

DIVERSITY AND INCLUSION IN THE FINANCIAL SECTOR: REGULATORS CONSULT ON IMPORTANT CHANGES

Following previous work in this area, both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) have published consultations¹ on diversity and inclusion (D&I) in the financial sector, including insurance. Although there is some time until implementation, it is important that insurers, and other financial services firms, are aware of the proposals and start considering what further steps will be required to comply now. In this article we outline some of the key proposals².

Firm-wide strategies

Whilst existing PRA rules require most firms to have a board-level diversity policy, the PRA proposes to introduce a requirement for these firms to have and publish a firm-wide policy promoting diversity and inclusion amongst all its employees. As a minimum, the policy must set out: the firm's core values and culture it is trying to create; clear objectives and goals for improving D&I and ways of measuring progress; and the role of the firm and staff in fostering an open and inclusive environment.

The strategy will form the foundation of a D&I action plan and the PRA would expect the strategy to be owned by the senior leadership and board. The D&I strategy must be supported by the appropriate risk and control functions at the firm, and for these functions to consider how effectively D&I practices are embedded.

The PRA proposes widening the requirement for a policy promoting diversity on the board to a strategy promoting both diversity and inclusion, and for this to be published alongside the firm-wide strategy. Supervisory Statement SS5/16 will be extended so firms must apply D&I strategies to board sub-committees. The PRA will also clarify that when considering succession planning³ upcoming appointments should be considered in the context of diversity. Boards will also be expected to have an explicit collective responsibility to set and oversee the firm's D&I strategy, and will be expected to monitor D&I progress and hold management to account. If achievement against D&I goals is not already taken into account in management level appraisals, it should be going forward.

Targets

Although certain firms are already required to set gender-related board targets, the PRA will extend this rule to require the largest UK firms to set targets for underrepresented demographic groups more widely as appropriate for the circumstances of the institution. Further, the nomination committee will not decide on a target, but will recommend a target to the board.

The largest firms (those with 251 or more employees predominantly carrying out activities from an establishment in the UK)⁴ will need to set diversity targets for the board, senior leadership, and throughout the employee pipeline, and targets must be set for women and ethnicity at a minimum. However, it will be for a firm to decide what underrepresentation looks like for their context and exactly what targets to set and for which other demographic characteristics. Firms may also wish to set targets to improve their inclusion metrics.

¹ [CP23/20: Diversity and inclusion in the financial sector – working together to drive change \(fca.org.uk\)](#)

[CP18/23 – Diversity and inclusion in PRA-regulated firms | Bank of England](#)

² Exactly how the proposals apply depend on a number of factors including the size of the firm.

³ Covered in SS5/16 which highlights the importance of boards having succession plans that consider skills, effectiveness and experience of members and recognise future business needs and requirements.

⁴ Referred to in the Glossary as the "diversity and inclusion employee number threshold".

The strategies and targets must be publicly available, as well as the rationale for setting them and reports on the progress towards them, together with D&I data.

Reporting

Larger firms must report to the regulators on the number of employees, various diversity statistics and inclusion metrics. Targets and policy for achieving them, and progress against targets must also be reported. The PRA has indicated that it will use the data to publish an aggregated benchmarking report on regulated firms.

Non-financial misconduct

It is noted in the consultations that the regulators already consider certain non-financial misconduct within the relevant regulatory rules and the vast majority of firms understand and consider such conduct in their own assessments. The aim of the proposed amendments is to give more certainty in this area.

In addition, after recent high-profile cases of alleged serious non-financial misconduct by individuals working in regulated firms, the FCA is also motivated by a desire to restore public confidence in the financial system in the UK. In their view, public confidence is damaged when individuals commit serious non-financial misconduct whether inside or outside the workplace.

Non-financial misconduct will be relevant as follows:

- Firms must be satisfied that individuals performing a Senior Management Function (SMF) or a certification function are "fit and proper" to carry out the role. Although guidance in the FCA FIT section of the Handbook already sets out that firms should assess honesty, integrity and reputation, the FCA will explain that bullying or similar misconduct in the workplace is relevant as well as similarly serious behaviour in a person's private life, (such as domestic abuse) and will give examples such as sexual or racially motivated misconduct. The PRA will⁵ also take into account established patterns of an individual's behaviour that would be likely to affect a firm's safety and soundness.

The FCA will expand the scope of the Code of Conduct Sourcebook (COCON) to make clear that serious instances of bullying, harassment and similar behaviour towards fellow employees will be a breach of the rules⁶.

- The FCA proposes to add guidance to the Handbook on how non-financial misconduct in relation to other members of the firms' workforce or in relation to someone outside the work context, should be incorporated into regulatory references. This is in line with the FCA's position that non-financial misconduct is misconduct and not its own separate lesser category.

Non-financial misconduct - the challenge for firms

The FCA states that the guidance will give firms the reassurance to take decisive and appropriate action against employees. However, firms should act with speed but not haste when an allegation of non-financial misconduct (whether inside or outside the workplace) concerning an employee comes to light, given the serious implications (which could be career-ending) for an employee found by the firm to lack fitness and propriety or to be in breach of the Conduct Rules.

It is crucial that the firm undertakes a thorough and fair investigation which is compliant with employment law and the ACAS Code on disciplinary and grievance procedures to ensure any decision to take disciplinary action is reasonable and can be justified later, for example if the employee whom action was taken against brings a claim for unfair dismissal.

Undertaking an investigation involving highly sensitive issues such as bullying, harassment, discrimination or sexual misconduct can be a minefield for firms. In cases concerning very serious, or a large number of, allegations, assembling a team including HR, senior management, compliance, external counsel and PR, is advisable to mitigate against the legal, regulatory and reputational risks.

Ahead of the new guidance coming into effect, firms should ensure HR, compliance and senior managers are fully up to speed with the regulators' expectations on how non-financial misconduct should be addressed. Codes of conduct and disciplinary and whistleblowing policies and procedures should also be reviewed and if necessary updated and communicated to employees so that the standards of expected behaviour and the implications for

⁵ By update to SS35/15 and SS28/15.

⁶ FCA guidance will include where conduct is out of scope because it relates to an employee's personal or private life.

falling short (inside or outside the workplace) are clear, as are the non-retaliatory means of reporting such legitimate concerns.

What is not happening

The regulators have listened to feedback from previous consultations and some of the more unpopular proposals will not go ahead. For example, the FCA will not take forward the withholding of Senior Management Function (SMF) approval due to a lack of diversity, and it will not mandate D&I training, although we assume that most firms already have a regular programme of D&I training in place, as not having one in place would prevent a firm putting forward the 'reasonable steps' defence when defending an Employment Tribunal claim for discrimination or harassment. The FCA will also not make changes linking remuneration to non-financial metrics such as D&I but may consider a wider review of remuneration policy at a later date.

Next steps

Both consultations close on 18 December 2023. Both regulators indicate that the new rules will come into effect one year after publication of the final policy.

For more information, please contact the authors of this alert



MICHELLE CHANCE

Partner, London

T +44 (0)20 7264 8384

E michelle.chance@hfw.com



LYDIA CAMMIADE

Associate, London

T +44 (0)20 7264 8011

E lydia.cammiade@hfw.com



WILL REDDIE

Partner, London

T +44 (0)20 7264 8758

E will.reddie@hfw.com

hfw.com

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