the annual report should include a policy on diversity and inclusion: 'The policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives; and the gender balance of those in the senior management and their direct reports.'

Box 4: Previous regulatory engagement with the financial sector on the importance of diversity and inclusion

Over recent years, we have reminded firms of the importance of diversity and inclusion in speeches and letters. A few key examples are:

In November 2016, Andy Haldane (Bank Chief Economist) gave a speech reflecting on the lack of diversity across financial services, and set out the analytical case for greater diversity in organisations.

In March 2018, Anna Sweeney (PRA Executive Director, Insurance Supervision) spoke on Making Impactful Change, covering the relevance of diversity to the PRA's regulatory objectives and the initiatives designed to encourage greater diversity in the PRA's own workforce.

In September 2018, Megan Butler (then an Executive Director of Supervision at the FCA) wrote a letter to Maria Miller, Chair of the Parliamentary Women and Equalities Committee, to explain the FCA's approach to sexual harassment in the workplace.

In February 2019, then FCA CEO Andrew Bailey spoke at the PIMFA Wealth of Diversity Conference on The Importance of Diversity.

Sarah Breeden (PRA Executive Director, UK Banks and Building Societies Supervision) gave a speech on the importance of creating an inclusive and diverse workplace for all at the LGBT The Network of Networks (TNON).

In January 2020, the FCA wrote a letter to CEOs of wholesale general insurance firms about non-financial misconduct in the sector. The FCA explained that poor culture in firms can lead directly to harm to consumers, market participants, employees and markets.

The PRA wrote a letter to the chairs of dual-regulated firms in March 2020. This sought to reinforce the importance the PRA places on diversity for improved decision-making.

Nikhil Rathi (FCA CEO) addressed the Women in Finance Forum in March 2021 on why diversity and inclusion are regulatory issues.

In April 2021, Andrew Bailey (Bank Governor) spoke at the launch of the 'Meeting Varied People' initiative, on how it is important for the Bank to engage with a more diverse range of people and institutions within the financial sector.

Also in April, Sheldon Mills (Executive Director of Consumers and Competition, FCA) spoke to New Financial on "Why black inclusion matters to us".

The FCA conducted research into how the Covid-19 Pandemic was disproportionately impacting women in the UK. In March 2021, we held a Women's Economic Empowerment TechSprint and Conference to share ideas on improving inclusion and create solutions, which the FCA will support developing, to enable women to increase their participation in financial services or safeguard them in the event of financial or domestic abuse.

4 Measuring progress

This chapter sets out our thinking on the collection and reporting of diversity data. It includes plans for a pilot data survey, which would enable firms, regulators and other stakeholders to get a better understanding of diversity and inclusion in the financial services sector. It also discusses the potential for future of regulatory reporting on diversity and inclusion and considerations for firms when collecting data. We discuss possibilities for disclosure of diversity metrics by firms to benchmark themselves and our aspirations for us to share aggregated industry wide data in Chapter 5.

Data collection and reporting for ongoing monitoring

4.1 Like many other stakeholders, we believe that good data are critical to understand the current state of play, monitor progress, identify potential barriers to progress on diversity and inclusion, and select the most effective interventions. (See New Financial: A forensic approach to data, BBBA: The Middle Report and the McKinsey Women in the Workplace Report 2020.)

4.2 When considering future data collections, we are conscious of the regulatory burden. Current initiatives, including those outlined in **Box 1**, are undertaken on a voluntary basis by a subset of firms. Firms are not however currently subject to any reporting requirements that give us an insight into the diversity of the financial services sector. As diversity and inclusion is a priority for us, we are considering introducing regular reporting, in relation to employee data, while being mindful of existing initiatives elsewhere that involve data collection (e.g. Women in Finance Charter) as well as of proportionality for smaller firms in particular and the potential impact that reporting on information relating to individuals can have.

Why is data collection, reporting and monitoring important

4.3 Firms can use data to identify areas for intervention and to set appropriate targets. The regular collection of data also allows firms to measure progress and change against any interventions or targets set, which in turn supports firms in holding themselves to account. (See also **Box 5** below.)

4.4 Data collection, reporting and monitoring advances our work in two ways. First, high quality data support evidence-based policymaking, by helping regulators identify ways in which we can make most effective policy interventions, supports supervisory interventions and our shift to data-driven regulation. Second, they enable the regulators to monitor firms' progress towards their stated objectives and targets.

4.5 We are interested in the diversity of a firm's Board and senior managers because of their central role in making key decisions within firms. Diversity, not only of senior managers but of the whole firm, encompassing those who might progress in future into senior management roles, will help support diversity of thought across the different levels of seniority where decisions are made. Gathering data on diversity of thought, through proxies such as demographic and socio-economic diversity will enable firms and regulators to monitor progress. In turn, data on inclusion will provide information on whether the firm culture is conducive to diverse views being incorporated in decision-making.

4.6 There is a growing appetite for diversity data from various stakeholders. Within firms, there is a desire to use data to measure progress from Boards, executive committees and business leaders, who are themselves being held to account for improving diversity and inclusion. Externally, clients, shareholders, government, academics, investors and members of the public are all increasingly interested in firm diversity data.

Box 5: Advantages of diversity and inclusion data collection

Reported by New Financial in 'A forensic approach to data':

- **The language of business:** A focus on data positions diversity as a strategic business priority. Business priorities are set by the board, led by the Executive Committee, monitored by data, and achievement is rewarded accordingly – the same logic needs to apply to decision-making around people.
- **Evidence based decision-making:** Collecting and analysing data shifts the diversity discussion from anecdotal to evidential. The data increase understanding of the current workforce and can then be used to identify where to focus energy and resources for a targeted approach to diversity planning and future recruitment, retention and promotion opportunities.
- **Delivering results:** Data allow organisations to measure the impact of their interventions, see what does and does not work in a granular way, and debunk unhelpful myths. Firms that have stepped up the rigour of their approach to diversity data are seeing swift results.
- **Driving accountability:** Data enable firms to hold their leaders to account. If managers are expected to deliver a diversity-related objective, they need to have access to the data that show them how they are doing and that can help them create customised strategies. For the more advanced organisations, granular diversity data can be linked to a range of performance metrics, including pay and promotion, just like any other business objective.

The Financial Services Skills Commission on identifying bias in people processes: The Commission has identified improvements in data measurement, analysis, and reporting as one of its ambitions for improving diversity, inclusion and progression. Having access to detailed data will allow companies to **understand issues with recruitment, attrition, promotions and any bias in the company's people processes**. Analysis of these data can therefore offer far reaching insights and have real financial impact. If businesses can discern where they have the highest rates of attrition and why, they can implement changes and retain skilled talent.

Which diversity and inclusion data should firms collect?

4.7 Research indicates that many firms have legacy systems that hinder effective collection of diversity data across all protected characteristics and socio-economic background (New Financial: A forensic approach to data). We would like to be able to gauge the extent of this issue and the pilot data request, set out below, will include opportunities for firms to explain why some information might not be readily available including whether there are any legal restrictions that affect availability. (See **Box 6** below for data commonly collected.)

4.8 One of our potential expectations would be for firms to develop metrics that enable monitoring of their diversity and inclusion initiatives. Appendix 2 outlines an approach to data and metrics which firms may like to consider. In 2020, the World Economic Forum, in collaboration with the Big Four accounting firms, published a proposal that contained a new set of core metrics and recommended disclosures for measuring non-financial aspects of business performance such as diversity, as well as other environmental, social, and governance topics. The core metrics in relation to diversity and inclusion were the percentage of employees per employee category, by age group, gender and other indicators of diversity (e.g. ethnicity) and pay equality.

4.9 The FCA's Guidance for firms on the fair treatment of vulnerable customers is clear that we expect firms to monitor that they are meeting the needs of customers in vulnerable circumstances, including through product and customer service design, and our proposals for a new Consumer Duty would require firms to monitor outcomes for different groups of customers. We are interested in views on the data that firms are using, or could use, to ensure that their products and services are meeting consumers' needs.

Box 6: Data most commonly collected by firms

Currently, research indicates that the data most commonly collected by firms are around gender (broken down by division, function and seniority for headcount, joiners, promotions and leavers). The more progressive firms are unpicking the top-level data, showing where women sit across the organisation to better understand the criteria that lead to someone joining, being promoted or leaving and are gathering data on those underlying stages. (See New Financial: A forensic approach to data). A main trend developing within the financial sector is a shift from static demographic data to mapping the lifecycle of employees, showing a breakdown by gender (and for the more advanced firms, ethnic minorities) of staff at key points as they move through the organisation – i.e. recruitment, promotion and attrition. (See New Financial: A forensic approach to data)

Some organisations are now increasingly collecting data in relation to ethnic minorities, with PwC reporting, in September 2020, that 2 in 3 companies that they surveyed are now collecting data on ethnicity (see PwC's Ethnicity pay gap reporting – A focus on inclusion, equality and fairness). However, recent research undertaken by the Black British Business Awards in partnership with JP Morgan has found that though most firms collect some ethnicity data many do not actually use the data they collect. While this research did not focus on the financial services sector, out of the 37 firms that took part, about half were financial services firms.

Pilot data survey

4.10 To help inform further policy development, which could include proposals for regulatory reporting, we intend to issue a one-off, voluntary pilot data survey this autumn that will seek to:

a. more deeply understand the levels of diversity within firms in order to inform future policy developments
b. understand what categories of data firms currently collect on diversity and inclusion in relation to staff
c. understand firms' strategies and plans to collect diversity and inclusion data in the future, including potential challenges and barriers faced and
d. inform the development of any future regular data collection

4.11 The pilot would also test firms' ability to provide data. Firms would not be asked to approach staff for further information but would be asked voluntarily to supply aggregated and anonymised data that they already hold. Firms can report on a minimum aggregate level so that it is unlikely to be identifying for individual staff. We are setting out our plans here to start the conversation to help refine the survey ahead of issuing. As the survey will be voluntary, we will need industry support to ensure we have a representative response.

4.12 For the purposes of the pilot, we are considering whether to gather data on all or a sub-set of the nine protected characteristics, plus socio-economic background. We will take in to account regulatory burden and the scope of our possible changes. We will ask firms about their ability to collect information on all of the nine protected characteristics plus socio-economic background to understand more on what is currently collected or what is intended to be collected and available in the near future.

Box 7: Categories of possible questions for the pilot survey

The aim of the pilot survey is to understand what data firms currently collect (or have plans to collect), and where possible, to see that information. It is to help inform our understanding on what we may wish to collect in the future. This survey aims to capture both diversity and inclusion.

Availability of data
To understand the data firms may hold on senior management and the wider workforce on the nine protected characteristics and socio-economic background.

Data on certain groups
To understand the make-up across senior management and the wider workforce on certain characteristics such as gender (including trans and non-binary identities), ethnicity, sexual orientation, disability and socio-economic background.

Monitoring diversity
To understand how firms monitor diversity, (e.g. using targets, performance objectives, pay gaps).

Measuring inclusion
To understand how firms measure inclusion (e.g. recruitment, employee surveys, work allocation, decision making, product design).

4.13 We believe that all firms would benefit from having a better understanding of the level of diversity within their workforce, and how they compare to peers. However, we also recognise that some firms may not be able to supply all the data that we would like to gather as individuals may become identifiable through the process (e.g. where the figures provided in aggregated data are so low that it could be possible to identify information relating to an individual from the data). Firms that participate in the survey would need to make sure that they comply with the data protection legislation when identifying information is processed for the purpose of being shared with us.

In particular, firms may need to provide data that is aggregated to a level where it is non-identifying.

4.14 We intend to survey a representative sample of solo-regulated firms, all firms jointly regulated by the PRA and FCA, and selected FMIs. We will contact firms in our sample in due course.

4.15 We are aware of recent discourse surrounding the term 'BAME', in particular noting that the term 'BAME' can be seen as exclusive, emphasizes certain ethnic minority groups, and masks underlying challenges faced by more specific groups.

4.16 We are mindful that firms that do collect ethnicity data may hold them in an aggregate form, and not broken down by UK census categories. As we do not wish to discourage reporting, for the purposes of the pilot survey, we are proposing to collect ethnicity data on any aggregated basis firms have available, including if reported as a BAME category, and if available, a breakdown according to UK census categories. Any future data collection would likely seek to collect ethnicity data in accordance with UK census categories, subject to consultation.

Future regulatory reporting

4.17 Any future proposal for a regular data collection would most likely involve firms approaching staff to complete a questionnaire. We recognise that this would require individuals to self-identify and are mindful that individuals might be reticent. We hope that firms will create a culture to encourage their staff of the benefits of making such a declaration.

4.18 In developing future policy in this area we will take into account any concerns firms may have on the potential lawful bases they would have to account for when processing staff data in relation to these proposals. We would expect firms as employers to build trust with their staff around the data collection by explaining its purpose in the service of increasing diversity and inclusion in the sector.

4.19 We recognise that developing a new data collection would take time, and firms would need to build systems and collect the data from employees, where they do not already do so. Based on feedback on this DP, and the evidence received in the pilot data collection, including consultation with the UK data protection supervisory authority (the Information Commissioner's Office), we will develop more detailed proposals on potential reporting requirements which we will consult on in due course.

4.20 The future consultation would be likely to propose that reporting to the regulators be based on the protected characteristics plus socio-economic background for different categories of staff, such as Board members, senior managers, and their direct reports, and all other staff.

4.21 As discussed above, the pilot survey we plan to undertake later this year will inform a regular future collection. Our initial aims for a regular future collection would cover:

- the membership of the Board, and the executive committees

- demographic diversity of the Board and senior managers (as mentioned above, we will use demographic and socio-economic diversity to represent diversity of thought)
- demographic diversity of the workforce
- whether there are any internal diversity targets for the Board and senior managers, and firms' progress and,
- high-level firm wide data on demographic diversity characteristics and inclusion practices

4.22 We hope to build a time series of diversity and inclusion data and monitor progress over time, leading to the observation of trends and enabling benchmarking. Setting benchmarks could also raise standards across the industry, in turn supporting competition.

4.23 Appendix 2 outlines a possible approach when considering building a framework for the design, monitoring and benchmarking of diversity and inclusion data to enable the creation of metrics that are significant to firm goals.

Box 8 – diversity and inclusion data collection

Solicitors Regulation Authority (SRA)
We have observed good practice of data collection, reporting and disclosure by the SRA, who have been undertaking mandatory diversity data collection, reporting and disclosure from the firms they regulate since 2012. The self-reporting form currently includes ethnicity, sexual orientation, gender, age, religion, and belief, disability, social mobility criteria and caring criteria. The SRA requires firms to make public disclosures and also aggregates law firm information disclosing it to stakeholders via their website. Stakeholders can then manipulate the data to show diversity stats for various categories of law firm staff. We think this an innovative and useful initiative to assess the state of play and progress across the sector.

(see the SRA's Law Firm Diversity Tool)

U.S Equal Employment Opportunities Commission (EEOC)
Since 1966, the EEOC has required all private employers with 100 or more employees, and federal contractors with 50 or more employees meeting certain criteria, to submit demographic workforce data, including data by race/ethnicity, sex and job categories for their workforce. This annual collection has helped EEOC to identify employment issues across sectors and take action. There is growing pressure from corporate leaders, institutional investors, not for profit organisations and the media for companies to be transparent and publish their EE01 forms. This illustrates how gathering standardised data can support identifying issues, monitoring progress over time and aid consistency in disclosure.

Questions

Q3: **Do you agree that collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector? What particular benefits or drawbacks do you see?**

Q4: **Do you have a view on whether we should collect data across the protected characteristics and socio-economic background, or a sub-set?**

Q5: **What data could the regulators monitor to understand whether increased diversity and inclusion is supporting better decision making within firms and the development of products and services that better meet customers' needs?**

5 Driving change: culture and policy

This chapter sets out potential policy options which we think could be effective in driving progress on diversity and inclusion in firms in order to achieve the desired outcomes we set out in Chapter 1. These options would build on the existing requirements and expectations on diversity summarised in Chapter 3, as well as the regulators' wider policy and supervisory frameworks. However, change cannot be driven by regulatory requirements alone. It relies on the positive engagement of firms to achieve cultural change, driven by committed leadership across the sector.

Policy scope

5.1 Diversity and inclusion are important to the entire financial sector. In our view, any future policy proposals should apply to the broadest range of firms. That would include firms that have a Part 4A permission under FSMA to carry on one or more regulated activities. It also includes other firms such as payment services and e-money firms regulated under the Payment Services Regulations and Electronic Money Regulations, credit rating agencies and recognised investment exchanges regulated by the FCA and FMIs regulated by the Bank of England.

5.2 FMIs perform a vital albeit often unseen role in the financial system. Prudent decision-making, aided by diverse and inclusive working cultures that foster diversity of thought, is a necessary part of ensuring that the payment, settlement and clearing services they provide are robust and reliable. FMIs operate under bespoke regulatory arrangements. They are not subject to the SM&CR or threshold conditions in the same way as firms with Part 4A permissions. Consequently, some of the policy options discussed in this Chapter are not immediately applicable to FMIs – the Bank will continue to assess the most effective means of driving progress on diversity and inclusion in FMIs, taking into account feedback on this DP. We welcome views on the scope of application for each of the policy options that we explore in this paper.

Proportionality

5.3 Diversity and inclusion are important for all firms, but we understand that we cannot take a one-size-fits-all approach. We want to encourage diversity and inclusion across the industry in a way that is appropriate to a firm's size and complexity and we recognise too that we must do so within the legal and regulatory framework applicable to different types of regulated firm. Our aim is to avoid imposing rules that would not be effective or appropriate for smaller firms.

5.4 For dual-regulated and solo-regulated firms, some of the options presented in this chapter would only apply to larger firms. However, there are some areas for which we would want to apply proportionate requirements to smaller firms (e.g. credit unions, small intermediaries, small payments firms, small insurance firms and other small firms) and the FCA will need to consider establishing thresholds. Ideally, we would want to define thresholds that are already familiar to firms.

5.5 For FCA solo-regulated SM&CR firms, we could use the existing categorisation, with Enhanced, Core and Limited Scope firms (see SM&CR Solo Firms Guide) subject to different levels of requirements in line with their size and complexity and exclusions for primarily non-financial firms. We could extend this approach to non-SM&CR firms regulated by the FCA (such as payment services firms) by applying a proportionality test based on volume of business, similar to the way that we define enhanced thresholds in SM&CR.

5.6 An alternative might be to use the definitions of company size used by the Companies Act for accounting and reporting: micro-entity, small, medium-sized and large. These are based on turnover, assets and number of employees, and some qualitative factors.

5.7 Many of the firms the FCA regulates are not primarily financial services firms. A significant proportion of these have permissions to conduct limited credit or insurance activities and are Limited Scope under the SM&CR. Our intention is to improve standards in the financial services sector, and we are considering how to design a scope that, for most of our proposals, encompasses appropriately those firms who are not primarily financial services firms.

5.8 We are also aware that some small firms, such as sole traders or those with few employees, could not meaningfully enact many elements of the options we are exploring. So we are considering only including these firms to a very limited extent in any proposals. For example, we might keep any future expectations for these firms high-level, requiring them to respond to the diverse needs of their customers and potential customers with respect to the products and services they deliver and not engaging in unlawful discriminatory practices.

5.9 For overseas firms operating in the UK including through branches, the governance is typically outside the UK and culture is influenced by the wider group based outside the UK. For the purpose of this initial discussion we want to gather views on bringing overseas firms that provide services in the UK into scope. We would therefore welcome views on the extent to which overseas firms should also be subject to these potential proposals.

Questions

Q6: **What are your views on our suggestions to approach scope and proportionality?**

Q7: **What factors should regulators take into account when assessing how to develop a proportionate approach?**

Q8: **Are there specific considerations that regulators should take into account for specific categories of firms?**

Tone from the top

Leadership and culture

5.10 We know that diversity and inclusion has become a priority for many leaders in the financial services industry but it has been difficult to sustain effective change. We believe that it requires deep cultural change in many firms. Leaders need to set a compelling strategy and empower their teams to develop and implement initiatives that deliver cultural change at all levels within their institutions. They will have to set goals, monitor the effectiveness of change programmes, identify barriers and make changes where necessary. Senior Managers will have a key role to play but, as with any culture issue, diversity and inclusion should be a concern for leaders at all levels.

5.11 Boards should monitor and challenge progress on diversity and inclusion within firms to satisfy themselves that decision-makers at all levels are reaping the benefits of diversity of thought. They should also ensure that good outcomes for their customers form an integral part of strategy. They should ask themselves what their firm's purpose means for diversity and inclusion.

5.12 Establishing inclusive cultures will be a critical part of making this work. Psychological safety is an essential first step to creating an inclusive culture. Without this, an organisation may try to be inclusive, but staff may be unwilling to speak up and raise concerns. People must, also believe that diverse perspectives will be welcomed and heard. We believe then that progress will be difficult without a safe culture.

Governance

5.13 Boards are ultimately responsible for firms' strategy and culture. We would expect the Board to hold management to account for promoting diversity and an inclusive culture that fosters open exchanges of ideas, constructive debate and sound decision-making. We also think that the Board is the appropriate body for setting the diversity and inclusion strategy and policy and overseeing its progress.

Representative Boards

5.14 For many larger firms, existing policy calls for a broad set of qualities and competence when recruiting Board members and to put a diversity policy in place for this purpose (see Chapter 3). Our view is that for governance arrangements to be most effective, the Board, and its committees, need diversity of thought, supported by demographic characteristics and an inclusive culture. The credibility of a firm's diversity and inclusion strategy could be called into question if it is overseen by a homogenous group without diverse experience and thought. We want to make it clear that this should be a key consideration in recruitment strategy. In our view, this would help to minimise risks to safety and soundness from groupthink and enable Boards to better understand diverse consumer groups.

5.15 We are conscious that this is an area where proportionality will be particularly important, given the limited size of Boards at smaller firms. We would welcome views on the minimum number of directors necessary for any future potential requirements or expectations around representative Boards to be meaningfully applied.

5.16 We believe that targets for representation can be a powerful way of driving change through commitment to shared goals. Significant banks, investment firms and some FMIs are already required to set a target for the underrepresented gender at Board level (as outlined within Chapter 3). We would welcome views on whether there is a case for applying such a requirement to a wider range of firms and for underrepresentation in relation to other characteristics. The FCA will also be exploring whether we should consider similar requirements for listed firms to those proposed by NASDAQ in relation to diversity on company Boards.

Board succession planning

5.17 Many firms are already required to consider the collective suitability of their Board and expected to pay close attention to the skills and experience of its members. The point is to have diversity of experience and capacity to provide effective challenge across a full range of the firm's business and the opportunity to explore key business issues rigorously. As part of this, Boards should ensure they have robust succession plans for their members that recognise current and future business needs and requirements.

5.18 We think it could be helpful to clarify how succession planning could support firms in driving better diversity and inclusion outcomes. We could make explicit in our 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. We think Boards could engage more positively with recruitment firms when seeking candidates for future directorships. Thinking further ahead means that Boards could develop a collective set of expectations to access a more diverse pool of candidates, and would reduce the risk of a box-ticking approach. We discuss the importance of building diverse representation across the firm – which can also help support the executive pipeline – later in this chapter.

5.19 Some firms will have a Nominations Committee that already has responsibility for overseeing new appointments to the Board and its committees (covered in Chapter 3). By extension, the chairs of these committees who hold the Senior Management Functions in banks, building societies, insurers, designated investment firms and enhanced solo-regulated firms would also be responsible for ensuring that the committee adequately consider diversity and inclusion in succession planning. Having a Nominations Committee provides a forum to discuss these issues and some firms may have set these up, including where requirements to do so do not exist. We would welcome views on the value of these committees or alternative arrangements in supporting consideration of diversity in succession planning, as well as broader benefits for governance in general. In firms that do not have a nominations committee, we envisage that these responsibilities would continue to sit with the firm's Board.

Questions

Q9: **What are your views on the best approach to achieve diversity at Board level?**

Q10: **What are your views on mandating areas of responsibility for diversity and inclusion at Board level?**

Individual accountability

5.20 We think that making senior leaders directly accountable for diversity and inclusion in their firms would be a way to drive strategic thinking and relevant discussions among the key decision-makers. This is additional and complementary to the collective responsibility of the Board. This focus from the top would help to empower individuals from across the firm to embed diversity and inclusion into the entirety of a firm's practices. The SM&CR is an important policy tool in this respect, although it does not apply to all firms.

Dual regulated firms

5.21 Most dual-regulated firms must already allocate the prescribed responsibilities (PRs) set out in the PRA Rulebook to a PRA Senior Management Function (SMF) holder – which include two Prescribed Responsibilities related to firm culture.

a. PR (I): responsibility for leading the development of the firm's culture by the governing body as a whole (often sitting with the Chair of the Board); and
b. PR (H): responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm (often sitting with the CEO).

5.22 The PRA's Supervisory Statements on Strengthening Accountability in banking and insurance explain that these Prescribed Responsibilities reflect the PRA's expectation that firms should have a culture that supports prudent running of a firm in support of safety and soundness.

5.23 We think that the two prescribed responsibilities are an obvious point of accountability for diversity and inclusion for firms that have them. These responsibilities seek to ensure that the CEO and Chair assume leading roles in the development and implementation of the firm's culture, given the importance of the tone from the top. Making the link between diversity and inclusion being part of culture even clearer would clarify that the PRA Prescribed Responsibilities for culture encompass responsibility for the implementation and execution of the firm's diversity and inclusion strategy. This could be supplemented by specific actions in the Senior Managers' Statements of Responsibilities to ensure that accountability for diversity and inclusion strategy is coherent and responsibility is not fragmented.

5.24 It is not enough to make a commitment to diversity and inclusion; it has to be purposeful and authentic. We think that these responsibilities include general responsibility for the rest of the initiatives outlined in this chapter. For firms that do not have Prescribed Responsibilities for culture we want to consider whether these responsibilities could be covered in the appropriate Senior Managers' Statement of Responsibilities. We envisage that it would be the responsibility of the Senior Managers to deliver results, being transparent about success and failure, and drilling down on the barriers hindering diversity and inclusion progress. Good data and ongoing monitoring, including through internal audit (see below), would also be necessary to be able to show that these responsibilities are being met.

Solo-regulated firms

5.25 Individual accountability is equally important in FCA solo-regulated firms. However, prescribed responsibilities for culture do not apply to solo-regulated firms. Instead, the FCA expects all Senior Managers to take responsibility for developing and embedding healthy cultures in their areas of responsibility.

5.26 This chapter sets out several options that could lead to specific requirements. We would want to ensure that there is clear senior management accountability for these. We believe that in most cases, responsibility would fall to the holder of an existing SMF (e.g. the chairs of the Nominations and Remuneration Committees, the Senior Manager responsible for the firm's people policies, or other Senior Managers in the business). We would like to explore express allocation of responsibility for elements of the diversity and inclusion policies to Senior Managers, rather than including them in their general wider responsibilities.

Question

Q11: **What are your views on the options explored regarding Senior Manager accountability for diversity and inclusion?**

Remuneration

5.27 Linking progress on diversity and inclusion to remuneration could be a key tool for driving accountability in firms and incentivise progress. All PRA and FCA remuneration policies include a requirement for firms to base variable remuneration awards on financial and non-financial performance for their Material Risk Taker population (individuals who can materially affect the risk profile of the firm).

5.28 The 2021 annual review finds that firms are increasingly linking D&I to the personal objectives of senior management (through remuneration scorecards for example), and through a collective objective for the firm or business unit (see **Box 9** below). Only 5% of signatories have reported that they believe the link to remuneration not to be effective.

5.29 It could be helpful for the regulators to develop guidance on how metrics linked to advancing diversity and inclusion can be used as part of non-financial criteria when setting variable remuneration awards. Similarly, poor performance in this area could be grounds for adjustment. We do not intend to be prescriptive, but to provide insight on good practice at both the individual and firm level. To implement this, firms would need to have framework in place to monitor and evaluate progress. Effective monitoring and data collection would enable this.

5.30 We want to explore a future environment where 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.

5.31 We could make explicit in our rules that a firm's remuneration policy should ensure that all types of remuneration, both fixed and variable, do not give rise to discriminatory practices. If a firm were to make an award based solely on an individual's protected characteristics this is likely to give rise to unlawful discrimination against others (see the Equalities Act 2010). This is also identified in the FCA's dual-regulated firm remuneration code as being non-compliant. However, this is not explicit across all FCA remuneration code guidance and we therefore want to gather views on establishing a consistent approach.

5.32 Some firms have remuneration committees to oversee their firm's remuneration policy. In our view, this committee should have oversight of how obstacles that give rise to pay gaps and other adverse diversity and inclusion outcomes are being managed in their firm. By extension the Chairs of these committees, who hold Senior Management Functions in banks, building societies, insurers and enhanced solo-regulated firms, would also be responsible for ensuring that the committee adequately considers diversity and inclusion to the extent relevant to its functions.

5.33 Similar to our approach to nominations committees, not all firms are required to have remuneration committees. Although we think that many do, we would welcome views on the value of a remuneration committee or alternative arrangements that for discussing these views as well as how this improves governance in general. In firms that do not have a remuneration committee, these responsibilities would continue to sit with the firm's Board and expected to carry out the same function.

Box 9: Incorporating diversity and inclusion into remuneration decisions

Some firms consider diversity and inclusion in the design of their balanced remuneration scorecards for senior executives – CEOs in particular. Where we have observed specific practices, the metrics have been weighted 7.5% of the overall scorecard, and based on a mix of diversity metrics – for example progress against targets for the underrepresented gender and ethnic minorities in senior roles; and inclusion metrics, such as the results of internal staff surveys.

We are also aware that some firms may incorporate progress against firm wide representation targets (gender and ethnicity) as a metric that contributes towards determining the size of the overall bonus pool.

Question

Q12: **What are your views on linking remuneration to diversity and inclusion metrics as part of non-financial performance assessment? Do you think this could be an effective way of driving progress?**

Firm-wide policies and practices

Firm diversity and inclusion policies

5.34 We believe that a diversity and inclusion policy should be a central consideration for all firms, as it forms the foundation of a strategy and action plan. Clearly documented policies help set out expectations of all staff on what diversity and inclusion means within their organisation, and what their respective roles are in fostering an open and inclusive environment and empowering their colleagues to speak up and express their views. We want to explore a requirement for all firms to have a policy and to publish it on their website. This would both show commitment and allow stakeholders, including the regulators, investors, consumers and employees to hold firms to account (some firms are already required to this, see chapter 3).

5.35 We would not intend to be prescriptive about the content and we are conscious of the need for proportionality. Areas that we would like to see included in all policies include some foundations such as clear objectives, realistic goals, a plan for meeting those goals and ways for measuring progress. As a minimum, policies should promote diversity on the Board. Firms may also need to take into account any legal requirements they are subject to in preparing their policies. Where firms are smaller in size or have fewer employees and governance structures, we would expect policies to be proportionately simpler.

5.36 We have considered guidance already produced by bodies such as the Equalities and Human Rights Commission and the Social Mobility Commission and we would take these into account in developing any future policy in this area.

Questions

Q13: What are your views about whether all firms should have and publish a diversity and inclusion policy?

Q14: Which elements of these types of policy, if any, should be mandatory?

Progressing diverse representation

5.37 Available data indicate that there is less diversity towards the top of an organisation. This is where the key decisions that have significant impacts on safety and soundness, consumer protection and markets regularly take place. We believe that fostering diversity and inclusion among senior management, including the Board, will have positive cultural implications across the firm. The senior management population is visible to all employees, consumers and wider society. Diversity at senior management level demonstrates equality of opportunity and offers role models for underrepresented groups. For this reason, we think that future regulatory initiatives should have a focus on the diversity of senior management and the progress firms are making.

5.38 A consistent definition of 'senior management' across all regulated firms for the purposes of monitoring diversity would support benchmarking between peers. For large firms, we consider that this definition of senior management should include the Board and the two leadership layers below the Board (this would normally include all SMF holders in firms covered by the SM&CR). This definition would be for the purposes of new policy related to diversity only. This definition is in line with the Hampton Alexander Review which some firms have already reported against.

5.39 We would like to use the same definitions in any future diversity reporting and disclosure policy. Where possible, we would encourage smaller firms to use the same definition to support comparability across the sector. However, there would clearly be difficulties in applying this definition to many smaller firms as it would include people who would not normally be classed as senior management and we would welcome feedback on this point.

Developing diverse talent for the future

5.40 To achieve diverse representation at senior management and Board level, from a practical perspective, we believe that firms need to think more about the progression of their employees, from their time of entry, to the top of the organisation. This can be in the shorter term when succession planning for executives and in the medium term when thinking how diverse talent can progress up through their organisation. To facilitate this, we think it is important for firms to improve diversity at all levels of management and reflect on their approach to diversity and inclusion in broader recruitment practices (See McKinsey's Women in the Workplace Report 2020 on representation of the corporate pipeline by gender and race).

Setting targets

5.41 We have set out above our thinking on targets to improve Board diversity. We would also like to gather views on the merits of setting any requirements or expectations for firms to set targets for underrepresented groups for entry into the wider senior management population, either quantitative or qualitative. We would want to avoid this becoming a 'tick box' compliance exercise. Any such target-setting would need to take account of the wider cultural context of the firm and firms would need to be able to explain the actions taken to meet any targets.

5.42 In addition to considering targets for senior management, we believe there is merit in considering targets for customer-facing roles. Here, greater diversity may help in understanding and serving diverse consumers. The FCA would therefore also welcome views on the use of targets in relation to customer-facing roles, especially certified staff, and the firm as a whole.

5.43 Where underrepresentation is particularly acute in one area, for example, gender or ethnicity, we recognise that it may be appropriate to focus on better representation in those characteristics. However, diversity in one area should not be an excuse for failing to make progress in others. We are conscious that this is an area where proportionality would be particularly important given that some management bodies and committees have relatively few members.

5.44 Where targets are used they should be stretching enough, with a defined timeframe, to contribute towards meaningful change. Progress against diversity targets and other metrics should lay the foundations for actionable next steps and guide the direction of future diversity and inclusion initiatives. Targets complement internal monitoring of diversity and inclusion and send an open message to all stakeholders about where firms are aspiring to get to.

5.45 Underrepresentation in some areas may also be particularly acute where there is significant difference between the demographic diversity of the firm compared to its customers or the markets it operates in. We think firms are best placed to consider the specific targets most relevant to the context of their firm.

5.46 For the firms in scope of this DP, we are seeking views on the merits, or otherwise, of setting regulatory requirements or expectations for firms to have targets for some or all of their boards, senior management population and the wider firm, including whether such targets should be set by firms or if there is any role for the regulators in overseeing target setting. We appreciate that firms are making progress against other external targets that firms have committed to (e.g. in the Women in Finance Charter, Parker Review) and it would be helpful for us to understand firms' experience of targets for driving progress.

Questions

Q15: **What are your views about the effectiveness and practicability of targets for employees who are not members of the Board?**

Q16: **What are your views on regulatory requirements or expectations on targets for the senior management population and other employees? Should these targets focus on a minimum set of diversity characteristics?**

Training

5.47 We think it is important that firms' employees understand diversity and inclusion and the reasons why it is important, not just from a regulatory standpoint but also to advance the diversity and inclusion strategy of their firm.

5.48 We think that training should be focused on real business outcomes, such as management recruitment, serving diverse customers or funding small businesses with diverse leaders. We are aware that evidence for some of the diversity training that has been popular, including unconscious bias training, is mixed.

5.49 The FCA is considering the role of training. We are aware that requiring employees to attend training can instil resistance, but voluntary training could have poor uptake. We want to ensure that any training is meaningful, not seen as a 'tick box' exercise and leads to change. We would also want it to be pitched at an appropriate level and to be followed up.

Questions

Q17: **What kinds of training do you think would be effective in promoting diverse workforces and inclusive cultures?**

Q18: **What kinds of training do you think would be effective for helping understanding of the diverse needs of customers?**

Products and services that meet the needs of real customers

5.50 The FCA wants firms to focus on consumer outcomes and put customers in a position where they can act and make decisions in their interests. Alongside increasing diversity and inclusion within firms, we want to set clear expectations of standards we expect firms to meet for consumers in the products and services that they provide.

5.51 Consumers are diverse and we know that due to the way that financial services markets operate, consumers don't always get the products and services that meet their needs or the outcomes they might reasonably expect. Consumers' ability to make good decisions can be impaired by various factors such as weaker bargaining position, asymmetries of information, lack of understanding or behavioural biases and market conditions. Some groups of consumers are more impacted by these than others. If firms do not adequately consider the diverse needs of their current and potential customers it can result in harm and poor consumer outcomes.

5.52 The FCA already has requirements and guidance in place around treating customers fairly and product governance. We would already expect firms to consider guidance on the responsibilities of product providers and distributors for the fair treatment of customers. There are also rules in place in some sectors, for example, for financial instruments and structured deposits and insurance products. We expect firms developing products to identify a target market for the product and to review products regularly to check they continue to meet the needs of the target market.

5.53 The FCA's Guidance for firms on the fair treatment of vulnerable customers explains that, to comply with the Principles for Businesses, firms should ensure that their business model, the actions they have taken and their culture ensures the fair treatment of all customers, including customers in vulnerable circumstances, taking into consideration their needs.

5.54 The FCA has recently issued a consultation to introduce a new Consumer Duty (CP21-13) that seeks to set clearer and higher expectations for the standard of care that firms provide to consumers. That consultation contains further analysis of the harm that can occur when firms do not focus on the interests of their customers. The Consumer Duty proposes additional requirements for firms to focus on the needs and outcomes of customers in their target market when designing products and services, in their customer service and their communications, including an understanding of the impact of behavioural biases on customers.

5.55 We do not expect firms to design products and services that meet the needs of all consumers, but firms should take care to ensure that their target market is not defined in a way that results in unlawful discrimination under the Equality Act 2010.

5.56 We recognise that there can be many reasons why a firm's conduct or business model results in different outcomes for distinct groups of customers within their target market and customer base. The FCA's proposals in CP 21-13 include an expectation that firms should be able to identify when particular groups of customers receive systematically poorer outcomes, and should investigate the root cause and what they can do to improve outcomes for those customers least well served. This is particularly important where those receiving poorer outcomes share protected characteristics under the Equality Act 2010.

Question

Q19: What are your views about developing expectations on product governance that specifically take into account consumers' protected characteristics, or other diversity characteristics?

Disclosure

5.57 To drive change, we could consult on requirements for firms to publicly disclose a selection of aggregated diversity data on the firm's senior management population and the employee population as a whole, as well as their diversity and inclusion policies, so that other firms and stakeholders can benchmark progress. Research shows that greater disclosure is linked to increased diversity (see New Financial: Diversity Disclosure – What the European Capital Markets Industry publicly discloses about diversity).

5.58 The aim of disclosure would be to reflect on firms' evolving understanding of diversity and inclusion, and the actions taken to improve diversity and inclusion for employees and customers. Firm disclosure on diversity is a clear statement of intent. It sends a strong message about how diversity is approached, where improvement is sought, and what is being done to deliver change. Such transparency is likely to be of interest to a range of stakeholders, including investors, customers and potential future employees – to name a few.

5.59 We would like to seek views on the merits of an aggregated disclosure report by the regulators to complement and follow any biennial data collection by firms (outlined in Chapter 4). This would provide stakeholders with further insight into diversity and inclusion across the sector and allow them to monitor progress. Disclosure by UK regulators would also complement the EBA diversity benchmarking publication, which would allow stakeholders to assess the progress of the UK financial sector against EU jurisdictions.

Scope of disclosure

5.60 Firms subject to the Corporate Governance Code are currently expected to publish some information (see Chapter 3) but how firms approach this varies, and many instances of 'tick-box' compliance and vague explanations have been identified. This makes comparability, including for the firms themselves, difficult.

5.61 Disclosures could include data on pay gaps (going beyond gender to include other characteristics), senior management and workforce diversity and measures of inclusion taken from internal survey data.

5.62 We welcome feedback on the benefits and challenges if we were to set out a disclosure template for firms to use. The aim would be to develop a minimum standard of disclosure, taking into consideration how this interacts with other diversity disclosure initiatives to help minimise any additional burden on firms. Combined with clear definitions and scope in our policy, this would help support a consistent approach across the sector. Not only would this support comparability among peers, but it would also aid comparability for among other stakeholders, including shareholders and investors. This could help identify wider problems in the sector and help highlight good practices, which could help us identify solutions to some of the barriers.

5.63 We appreciate that proportionality will be very important in this area and we would particularly welcome feedback from smaller firms. We are thinking especially about the level of disclosure that would create genuine progress without imposing an excessive burden on smaller firms.

5.64 We would note that remuneration disclosures are being considered as part of wider disclosures under the Investment Firms Prudential Regime, in the process of consultation, and that these are also relevant.

Questions

Q20: **What are your views on whether information disclosures are likely to deliver impact without imposing unnecessary burdens? Which information disclosures would deliver the biggest impact?**

Q21: **How should our approach for information disclosure be adapted so that we can place a proportionate burden on firms?**

Q22: What should we expect firms to disclose and what should we disclose ourselves from the data that we collect?

Diversity and inclusion audits

5.65 Regardless of firms' progress in this area, diversity audits can play a key role in starting to improve diversity and inclusion at work. These can help in maintaining inclusive workplaces by assessing whether the actions are in line with the organisation's values, ethics, risk appetite and diversity and inclusion policies.

5.66 Effective internal audit functions have already broadened their scope beyond traditional financial risk and controls to consider areas such as culture risk. They have also added value by bringing their expertise and insights to the evaluation of corporate culture. Auditing culture is a key feature of the Institute of Internal Auditor's Internal Audit Financial Services Code of Practice. Internal audit's role is to analyse to what extent processes (such as performance management and remuneration), actions (such as decision making) and tone at the top are in line with the values, ethics, risk appetite and policies of the organisation. They can therefore help boards judge whether measures put in place to change culture and thus behaviour are actually working. As an element of culture, diversity and inclusion represents an area where internal audit can assess whether programmes that firms have established to support diversity and inclusion are meeting their intended objectives and report results to the board and senior leaders.

5.67 Diversity audits should be considered, as for any strategic piece of work that an organisation will undertake. We regard a lack of diversity as an organisational risk as relevant as any other risk that is worth being recognised by an internal audit. Another benefit of diversity audits is that they allow organisations to provide an evidence-based approach to developing their diversity and inclusion plans.

Questions

Q23: What are your views on how we should achieve effective auditing of diversity and inclusion?

Q24: How can internal audit best assist firms to measure and monitor diversity and inclusion?

Regulatory measures

Fitness and propriety

5.68 Before Senior Managers are approved to carry out a controlled function, or a person is certified to carry out a certified function in a firm under FSMA, the firm must be satisfied that a person is 'fit and proper' to carry out their role (see the PRA quarterly bulletin). This includes having regard for an individual's honesty, integrity and reputation. All employees and directors subject to the SM&CR must comply with the FCA and PRA Conduct Rules and Standards. These set basic standards of conduct and behaviour that these individuals must meet. The Bank scrutinises candidates for senior management roles at FMIs in a similar way, on a non-statutory basis.

5.69 We are exploring whether adverse findings in relation to individuals' conduct with respect to diversity and inclusion issues could affect our assessment in the future. There have been instances in the past where the FCA has found an individual not to be fit and proper on the basis of their 'non-financial misconduct'. We recognise that firms may find it helpful to have guidance as to what constitutes 'non-financial misconduct'. We could 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.

5.70 Firms would need to assess whether evidence of such behaviour constitutes a breach of the Conduct Rules which would need to be disclosed in future regulatory references. We think it could also be helpful for the regulators to develop guidance on how such behaviour, or failure to take reasonable steps to address these kinds of behaviour, could result in a breach of the Conduct Rules. We believe that developing this guidance would provide firms and the regulators with clarity, leading to a more consistent approach and could have a significant impact on reducing non-financial misconduct in the sector, supporting inclusive cultures.

SMF Approval

5.71 The PRA assesses the individual and collective suitability of the firm's Board. The FCA assesses individual suitability and may also ask questions about board diversity. For firms in scope of the SM&CR, we want to be able to increase our scrutiny of firms' senior management diversity, including of those Senior Managers who do not sit on the Board. To do this, we are considering whether to collect diversity data about the individual as part of the information provided for Senior Management Function applications. This would be collected and processed in accordance with the regulators' obligations under GDPR. We would like to understand more explicitly how firms have 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. Where we have concerns that a proposed appointment would worsen or not address risks arising from a lack of diversity and groupthink we would look to scrutinise applications further and discuss this with firms. This would help us consider whether this could provide grounds for withholding approval.

5.72 We are taking this opportunity to confirm that the SM&CR should not be considered a barrier to diversity of skills and experience among approved senior managers. The PRA policy evaluation of the SM&CR found anecdotal evidence that some firms may be tempted to adopt a 'safe' approach to meeting the SM&CR suitability requirements, by replacing one senior manager with another from a similar background. It is important to dispel any misconceptions.

Questions

Q25: **Do you agree that non-financial misconduct should be embedded into fitness and propriety assessments to support an inclusive culture across the sector?**

Q26: **What are your views on the regulators further considering how a firm's proposed appointment would contribute to diversity in a way that supports the collective suitability of the Board and senior management?**

Threshold Conditions

5.73 Under Part 4A and Schedule 6 of FSMA, firms must meet a set of Threshold Conditions at authorisation and on an ongoing basis. These are the minimum requirements a firm needs to meet to carry on regulated activities. These include conditions requiring the firm to conduct its business in a prudent manner which includes having appropriate financial and-non financial resources, to be a 'fit and proper person' which would include the firm's management having the right skills and experience and the firm being capable of being effectively supervised by the PRA or FCA, as appropriate.

5.74 Evidence of a firm engaging in discriminatory activities could influence our consideration of whether a firm could be considered a 'fit and proper person' for the purposes of carrying out regulated business. We think that developing additional guidance on how we may take into account the firm's record on diversity and inclusion in assessing whether the firm meets Threshold Conditions could help prevent bad actors from entering the market and act as an added incentive for firms to address significant failings. This would also provide a basis for more effective intervention. The guidance could cover matters such as:

- how the PRA and FCA could take into account Board and senior management diversity in assessing whether the firm has appropriate non-financial resources.
- how non-financial misconduct by individuals connected with the firm and discriminatory market practices may influence our assessment of suitability.

Question

Q27: **What are your views on providing guidance on how diversity and inclusion relates to the Threshold Conditions?**

Embedding diversity and inclusion into existing supervisory practices

5.75 We will be using responses to this DP and ongoing dialogue with industry and stakeholders to refine our supervisory approach to more clearly take account of diversity and inclusion. The FCA already considers diversity and inclusion within its approach to assessing culture, as outlined in the Approach to Supervision. In addition, the PRA's Supervisory Statement SS5/16 Corporate Governance: Board responsibilities outlines the value in having diversity of experience whilst both the PRA's banking and insurance approach to supervision documents outline the importance of diversity. Our vision is that diversity and inclusion is embedded as part of our supervision of management and governance.

5.76 In his speech to the Women in Finance Forum, FCA CEO Nikhil Rathi shared a diversity and inclusion conduct question – "Is your management team diverse enough to provide adequate challenge and do you create the right environment in which people of all backgrounds can speak up?". We will use responses to this DP to develop our approach and support supervisors in their conversations with firms. Firms can expect supervisors to ask more questions about how firms are embedding diversity across their businesses and creating a culture of inclusion to unlock the benefits of diversity. Firms can expect diversity and inclusion to be a regular part of our engagement with senior management and the Board.

5.77 We will want to:

- understand the role of leadership, how diverse workplaces can create the right environment in which everyone can speak up and challenge, what actions are being taken to address gaps and how the firm is assessing its success in achieving more diversity and inclusion.
- see how diversity and inclusion is embedded at all levels within a firm and how representative firms are of the people they serve.
- understand how firms are taking diversity and inclusion into account in their strategy, the products and services they design and the diverse needs of those that they serve

5.78 The FCA's approach to diversity and inclusion will sit alongside our Guidance on the fair treatment of vulnerable consumers, as well as the new Consumer Duty (NCD) when proposals are finalised. We will ensure these are fully embedded in our approach to consumer protection.

5.79 As outlined above, we would also propose to assess for Part 4A FSMA authorised firms how SMF appointments contribute to firm's senior management diversity and and to take into account senior management diversity in assessing whether firms meet Threshold Conditions.

5.80 We recognise that it is not for the regulators to define what diversity and inclusion looks like for each firm, so we will not apply a one size fits all approach (see our questions regarding scope and proportionality throughout this DP). We acknowledge that the financial services sector will make more progress if we can learn from each other, so we will consider how we can share insights, and work with industry and other stakeholders to collectively drive forward change.

5.81 The Environmental, Social and Governance (ESG) agenda is rightly gaining increased focus and our engagement on diversity and inclusion will be an important part of our wider engagement on ESG.

5.82 The regulators will consider how best to embed diversity and inclusion into supervision processes and practice, as we monitor more closely firms' progress on diversity and inclusion as part of our supervisory approach and engagement with firms. We will also invest time to ensure we build both capability and confidence in our colleagues to constructively challenge progress.

Questions

Q28: **Do you have any suggestions on which aspects of our supervisory engagement with firms that you think could be improved to help deliver and support greater diversity and inclusion?**

Q29: **What impact do you think the options outlined in this chapter, alongside the FCA's proposals for a new Consumer Duty, would have on consumer outcomes?**

Appendix 1
List of questions

Where relevant, stakeholders are encouraged to provide examples of positive industry practices that we can learn from in their responses to the questions presented below.

Chapter 1: Overview, including context and desired outcomes

Q1: **What are your views on the terms we have used, how we have defined them, and whether they are sufficiently broad and useful, now and in the future?**

Chapter 2: The role of the regulator

Q2: **Are there any terms in the FCA Handbook, PRA Rulebook or Supervisory Statements or other regulatory policies (for any type of firm) that could be made more inclusive?**

Chapter 3: Existing requirements and expectations

No questions

Chapter 4: Measuring progress

Q3: **Do you agree that collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector? What particular benefits or drawbacks do you see?**

Q4: **Do you have a view on whether we should collect data across the protected characteristics and socio-economic background, or a sub-set?**

Q5: **What data could the regulators monitor to understand whether increased diversity and inclusion is supporting better decision making within firms and the development of products and services that better meet customers' needs?**

Chapter 5: Driving and supporting change

Q6: **What are your views on our suggestions to approach scope and proportionality?**

Q7: **What factors should regulators take into account when assessing how to develop a proportionate approach?**

Q8: **Are there specific considerations that regulators should take into account for specific categories of firms?**

Q9: **What are your views on the best approach to achieve diversity at Board level?**

Q10: **What are your views on mandating areas of responsibility for diversity and inclusion at Board level?**

Q11: **What are your views on the options explored regarding Senior Manager accountability for diversity and inclusion?**

Q12: **What are your views on linking remuneration to diversity and inclusion metrics as part of non-financial performance assessment? Do you think this could be an effective way of driving progress?**

Q13: **What are your views about whether all firms should have and publish a diversity and inclusion policy?**

Q14: **Which elements of these types of policy, if any, should be mandatory?**

Q15: **What are your views about the effectiveness and practicability of targets for employees who are not members of the Board?**

Q16: **What are your views on regulatory requirements or expectations on targets for the senior management population and other employees? Should these targets focus on a minimum set of diversity characteristics?**

Q17: **What kinds of training do you think would be effective in promoting diverse workforces and inclusive cultures?**

Q18: **What kinds of training do you think would be effective for helping understanding of the diverse needs of customers?**

Q19: **What are your views about developing expectations on product governance that specifically take into account consumers' protected characteristics, or other diversity characteristics?**

Q20: **What are your views on whether information disclosures are likely to deliver impact without imposing unnecessary burdens? Which information disclosures would deliver the biggest impact?**

Q21: **How should our approach for information disclosure be adapted so that we can place a proportionate burden on firms?**

Q22: **What should we expect firms to disclose and what should we disclose ourselves from the data that we collect?**

Q23: **What are your views on how we should achieve effective auditing of diversity and inclusion?**

Q24: **How can internal audit best assist firms to measure and monitor diversity and inclusion?**

Q25: **Do you agree that non-financial misconduct should be embedded into fitness and propriety assessments to support an inclusive culture across the sector?**

Q26: **What are your views on the regulators further considering how a firm's proposed appointment would contribute to diversity in a way that supports the collective suitability of the Board?**

Q27: **What are your views on providing guidance on how diversity and inclusion relates to the Threshold Conditions?**

Q28: **Do you have any suggestions on which aspects of our supervisory engagement with firms that you think could be improved to help deliver and support greater diversity and inclusion?**

Q29: **What impact do you think the options outlined in this chapter, alongside the FCA's proposals for a new Consumer Duty, would have on consumer outcomes?**

Appendix 2
Introduction to developing metrics

The following outlines our preliminary thinking on future diversity and inclusion metrics. It is set out in order to generate discussion and does not represent a firm view on what any future data collection exercise might look like. There are many diversity and inclusion metrics that firms can choose and best practice is that there is no standard or universal set of metrics to measure diversity and inclusion. Each company should take a personalised approach to decide which metrics they want to measure; here we set out potential steps firms may wish to consider when developing metrics. Our initial analysis suggests that most metrics can be classified into five categories to include: recruitment, retention, advancement, representation and pay; potential metrics for these are summarised in the table at the end.

Suggested steps to developing metrics

1. **Define which diversity dimensions to monitor** – most firms collect data on gender. However, diversity is wider than gender and the regulators will look to firms not to limit their metrics to data captured by existing systems. Other dimensions that firms could collect data on could include any of the protected characteristics and nationality, educational attainment, age, disability, sexual orientation, family status, carer and parental status, employment status (full time, part-time, flexible working), for example. This is something that firms can look to develop as diversity and inclusion data collection and monitoring evolves, and it will be important that firms are able to clearly explain to staff the rationale for such data, and how it will be used and stored (see Chapter 4) in order to encourage reporting.

2. **Define which inclusion initiatives to monitor** – the table below indicates what type of inclusion initiatives firms sometimes undertake and monitor in order to measure their internal progress on diversity and inclusion. We appreciate that firms can have many types of inclusion metrics which they will use internally, however, we welcome views on what data on inclusion regulators could best collect from firms.

3. **Review data policies** – defining diversity broadly will likely necessitate the establishment of new data analytics, and firms should consider the legal and ethical requirements regarding the storing of sensitive information under UK GDPR. Firms can manage this through surveys seeking voluntary disclosure of sensitive information. Firms should seek their own legal advice on this.

4. **Select metrics for three different purposes** – (i) diagnosis; (ii) tracking progress; and (iii) measuring return on investment, so as to track the impact of diversity and inclusion initiatives:

   i. ***Metrics for diagnosis*** – these are metrics that can help identify bias blind spots and can include: the broad categories of recruitment, retention, advancement, representation and pay as outlined in the table below. In relation to other metrics, we would also expect firms to include monitoring of the attrition rate, pipeline management up to the senior managers and the Board, employee development, exit interviews, grievances, to be included within the retention category.

ii. ***Metrics for tracking progress*** – metrics could help firms to identify risk areas and prioritise initiatives. Once implemented, firms should track the progress of their efforts including against any targets set. Regularly measuring progress enables an organisation to assess whether it is headed in the right direction towards the achievement of its goals. Other metrics used to track progress include membership of employee resources groups, participation rates in formal mentoring programs or sponsorship schemes, participation rates in diversity and inclusion training programs, diversity awards, positive press and employees' feelings of inclusion via staff surveys.

iii. ***Metrics for measuring return on investment*** – The focus here is on linking diversity and inclusion to performance measures, which are often (but not always) quantified as the financial benefit to the bottom line. For example, if an organisation is seeking to leverage diversity for increased innovation, relevant return on investment metrics quantifying the monetary value of increased innovation could be used. For example, how much revenue was generated by new products or services could be a way of quantifying the benefit. Firms that are focused on diversity and inclusion as a talent retention strategy could translate the results of their effort on retention into cost savings.

5. **Establish baseline measures** – it is impossible to track progress unless there is a baseline measure. The future permanent data collection will support firms and regulators to monitor progress (and some firms may have their own additional metrics). In addition, the pilot set out in chapter 4 could provide a useful initial benchmark for those not already collecting this information. This information can then be benchmarked against any future data collection.

6. **Track and analyse results** – firms should have a formal plan for measuring firm progress – what metrics will be calculated, by whom, and how often? However, merely tracking and reporting diversity and inclusion metrics is not sufficient. The resulting data should also be analysed to assess what is working and what isn't with the findings used to determine what modifications or additions to the initial action plan are required.

7. **Report results and outline new initiatives** – results of diversity efforts should be transparent internally. This fosters trust and encourages accountability. Sharing results externally can also be valuable for industry benchmarking, strengthening employer brand and an organisation's reputation in the sector. As part of the regulators' consideration of diversity, we discuss firms reporting the results of their efforts to us and also publishing some aggregated data (the type of data that we would like firms to publish will be considered after feedback is received to this Discussion Paper and consulted on in due course) for the benefit of stakeholders.

8. **Review metrics regularly** – employers should regularly review diversity and inclusion metrics, changing them as needed as the diversity and inclusion programme matures and as business goals change.

Measuring Diversity and Inclusion

Recruitment	Retention	Advancement	Representation	Pay
Number of applications interviews, hires etc. by demographic. Employees perception whether the firm is a good place for diverse talent to work. Cultivating sources of diverse talent e.g. Scholarships, career returners, internships etc.	Retention numbers, accounting for voluntary and involuntary departures by diversity characteristic. Engagement survey results on employee morale and intent to stay at the firm. Engagement survey results on employees' well being and personal resilience (including psychological safety). Inclusion training.	Promotions tracked by diversity characteristics by level. Diversity in succession plans. Parity of performance reviews. Participation in acting up, secondment or project opportunities	Percentage by level and business (including the Board and senior managers) Employees' perception of inclusion (e.g. Do you believe your opinion matters? Do you have role models at work?)	By role and tenure Base pay Discretionary and bonus pay Pay gaps

Appendix 3
Abbreviations used in this paper

Abbreviation	Description
Board	A firm's management body' or 'governing body' as these terms are defined in the glossary of the PRA Rulebook and FCA Handbook.
EBA	European Banking Authority
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FMI	Financial market infrastructure firms
FRC	Financial Reporting Council
Intersectionality	Intersectionality is formally defined as "the interconnected nature of social categorisations such as race, class, and gender, regarded as creating overlapping and interdependent systems of discrimination or disadvantage".
GDPR	UK General Data Protection Regulation
MRT	Material Risk Taker
PRA	Prudential Regulation Authority
Psychological safety	A characteristic of a healthy culture. An environment where employees feel safe to share ideas and speak up where they see issues results in more productive and innovative businesses.
SM&CR	Senior Managers and Certification Regime
SRA	Solicitors Regulatory Authority
SMF	Senior Management Function
UKRN	UK Regulator's Network

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FINANCIAL CONDUCT AUTHORITY

BANK OF ENGLAND

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk

Bank of England
Threadneedle Street, London, EC2R 8AH
Switchboard: +44 (0)20 3461 4444
Enquiries: +44 (0)20 3461 4878
Website: www.bankofengland.co.uk