



UK REGULATORS CONSULT ON MEASURES TO BOOST DIVERSITY AND INCLUSION IN FINANCIAL SERVICES

On 25 September 2023 the UK’s Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA) published consultation papers, setting out their proposals to boost diversity and inclusion to support healthy work cultures, reduce groupthink and unlock talent.

The FCA states that the measures also aim to enhance the safety and soundness of firms and improve understanding of diverse consumer needs, and that increased diversity and inclusion in regulated financial services firms can deliver better internal governance, decision making and risk management.

The FCA adds that the proposals include new rules and guidance to make clear that misconduct such as bullying and sexual harassment poses a risk to healthy firm culture. It says its guidance will help ensure firms can take decisive and appropriate action against employees for such behaviour.

Background to the consultations

The FCA states that, alongside the PRA, it is consulting on proposals to introduce a new regulatory framework on Diversity and Inclusion (D&I) in the financial sector. This

builds on its [July 2021 D&I Discussion Paper \(DP21/2\)](#), which was issued jointly with the PRA and the Bank of England. The FCA states that responses to DP21/2 were broadly positive, with most respondents endorsing regulatory action.

Additionally, the PRA stated that whilst DP21/2 recognised that the financial sector had already taken steps forward on diversity and inclusion, it also identified room for improvement, which could help individuals and firms to:



Provide advice and challenge to enable effective and prudent decision making that supports safety and soundness in firms;



Create an environment where firms can recruit from a wider talent pool and retain staff;



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 developing new markets.



Also, in April 2022, the FCA launched its [three-year Strategy](#) to improve outcomes for consumers and markets. The FCA set a number of priorities, including accelerating the pace of change on D&I. It says its latest proposals support this goal and are designed to form an integral part of the FCA's existing regulatory framework.

The FCA says it also supports the objectives of its [Consumer Duty](#), which went live on 31 July 2023, including ensuring that firms consider the needs, characteristics and objectives of their customers, particularly those who are vulnerable.

Wider developments

The FCA states that it is not alone in seeking to drive forward progress on D&I. In particular, a number of international initiatives have sought to address diversity at board level. For example, the Australian Securities Exchange has recommended that S&P/ASX 300 entities set measurable objectives for achieving gender diversity on boards.

Also, in 2022, the European Union adopted a law aiming to achieve gender balance on corporate boards. By 2026, large listed companies will be expected to ensure that the 'underrepresented sex' makes up 40% of non-executive directors and 33% of all directors.

FCA's proposals

The FCA's Consultation Paper ([CP23/20](#)): '[Diversity and inclusion in the financial sector – working together to drive change](#)', sets out proposals to better integrate non-financial misconduct (NFM) considerations into staff fitness and propriety assessments, Conduct Rules and the suitability criteria for firms to operate in the financial sector (Threshold Conditions).

It also proposes to require certain firms to report their average number of employees to the FCA on an annual basis; collect, report and disclose certain D&I data; establish, implement and maintain a D&I strategy; determine and set appropriate diversity targets; and recognise a lack of D&I as a non-financial risk.

The FCA says that the proposals would apply differently to firms depending on their number of employees, their categorisation under the Senior Managers and Certification Regime ([SM&CR](#)), and whether they are dual-regulated. To reduce regulatory burden, the FCA states that smaller firms with fewer than 251 employees would be exempt from many of the requirements (further details below).

Scope/proposed framework

The FCA proposes applying a minimum standard to all FSMA firms with a part 4A permission with the aim of reducing discrimination and misconduct.

It then proposes introducing additional requirements for firms with 251 or more employees where additional measures are more likely to be effective, for example on firms setting targets and strengthening disclosure. To align with the PRA, the FCA states that all dual-regulated Capital Requirements Regulation (CRR) and Solvency II firms will be subject to the proposals on D&I strategies. The additional requirements would not apply to Limited Scope SM&CR firms regardless of size.

The FCA says all FSMA firms with a part 4A permission, excluding Limited Scope SM&CR firms, would be required to report employee numbers to it annually on RegData, so the FCA can determine who is in scope of the additional requirements.

Additionally, the FCA states that whilst its proposals would amend the Fit and Proper test for Employees and Senior Personnel (FIT), Code of Conduct (COCON), and Threshold Conditions (COND), it is not proposing to change their scope. This means that if a firm is not currently in scope of these rules and guidance, then the proposed changes would also not apply to them.

Large firm metric

The FCA states that it identified the number of employees as the simplest and most suitable metric to define a large firm. It proposes that this threshold is set at 250 employees. So, a firm with 251 or more employees will be a large firm for the purposes of the proposed additional requirements.

In terms of applying the large firm threshold, the FCA is proposing relying on the average number of employees over a rolling three-year period as at a specified annual reference date.

If a previously small firm calculates that its three-year average is 251 or more employees, it would have 12 months from the relevant reference date to meet the additional requirements for a large firm, while if a firm's average number of employees falls below the 251 or more threshold as at their annual D&I reporting date, they would immediately fall outside of scope of the requirements for large firms.

The FCA proposes that this employee number is calculated on a solo entity basis. Additionally, the FCA says firms should review the definition of 'employee' in its glossary as it may include, for example, contractors, individuals seconded to the firm and non-executive members of the board.

Also, the FCA clarifies that for the purposes of these proposals, dual-regulated firms must calculate their number of employees by applying the definition of 'employee' in the PRA rulebook. This approach avoids the need for dual-regulated firms to consider two different definitions.

Proposals for firms of any size

In its proposals the FCA sets out to establish a minimum standard for firms of any size with the aim of reducing discrimination and misconduct. The FCA proposes to explicitly include NFM within the Conduct Rules; Fit and Proper assessments and Suitability guidance on the Threshold Conditions.

The FCA proposes to add guidance on how NFM should be incorporated into regulatory references. Its proposals would amend its Handbook to reflect the FCA's publicly expressed view that NFM is misconduct and not an additional principle.

Fitness and propriety

In CP23/20, the FCA proposes to explain in more detail how NFM forms part of the FIT section of its Handbook.

The FCA explains that currently, firms must be satisfied, on an ongoing basis, that individuals performing a Senior Management Function (SMF), or a certification function, are 'fit and proper' to carry out their role. FIT provides guidance on how firms should assess honesty, integrity and reputation and all relevant matters arising in the UK or elsewhere should already be considered. Misconduct both within and outside the workplace can be relevant for FIT and the FCA's proposals do not change this existing position.

CP23/20 proposes to explain that bullying and similar misconduct within the workplace is relevant to fitness and propriety and that similarly serious behaviour in a person's personal or private life is also relevant. The FCA proposes giving examples of NFM, such as sexual or racially motivated offences.

Conduct Rules

The FCA is proposing to make changes to the Conduct Rules by adding guidance on:

- The types of behaviour that would fall within the expanded scope of COCON, and that may breach its Conduct rules; and
- What conduct is out of scope because it relates to an employee's personal or private life.

The FCA proposes to include guidance that not every instance of misconduct towards a fellow member of the workforce will amount to a breach of COCON. Only serious misconduct would amount to a breach of COCON, and the FCA states that it provides examples of this.

Data reporting

With the exception of employee numbers, the FCA states that its proposed data reporting requirements would only apply to large firms.

For the FCA and PRA to monitor which firms are in scope of the additional requirements, the FCA proposes that all FSMA firms with a Part 4A permission with 250 or fewer employees, excluding Limited Scope SM&CR firms, are required to report their average number of employees using the same single data return on the RegData platform.

Proposals for large firms and for CRR and Solvency II firms of any size

In this chapter, the FCA sets out its additional proposals to drive positive change and progress towards its policy objectives. Policy areas include:



D&I Strategies;



Data Reporting;



Disclosure;



Setting Targets; and



Risk & Governance.

D&I Strategies

The FCA clarifies that in DP21/2 it used the term 'D&I policies' but as it wants to encourage firms to set out a proactive approach to embedding D&I across their organisation, it now proposes to use the term 'D&I strategies' in its rules instead.

The FCA proposes that firms in scope must develop an evidence-based D&I strategy that takes account of their current progress on diversity and inclusion and advances the aims set out in sections 2.1-2.17 of CP23/20.

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

To ensure effective governance and oversight arrangements are in place, a firm's board would be responsible for the maintenance and oversight of the firm's D&I strategy.

The board would need to review the strategy to ensure it remained appropriate and effective. Though at this stage the FCA doesn't propose to mandate how frequently the D&I strategy should be reviewed but firms need to be satisfied that it remains fit for purpose.



As stakeholder engagement and scrutiny will be key to the FCA's overall framework for driving and embedding ambitious progress on D&I within firms, it proposes that firms who must adopt a D&I strategy would have to make it easily accessible and free to obtain. The FCA says that making the strategy freely available on the firm's website is likely to satisfy this requirement.

Firms setting targets

In CP23/20 the FCA is proposing that firms would be required to set targets to address underrepresentation in their firms.

The FCA states that it would normally expect firms to set at least one target for each of the board, its senior leadership and the employee population as a whole (which includes the board and senior leadership).

The FCA also proposes that firms may choose to set inclusion targets on a voluntary basis in addition to the diversity targets.

When setting targets, the FCA says firms must take into account their D&I strategy and current diversity profile and that firms may want to prioritise areas of greater underrepresentation in the short to medium term so they can make more rapid progress on increasing diversity. Firms may also use their own employee networks to help identify areas of weakness.

Additionally, the FCA proposes that firms are required to consider the context in which they operate by having regard to available data on the diversity profiles of the UK population and the geographical area in which they carry out regulated activities.

The FCA does not propose to mandate which demographic characteristics the targets must cover nor what those targets should be. This approach builds on, but is different from, the FCA's approach to targets for listed firms set out in 'Diversity and inclusion on company boards and executive management' (PS 22/3) where the FCA requires disclosure against specific targets for gender and ethnicity on a 'comply or explain' basis.

Also, the FCA does not propose to determine how frequently firms must update their targets as it recognises that meaningful progress may take several years. Firms would instead need to review and update their targets regularly to ensure that they remain stretching but realistic, and to assess whether to establish targets for other underrepresented characteristics.

The FCA proposes that firms publicly disclose their targets and their progress towards them annually. This disclosure would promote transparency and allow firms and other interested stakeholders to benchmark progress.

Data reporting

For large firms, in CP23/20 the FCA is proposing to introduce requirements to:

- Annually collect and report to the regulators in numerical figures, data across a range of demographic characteristics, inclusion metrics and targets via a regulatory return;
- During the first year the requirements are in place, report such data as is reasonably practicable and explain the reasons for any gaps and how they will be closed; and
- Report data to the FCA and PRA using a single data return (referred to as REPxxx Diversity and Inclusion for indicative purposes at this stage) on the RegData platform.

The FCA proposes producing a regular aggregated disclosure report based on data that firms report to it. It says an industry D&I report would allow firms and their stakeholders to see how their progress compares to peers' and help drive progress.

The FCA also plans to integrate the data reported to it into the framework it uses to understand culture in firms. The FCA says this data would help it identify areas that could require further supervisory attention.

In terms of what to report, the FCA recognises the challenges that firms face in collecting good quality data. Some firms may not currently have systems in place to collect data against a wide range of characteristics. Others may need to continue building trust with their employees before they are comfortable sharing their personal data.

The FCA states it has carefully considered these concerns when developing its proposals and have decided to apply them only to large firms to limit any additional burden on smaller firms. In addition, the FCA proposes that firms report some data on a voluntary basis.

Mandatory demographic characteristics

- ✓ Age
- ✓ Sex or Gender (firms are required to report on either Sex or Gender. Firms may choose to report on both Sex and Gender on a voluntary basis.)
- ✓ Disability or long-term health condition(s)
- ✓ Ethnicity
- ✓ Religion
- ✓ Sexual orientation

Voluntary demographic characteristics

- ✓ Sex or Gender (firms are required to report on either Sex or Gender. Firms may choose to report on both Sex and Gender on a voluntary basis.)
- ✓ Gender identity
- ✓ Socio-economic background
- ✓ Parental responsibilities
- ✓ Carer responsibilities

The FCA explains its rationale to make reporting against certain demographic characteristics voluntary is based primarily on the responses to its 2021 pilot data survey, which indicated that less than 50% of large firms currently collect data against parental or carer responsibilities, gender identity, or socio-economic background.

Over time, the FCA states it expects to see increasing numbers of firms reporting data against voluntary metrics. And to that end, it may consider moving to mandatory reporting against these demographic characteristics at a later date.

The FCA proposes that the data is reported to it in three categories: board, senior leadership and all employees (including the board and senior leadership).

In addition to reporting demographic data, the FCA proposes that firms report to it and the PRA on a selection of inclusion metrics. This is because the FCA considers that the full benefits of diversity can only be realised in an inclusive environment that uses the capabilities of a diverse workforce.

The FCA proposes firms report to it annually on the following measures of inclusion. This data should be reported on a five-point scale of strongly agree to strongly disagree, including a neutral option. The measures are whether employees feel:

- Safe to speak up if they observe inappropriate behaviour or misconduct;
- Safe to express disagreement with or challenge the dominant opinion or decision without fear of negative consequences;
- That their contributions are valued and meaningfully considered;
- They are subject to treatment (for example actions or remarks) that had made them feel insulted or badly treated because of their personal characteristics;
- Safe to make an honest mistake; and
- That their manager cultivates an inclusive environment at work.

The FCA states that data on inclusion must be captured on an anonymous and voluntary basis and should always include a response option to 'prefer not to say'.

The FCA also proposes using the regulatory report to monitor large firms' progress against targets they have set for themselves. This information would inform the FCA's understanding of how firms are applying its proposed rules, including addressing areas of underrepresentation.

The FCA proposes that firms would report data to it annually and are also proposing that its rules on reporting come into force 12 months from the publication of final rules.

Additionally, the FCA proposes a transitional regime so that the first reporting cycle would be on a 'comply or explain' basis, to better enable firms to establish the necessary processes.

Data protection considerations

The FCA says firms should ensure any collection or reporting of diversity data complies with data protection legislation where personal data is processed for the purpose of being shared with the regulators.

Further, the FCA says it has reviewed its proposed requirements on data collection, reporting and disclosure against the UK GDPR. The FCA considers its proposals to be consistent with its obligations under the legislation. The FCA states it has also consulted with the Information Commissioner's Office, in line with Article 36(4) of the UK GDPR, and it had no comments.

Data disclosure

In CP23/20 the FCA are proposing that firms make public disclosures on D&I data to increase transparency and scrutiny, as well as facilitate comparisons between firms on D&I performance.



The FCA proposes that firms disclose the same information that they report to it in the proposed reporting requirements (set out in CP23/20) except in percentages rather than whole numbers.

The FCA says firms are not required to make disclosures that breach any laws applicable in the UK or the laws of another jurisdiction, including the UK GDPR, though it is up to firms to make an assessment based on their specific circumstances.

The FCA says firms would make disclosures on an annual basis. It proposes that its rules on disclosure come into force 12 months after it publishes final rules. In the first year of its rules being in force, firms can make their disclosures on a voluntary basis. From the following year onwards, disclosures are mandatory for firms in scope.

Risk and governance

In CP23/20 the FCA are proposing to introduce new guidance for large firms to make clear that matters relating to D&I are to be considered as a non-financial risk and treated appropriately within the firm's governance structures.

The FCA wants firms to consider how a range of relevant functions can contribute to progress on D&I. Risk functions, for example, should consider potential risks stemming from a lack of D&I such as increased groupthink and poor decision making, which can affect outcomes for consumers and markets.

The FCA wants to give firms significant flexibility to implement this proposal in a way that is aligned with their internal governance structures. The FCA adds that this means it is not proposing to prescribe how firms consider these risks.

PRA's proposals

For details on the PRA's proposals, relevant firms can find these in [CP18/23 – Diversity and inclusion in PRA-regulated firms](#).

In terms of topics consulted on, firm-wide strategies; monitoring diversity and inclusion and individual accountability is applicable to all CRR and Solvency II firms with respect to their establishment in the UK, including third country branches.

Board governance is applicable to all CRR and Solvency II firms with respect to their establishment in the UK, excluding third country branches.

Targets, regulatory reporting and disclosure are applicable only to those CRR and Solvency II firms (including third country branches) with 251 or more employees who are predominantly carrying out activities from an establishment in the UK.

Finally, no proposals apply to non-CRR and non-Solvency II firms (e.g., credit unions and friendly societies).

Next steps

The FCA says that flexibility is at the heart of its proposals. Each firm is different, so they need to come up with their own solutions. Most of these requirements, including setting targets, regulatory reporting and disclosure, would only apply to the largest firms.

CP23/20 is open until 18 December 2023. The FCA reminds firms that the PRA has published its own proposals at the same time as CP23/20 and it has the same deadline for response. The FCA says it has worked closely with the PRA to develop a consistent and coordinated set of proposals for consultation.

The FCA proposes to bring its rules into force 12 months from publication of the Policy Statement. This is to allow firms time to improve existing policies where necessary, or to develop and implement new policy, governance, oversight and data collection processes.

Please contact for further details:

David Morrison

Global Head of Trustee and Fiduciary Services
david.m.morrison@citi.com
 +44 (0) 20 7500 8021

Ann-Marie Roddie

Head of Product Development Fiduciary Services
annmarie.rodzie@citi.com
 +44 (1534) 60-8201

Amanda Hale

Head of Regulatory Services
amanda.jayne.hale@citi.com
 +44 (0)20 7508 0178

Caroline Chan

APAC Head of Fiduciary Business
caroline.mary.chan@citi.com
 +852 2868 7973

Shane Baily

EMEA Head of Trustee and Fiduciary Services
 UK, Ireland and Luxembourg
shane.baily@citi.com
 +353 (1) 622 6297

Jan-Olov Nord

EMEA Head of Fiduciary Services
 Netherlands and Sweden
janolov.nord@citi.com
 +31 20 651 4313

www.citibank.com/mss

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