Consultation Response

FCA CP23/20 - Diversity and Inclusion in the Financial Sector – Working Together to Drive Change

15 December 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on **FCA CP23/20 DIVERSITY AND INCLUSION IN THE FINANCIAL SECTOR – WORKING TOGETHER TO DRIVE CHANGE**. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

AFME and its members strongly believe in the benefits of a diverse workforce and inclusive workplaces and are supportive of initiatives to support Diversity and Inclusion (D&I) in the financial sector. We welcome the regulatory focus on this issue and the intention of the FCA and PRA to assist firms in striving towards improvements in this area.

In relation to the specific proposals made by the FCA and PRA, AFME would like to highlight the following key points from our consultation response:

- We encourage the regulators to consider how the definitions used in these proposals could be better aligned with existing definitions, for example under UK Equality and Employment law, and how ambiguities can be removed.
- The FCA and PRA's proposals would introduce a very significant data collection, reporting and disclosure regime. While robust data can be an important tool to support D&I strategies within firms, there is strong concern that these proposals may lead to an overemphasis on data as an end in itself. In addition, there are concerns about some of the individual demographic characteristics in relation to how they are defined and how they will be used.
- Members are concerned by the suggestion in the papers that high numbers of individuals who "prefer not to say" or did not respond to a request for diversity data could indicate a lack of trust or inclusiveness. There will be many good reasons why the data sets generated by firms will be partial and reassurance is sought that this will not be grounds to make inferences about trust, culture or psychological safety within individual firms or the sector as a whole.
- We are concerned that the UK solo entity approach, while understandable from the FCA and PRA's perspective, will present challenges for many of our members who are part of wider, global groups.

These range from tensions between setting UK-only strategies in a group context to potential duplication or conflict with existing programmes or data collection. It should also be considered that many firms drive initiatives such as D&I via group resources, rather than having dedicated jurisdictional teams. D&I is an important topic that should be considered across the entirety of an organisation rather than in a siloed manner.

- We welcome the FCA's intention to clarify how non-financial misconduct should be treated under FIT and COCON. However, we raise a number of areas in which further clarification on the scope of the rules and the regulators' expectations would be welcome.

We remain available to discuss in more detail any areas of our response.

Questions

Q1: To what extent do you agree that our proposals should apply on a solo entity basis?

AFME notes that applying the FCA's proposals on a solo entity basis could, for firms that operate through multiple legal entities, result in a fragmented approach to reporting, disclosure and D&I strategies. This may be further complicated by the fact than an individual contractually employed by one group entity may in fact be performing services for multiple group entities. We are concerned that public disclosure on a solo entity basis may provide a distorted view of a firm's UK population, which will add to the risk that disclosures could be misinterpreted (see also our comments under Q14 on lack of contextual information in disclosures).

Further to this, firms' hiring practices may vary considerably, including country-level or business line-driven hiring as well as entity specific hiring. Strategies, data, targets and disclosures need to be aligned with hiring practices to be most effectively implemented, and to reflect the realities of firms' workforce. For firms with multiple UK authorised entities, we request that the FCA considers permitting firms to consolidate strategies, reporting and disclosure at the level appropriate for their organisation, including across these entities where appropriate, as an alternative to reporting on a solo entity basis. This would also have the advantage of allowing firms to leverage existing structures, governance and processes to develop and execute their strategies in line with their approaches to business and organisational strategies, which is likely to produce significantly more effective outcomes. We do not consider the risk of such an approach masking underrepresentation at an individual firm to be material, given the global / regional approach firms typically adopt when addressing D&I topics.

In addition, this presents challenges for UK branches and subsidiaries on which we would welcome further dialogue. As noted in our response to Q7, strategies on areas such as Diversity and Inclusion (D&I) are often set at a group level and may apply group-wide or on a divisional or regional (e.g. EMEA) basis. The extent to which branches and subsidiaries may be able to influence these strategies and the setting of any accompanying targets may, therefore, be limited and they may face the tension of moving away from consistent group targets and reporting methodology impacting overall effectiveness of global initiatives, or of having to provide for dual targets, collation and reporting methodology risking unnecessary cost and declining engagement resulting from different processes with ultimately similar aims.

Q2: To what extent do you agree with our proposed proportionality framework?

AFME has no comments in response to this question.

Q3: Are there any divergences between our proposed regulatory framework and that of the PRA that would create practical challenges in implementation?

We note some divergences between the FCA's and PRA's proposed frameworks that could create practical challenges in implementation for dual-regulated firms. For example, the FCA does not require firms to assign Senior Manager responsibility for D&I, whereas the PRA's consultation (CP18/23) proposes to state that D&I will form part of the Prescribed Responsibilities (PRs) for Culture, which are generally assigned to the Chair and Chief Executive Officer (CEO). Members are of the view that allocating responsibility for implementation of D&I strategies across the firm to the CEO (per the PRA's proposal) may be inconsistent with the arrangements that many firms have put in practice, whereby a Senior Manager other than the CEO has been specifically assigned responsibility for D&I. However, we appreciate that some firms will be happy to include D&I under the Culture PRs. We therefore support the FCA's approach that firms should be given flexibility to assign D&I responsibility as per their internal allocation of responsibilities, which may or may not involve the Culture PRs. In parallel, we also support the FCA's statement that all Senior Managers should have some responsibility for the implementation of the D&I strategy within their individual areas of control.

Whilst the assurances that a failure by the relevant Senior Manager to move the dial on D&I within their firm will not necessarily amount to a breach of their relevant responsibilities (as long as reasonable steps can be demonstrated) it is important to recognise that this is a deeply challenging area in which meaningful change can take years. Greater clarity and guidance around the types of 'reasonable steps' the PRA expects to see here would help support Senior Managers.

In relation to the above point, we also request that any changes to the Senior Managers Regime and consulted on and made under the Senior Managers Regime rules, rather than as part of a separate consultation. This will ensure a consistency of approach and ensure that there is a single, consistent reference point for firms in relation to the Regime's application.

In addition, we note that the PRA has taken a more prescriptive approach to setting targets for increasing diversity, by mandating targets for women and ethnicity (CP18/23 paragraph 3.6) at a minimum, whereas the FCA simply states that firms should set at least 1 target for each of the board, its senior leadership and employee population. While it may be that the majority of firms set targets for gender and ethnicity, we support the FCA's more flexible approach (noting the existing 'comply or explain' approach to these targets in the rules for listed companies introduced in FCA PS22/3). This will allow firms to assess their individual positions and any specific challenges, in the context of factors such as group structures and talent markets, and to set bespoke targets appropriately.

Q4: To what extent do you agree with our definitions of the terms specified?

Employee

We note that the proposals take their definition of employee from the FCA Handbook/PRA Rulebook and not from employment law. This will capture a wider range of individuals, including contractors and overseas staff seconded to the UK, which is likely to present specific challenges. For example, contractors may be less willing to disclose personal information to a temporary employer, potentially contributing to non-response rates. Collecting data on staff seconded or recruited from overseas may also be particularly challenging and require a bespoke process, with difficulties being exacerbated by cultural norms and/or employment law in the individual's country of origin. We also note under Q1 the additional complexity of individuals being contractually employed by one entity but performing services across additional group entities. Therefore, we request that the FCA considers whether the definition of employee could be amended so as to not require collection and reporting of data for certain categories of staff (e.g. secondees or contractors.

Demographic Characteristics

As noted under Q10, there are issues with the definitions of a number of the demographic characteristics, most notably socio-economic background (the definition for which risks being overly narrow) and disability (which includes long-term health conditions).

Senior Leadership

We note that the definition for Senior Leadership does not align with the approach taken by the well-established Women in Finance Charter (WIFC)[1], in which firms are given the flexibility to use their own definition according to their internal structure. We understand that the FCA's proposal would bring consistency across firms, allowing greater comparability of data. However, markers of seniority differ by firm, for example some currently define their WIFC population by job title, whereas for other firms a reporting line approach is taken. These approaches are also generally applied group-wide and so may not be determined from within the UK. Requiring firms to use one approach over another will result in a significant proportion of firms having to redesign HR systems or introduce manual workarounds, each of which comes with a cost. Mandating a single approach, particularly based on reporting lines, will also result in too many or too few employees being captured in some firms. We encourage the regulators to consider whether this additional complexity and cost to firms will be worth the marginal benefit to their data analysis.

Non-financial misconduct

The proposed changes to COCON to deal with non-financial misconduct also contain terms with potentially conflicting definitions, or in some cases no known legal definition – e.g. 'bullying' and 'harassment' in the draft COCON rules and guidance. The FCA's proposed amendments to COCON use the term 'bullying' as an example of behaviour by a member of conduct rules staff in relation to a fellow member of the workforce that will breach Conduct Rule 1, however the proposed rules do not give any context as to its meaning. 'Bullying' is not a defined term in a legal or employment sense. Organisations typically seek to have their own definitions of bullying in HR policies to help manage disciplinaries, grievances and workplace conflicts, but there is no legal claim for bullying and no formal legal definition. There is a real risk that references to 'bullying' in a regulatory context will be interpreted inconsistently with the way regulated firms are currently using this term in the employment and HR context, including in their own policies.

Workplace harassment is defined in the Equality Act 2010 as unwanted conduct related to a relevant protected characteristic, which has the purpose or effect of violated the intended target's dignity or causing them to experience an intimidating, hostile, degrading, humiliating or offensive environment. It also includes sexual harassment and discrimination as a result of harassment. Under criminal law, harassment requires behaviour intended to cause a person alarm or distress occurring on more than one occasion. AFME considers that, when using the term harassment in relation to non-financial misconduct, any definition proposed by the FCA for the purposes of COCON should mirror that found in the Equality Act. The use of the term "intention" should also match the relevant employment test here, which does not appear to be the case in the current draft rules (COCON 4.1.1I). Otherwise, there is a real risk that the relevant standard is either confused with the criminal definition of harassment or misunderstood entirely. People may claim they have been "harassed" or "victimised" where the treatment they have received does not meet the test under either the Equality Act (for example because it is not based on one of the nine protected characteristics) or criminal law.

[1] https://www.gov.uk/government/publications/women-in-finance-charter

Q5: To what extent do you agree with our proposals to expand the coverage of non-financial misconduct in FIT, COCON and COND?

On the changes to the Suitability Threshold Conditions, further guidance would be welcome as to the FCA's own assessment threshold. For example, we assume that a single incident would be treated differently from a pattern of behaviour. It is also unclear how far back the FCA will go in considering past incidents as part of a patterns of behaviour. Finally, for UK branches of third country groups, clarity is requested as to whether incidents in other, non-UK parts of the group might be taken into consideration.

In relation to the expansion of the Fit & Proper assessment and Conduct Rules to cover non-financial misconduct, AFME generally welcomes the provision of more detailed guidance from the FCA. To date, there has been uncertainty as to how to treat non-financial misconduct, resulting in inconsistent approaches across the industry. The proposed guidance is generally helpful in its provision of detailed examples and the way in which it distinguishes between different types of role. However, there remain some issues with the FCA's proposals, which we set out below.

As regards the amendments to FIT, we consider the guidance in 1.3.9-1.3.17 is overly elaborate and arguably too specifically driven by a desire on the part of the FCA to respond to the particular circumstances and findings of the Upper Tribunal in *Frensham v FCA*. The facts and circumstances of future cases will inevitably be different and it would in our view be more appropriate to make more principles-based amendments to FIT to address this. We also question the feasibility or appropriateness of requiring firms or the FCA to make judgments regarding "moral soundness, rectitude and steady adherence to an ethnical code" (per 1.3.12G(5)) or whether conduct is "disgraceful or morally reprehensible" (per 1.3.15G(1)). Lastly, we consider that there are real challenges for firms in relation to the practical implications of this guidance – e.g. as regards the extent of any diligence required to establish whether any such allegations/concerns exist (beyond the standard screening processes and declarations that firms generally require currently) and, where such concerns arise in relation to conduct which took place in an individual's personal life or prior to them joining the firm, what firms can realistically do to investigate and/or reach conclusions in relation to allegations where they are contested.

As regards the amendments to COCON:

- First, we are concerned by the proposed amendment to COCON 1.1.7F and COCON 4.1.1B which expands upon the kind of conduct to which the Conduct Rules apply for solo-regulated firms. The expansion of the application of COCON includes not only the definition of harassment under the Equality Act, but without any linkage back to a protected characteristic, but also any offensive, unreasonable or degrading conduct introduces a series of tests which have no definition in either the regulatory rules or in employment law. COCON 4.1.1B-C refers to conduct which is inconsistent with an employee feeling *"valued and able to give their best"* as potentially a breach of Conduct Rule 1, whilst 4.1.1F gives an example of *"causing… distress to a fellow member of the workforce"* as potentially amounting to a breach of Conduct Rule 1, but this is likely to be too low a threshold for a Conduct Rule Breach. In addition, how an employee feels is subjective, based on their own perception and may not necessarily reflect how they have been treated. It is also possible that investigations may not substantiate allegations driven by how people feel, but their feelings remain. We therefore propose that COCON 4.1.1BG be reconsidered and COCON 4.1.1BG(1) removed.
- Second, the proposed guidance that conduct in breach within COCON 1.1.7F is only a breach of COCON if it is 'serious' risks creating confusion, subjectivity and uncertainty, with likely consequent inconsistency. The factors listed at COCON 4.1.1D do not align with how firms assess or seek to quantify seriousness or gross misconduct in an employment law context. Given that, in most scenarios, firms will need to have taken disciplinary action (as defined) before a breach reporting obligation is

triggered, is the seriousness test to be interpreted as meaning that there may be situations where a firm has issued a written warning or another disciplinary sanction for non-financial misconduct but the conduct itself may not be sufficiently serious to amount to a breach of the Conduct Rules? If the FCA has a different intention, clarity would be useful. Further, the test of seriousness in this context appears to be different from the use of that term in other, related, contexts – e.g. the test for assessing whether conduct more than six years old needs to be referenced in regulatory reference. It is unclear why seriousness has been used as a limitation for this type of Conduct Rule breach, but not for other forms of conduct in scope of COCON (particularly given the existing guidance in COCON 3.1 for assessing personal culpability).

- Third, a concern has been raised that readers could interpret the extension of scope of the FCA's FIT and COCON rules for solo regulated firms as being an expansion of scope for dual-regulated firms as well. This could lead employees who have been deemed to have breached COCON rules based on non-financial misconduct seeking to have their cases reviewed or overturned. It would be helpful for the regulators to set out clearly and explicitly that this is only an expansion of the scope of activities to which COCON applies for FCA solo-regulated firms and not for dual-regulated firms (even if additional guidance is now included regarding whether conduct is or is not related to their private / personal life – as to which see below).
- Fourth, the proposed amendments to COCON 1.3 which seeks to delineate whether conduct is within the scope of COCON (or out of scope because it relates to an individual's private or personal life) is overly complex and will be difficult to apply in practice. It also risks creating new boundaries which will could lead to inconsistent outcomes and be difficult to judge. For example, it will be challenging for investigations to determine whether a social occasion was organised in a personal capacity. The guidance also appears to be inconsistent with the approach taken in employment law, which focuses on whether the conduct took place *"in the course of employment"*. We suggest it would be preferable for the regulators to adopt the definitions used in employment law or, if broader, the scope of application used by firms in their own dignity at work or equivalent policies.
- Fifth, we reiterate the concern raised within AFME's response to the recent consultation on the SMCR Review[2] that it is not clear to what extent the regulators consider a Conduct Rule breach to effectively end an individual's career within the industry. This is most pertinent for breaches of Individual Conduct Rule 1, which many firms consider to be the most serious breaches and often incompatible with continued employment of an individual. We note that a recent speech by Emily Shepperd[3] suggested that firms should think very carefully about employing individuals with such breaches on record, a point which the proposed updates to COCON (particularly the expansion of Individual Conduct Rule 1) will only serve to amplify. The feedback from the FCA appears to be at odds with comments made by the PRA in its 2020 evaluation of the SMCR[4], where the PRA said "*One point that was apparent from discussions with firms was nervousness about hiring individuals who had an adverse comment on their reference, and a corresponding sensitivity on the part of employees to such comments. It is clearly for firms to exercise judgment in dealing with the information they receive. The SM&CR was not established to eliminate all mistakes or errors of judgment, especially as individuals can learn from these. There is therefore a case for the PRA to engage with external stakeholders to determine if there is a danger that regulatory references, in some cases, may be being used in ways that are unnecessarily punitive*".

[2] https://www.afme.eu/Portals/0/DispatchFeaturedImages/240531%20PRA-FCA%20DP1.23%20SMCR%20Review%20final%20.pdf
[3] https://www.fca.org.uk/news/speeches/cultural-evolution-how-culture-must-change-meet-expectations
[4] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/report/evaluation-of-smcr-2020.pdf

- Lastly, greater clarity on the consideration of non-financial misconduct for Conduct Rule 2 would be helpful. While firms may conclude that conduct in line with the examples set out in 4.1.1 F G but which meet the criteria set out in 4.1.1 I G (1) could be considered to be breaches of Conduct Rule 2, this is not completely clear, and to ensure consistency of implementation across industry, further specific guidance on what would constitute a Conduct Rule 2 breach (for employees not in the same line management). The proposed guidance in COCON 4.1.1 I G (1)(b) lists some helpful factors to delineate between breaches of Conduct Rules 1 and 2. However, the terms "intention" and "reckless" could pose substantial difficulties to implementation in practice. These are complex legal terms which compliance officers in financial services firms may find challenging to apply in live cases. Furthermore, determining intent is a difficult enough task for courts and other formal judicial processes, and will be extremely challenging for firms in practice. We would encourage the FCA to find an alternative approach to delineating between Conduct Rules 1 and 2 without using terms such as intent and reckless

Q6: To what extent do you agree with our proposals on data reporting for firms with 250 or fewer employees, excluding Limited Scope SM&CR firms?

AFME has no comments in response to this question.

Q7: To what extent do you agree with our proposals on D&I strategies?

AFME supports that every firm should have a strategy to promote and support D&I. However, there are a few points of clarification that would be welcome.

We note that under the FCA's proposed SYSC 29.2.4 *"A firm's management body is responsible for: (1) maintaining and overseeing the firm's diversity and inclusion strategy…"*, which is mirrored in the PRA's proposals (CP18/23 paragraph 4.7). However, we suggest that there in fact are two different sets of responsibilities which could be distinguished more clearly here (1) setting a strategy and overseeing its implementation and (2) developing proposals for approval by the management body, and implementation of the approved strategy. (1) should be assigned to the management body (encompassing non-executive functions), whereas (2) should be assigned to the executive function.

We would also welcome an approach similar to that taken by the PRA in paragraph 2.6 of CP18/23, which recognises that branches subject to a group-wide D&I strategy may have to tailor their strategies to cover only "*relevant aspects…with regard to the UK operations*".

As noted in Q1, for international firms operating in the UK with multiple legal entities, D&I strategies would also be most effective if firms have the flexibility to both develop and oversee them in a way best suited to their organisation, including doing so at a consolidated level, which may include group led initiatives which broadly meet the aims of the FCA and PRA as set out in their respective consultation papers.

Given the expectation that D&I strategies should be data-led, we suggest that the FCA considers allowing for this in the timing of implementation of this aspect of the proposals. While all firms currently collect some data on their employee populations, these proposals represent a significant new data collection undertaking (see our comments under Q10 below). It would therefore be more appropriate for this data collection to be embedded before new strategies are required and a % threshold for data collection set. This would also apply to target setting under Q8 below.

Finally, on a practical level, many UK firms and branches do not have their own website – clarity would be welcome as to where they should publish their D&I strategy.

Q8: To what extent do you agree with our proposals on targets?

In relation to the use of the word "targets", we note that this term may be associated with hard minimum limits or may be at risk of conflation with "quotas".

Both regulators have noted in the consultation papers that the proposals for firms to set and disclose data-led and evidence-based targets for underrepresented groups would not breach provisions of the UK Equality Act 2010. However, in reality, the circumstances in which an employer can take positive action lawfully, without this amounting to unlawful positive discrimination, can be limited and restrictive, and there are nuances that employers must understand in how they achieve these targets. Whilst the setting of targets per se might not be unlawful under the UK Equality Act where these are aspirational in nature, the measures which an employer might take to achieve those targets could amount to unlawful positive discrimination.

This is a very difficult area for employers, particularly global employers, in light of the ongoing scrutiny over the use of affirmative action programmes in the US following the recent US Supreme Court decision in *Students for Fair Admissions v Harvard University and the University of North Carolina.* Whilst that decision applies to the higher education sector in the US and not private employers, it remains to be seen whether and precisely how the decision will impact the way in which courts decide discrimination and reverse discrimination (i.e. positive discrimination) claims in an employment context in the US. Given the ongoing scrutiny over the use of affirmative action programmes in the US, global employers may be nervous of the impact of this landscape on its UK operations, particularly with target setting as proposed by the regulators.

It would be helpful if the FCA could introduce additional guidance stating that (1) targets are not intended to operate as quotas or to require firms to act in a manner which would be unlawful; and (2) firms may choose to use more neutral terms such as "aspirational goals" when referring to these targets internally or in their published strategies.

As noted in Q1, there are challenges for UK branches and subsidiaries of overseas headquartered firms, who may not have the ability to influence strategic decisions that are generally made and implemented at a regional or global level. Setting targets at a branch level or UK entity level may be challenging in a group context.

As also noted in Q1, for international firms operating in the UK with multiple legal entities, D&I strategies would be most effective if firms have the flexibility to both develop and oversee them in a way best suited to their organisation, including doing so at a consolidated level.

There is also confusion as to how the FCA's proposals are to be operated alongside the existing WIFC, which is well established and benefits from significant public awareness but which has different requirements. We note under Q4 above that the definition of Senior Leadership under the FCA's proposals is unhelpfully prescriptive compared with the WIFC's flexible approach. Consequently, the two populations will be different, which is likely to cause confusion for anyone consuming or comparing the data disclosed. However, if the FCA's proposals are intended as a successor to the WIFC, this should be made clear and an end date for the Charter announced. Collecting and reporting against two overlapping but distinct requirements is likely to be administratively burdensome, time consuming and confusing.

Finally, we refer back to our comment under Q7 above on the need for the new data collection requirements to be embedded and a % threshold for data collection set before they can effectively feed into D&I strategies and target setting.

Q9: To what extent do you agree with the date of first submission and reporting frequency?

We appreciate the FCA's flexibility in providing a 3-month window for firms to submit data. However, we encourage the FCA to consider how this new reporting obligation fits within the wider landscape of reporting

obligations for firms. For example, firms already have annual reporting at financial year end, gender pay reporting at the end of the tax year[5] and reporting for the WIFC (see also Q4 and Q8 above) by end-September. Firms may also have additional reporting deadlines driven by group-level requirements, or may need to adjust their data collection timelines to fit around other group data collections or surveys. A key concern for our members in this respect is the EU Corporate Sustainability Reporting Directive[6], for which the first report is due in 2025 and for which the required data are extremely granular, necessitating the creation of specific new data collection processes and systems. While we appreciate that the UK regulators cannot be beholden to deadlines within in other jurisdictions, the introduction of another – annual - reporting deadline will further complicate this reporting landscape and will increase the resource requirement for firms.

Therefore, we request that the FCA considers (1) the timing of the first submission date and (2) the annual reporting deadlines. In relation to the latter, we request consideration of whether there could be greater formal alignment of reporting deadlines (such as the 5th April gender pay reporting deadline), or the option for firms to report well in advance (i.e. more than 3 months) of a final annual deadline in order to voluntarily align with existing obligations.

We also note our comment under Q10 below that annual reporting may place too much pressure on firms to demonstrate continuous upward progress on what will be a significantly longer-term process. We would support less frequent reporting.

Q10: To what extent do you agree with the list of demographic characteristics we propose to include in our regulatory return?

In relation to the demographic characteristics proposed by the FCA, we note that even some of the mandatory characteristics are not currently routinely collected by firms and that many of the characteristics will pose additional challenges in collection. As a general point, every element of the data collection, reporting and disclosure will establish additional costs for firms in the UK. Where characteristics may be less impactful on groupthink and diversity of though, or where there is an absence of data to demonstrate such a link, they should be kept as voluntary. In that way, competition is likely to increase their adoption amongst firms without creating additional mandatory costs which can impact the UK's competitiveness and attractiveness to international firms.

Some specific challenges include:

- Ethnicity: this is likely to be culturally challenging for some firms, particularly where collection of data on ethnicity is restricted in the home jurisdiction. We note, for example, that in France the collection of employee ethnicity data is prohibited[7]. In addition, where firms do collect ethnicity data, the sub-categories may be set by head office and may therefore differ from those required by the FCA (which are drawn from the Office of National Statistics and therefore tailored to a UK population), necessitating a UK-specific process.
- Religion: data on religion is not routinely collected by most firms and will require a new collection process. We note that data on employee religion is also prohibited in some jurisdictions (e.g. France[8]) which will be a challenge for some firms. There may also be a reluctance from some employees to provide information on their religion, even where it will be aggregated before public disclosure, given current world events. While this may be considered unintrusive for many UK staff, international firms frequently have a high number of international staff. For those staff from a non-UK cultural

[5] https://www.gov.uk/government/publications/gender-pay-gap-reporting-guidance-for-employers/when-to-report
[6] https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en
[7] https://www.insee.fr/en/information/2388586
[8] Ibid.

background there can be substantial cultural sensitivity regarding religion, regardless of the culture and psychological safety present in the firm. This can also be substantially exacerbated by geopolitical events, outside of the influence of firms. Furthermore, it is unclear how useful data on religion will ultimately prove to be;

- Sex or gender: this is also likely to be culturally challenging for some firms. We note that such data are not included on ID cards in Germany, for example[9]. We also suggest that the categories may need to be further expanded, for example to align with Stonewall Monitoring Guide 2019: Male, Female, I Use Another Term (although we note that a free text option to specify a different term may not be helpful for comparability, Prefer Not to Say. This may also necessitate allowing employees to select more than one response option, =while accepting that this will then require an explanation versus overall response numbers.
- Sexual orientation: again, we suggest alignment with the Stonewall Monitoring Guide 2019: Bi, Gay/Lesbian, Heterosexual/Straight, I Use Another Term (although we note that a free text option to specify a different term may not be helpful for comparability), Prefer Not to Say. We again note that it is considered best practice to allow employees to select multiple options. This is also be a characteristic that, while it may be considered unintrusive for many UK staff, can be challenging for staff with a non-UK cultural background, where there can be substantial cultural sensitivity regarding sexual orientation, regardless of the culture and psychological safety present in the firm.
- Disability: the definition of this characteristics is not clear and, in particular, the inclusion of long-term health conditions introduces considerable uncertainty as to its scope. Many firms also do not routinely collect data on employees' long-term health conditions, however defined. We suggest that the FCA removes long-term health conditions and then either sets out a clear definition of disability or specifically gives firms the flexibility to use existing internal definitions.
- Socio-economic background: we appreciate the FCA's intention to support data collection on this characteristic. However, whilst the proposals use the Social Mobility Commission background categorisations, these have been criticised as overly simplistic and unduly narrow. Social mobility is difficult to define and subject to significant nuance. Classification based on just three groups limits the extent to which individuals are likely to find a category that they feel reflects their particular background, increasing the likelihood of them choosing the 'prefer not to say' option. The categories also fail to capture the fact that for employees of regulated firms who grew up overseas, social mobility will manifest itself in different ways. Many firms have responded to this in practice by allowing individuals to self-identify as socially mobile or have retained a broader range of categories. We suggest the same approach is taken here and also support this characteristic remaining voluntary for reporting.

As a general point on reporting, our members have a concern regarding identifiability in the regulatory report. While the regulators recognise the concerns firms and individuals may have around identifiability of small groups for disclosures, the same concern is equally valid regarding regulatory reporting. Failing to allow firms to take steps to protect the anonymity of their employees when reporting demographic data would not only be a breach of trust, but also likely a breach of data protection law. It would be helpful if the regulators could set out guidance on minimum response rates below which individuals may be identifiable, and allow firms to apply judgement in addition to these to account for other relevant factors.

In relation to the FCA's proposals on data collection for the purposes of reporting and disclosure, we would also like to raise the following overall comments.

[9] https://www.germany.info/us-en/service/02-PassportsandIDCards/id-card/917860

The data collection proposed by the FCA, even with a limited set of mandatory fields, will be a very considerable change for the industry and we welcome the FCA's recognition, in Chapter 5, of the challenges. Some firms will need to build data collection mechanisms from scratch, whereas other firms will need to adapt existing processes (in many cases significantly). All firms will need to conduct extensive employee awareness programmes on the new requirements and what the firm plans to do with the data collected.

The FCA recognises in its proposals that employees must be given the option not to respond to some or all of the data collection request (indeed, there could be a difference drawn even between those who do not respond to their firms' request, who only respond to particular elements, or who specifically choose 'prefer not to say'). In order to build the trust required to collect the metrics, it is important that employees understand how employers will use the data. A larger set of metrics could be counter to this aim (see comments above). In light of this, we believe a careful balance will be needed between, on the one hand, the desire to increase response rates through a culture of trust, respect and psychological safety and, on the other, the risk that pursuing increased response rates could actually work counter to these aims.

There will be many legitimate reasons why an individual, who otherwise trusts their firm and feels psychologically safe, may not wish to disclose personal information. Such reasons may include deeply held cultural beliefs and norms about personal privacy, or considerations related to an individual's life outside their employment. In addition, there may also be temporary factors driving non-response rates e.g. related to an employee's state of mind on the day on which the request is made or the importance the employee places on the request. Conversely, high response rates do not always correlate to a diverse workforce – individuals in a homogenous culture may feel sufficiently comfortable to respond precisely because the majority of their colleagues come from similar backgrounds. There are real risks in drawing conclusions about a firm's culture based simply on this one data point. Consequently, we would welcome further reassurance from the FCA it is not their intention to compare or aggregate response rates to draw inferences about culture within the industry or within individual firms (particularly given the breadth of firm types and sizes).

Given the importance of allowing employees the option not to respond, the resulting data sets will be partial at best and will take many years to develop into meaningful sources of information. Therefore, there also needs to be recognition of the limitations of what conclusions about a firm's D&I progress can be drawn from a partial data set. Even a non-response rate of only 20-30% would significantly obscure the full picture of a firm, particularly if we assume that non-respondents may also be those whose responses would otherwise have increased a firm's diversity scores in one or more metrics. In addition, many of AFME's members have small enough employee populations for individual hires/departures to have a disproportionate effect on overall percentages, which would be magnified in a partial data set.

Cultural change, including on D&I, is a long-term project, in which change may be slow and non-linear. We note, however, that the FCA proposes annual reporting and disclosure against targets, which may place unnecessary pressure on firms to evidence constant positive trends. Further guidance from the FCA on its thinking in this regard would be helpful. Less frequent reporting and/or public disclosure may be more appropriate.

Therefore, we consider it important to emphasise that data collection should be a means to an end rather than the end goal. The limitations of the data set, likely for many years, must be acknowledged. The resultant statistics should not be used as a primary or most reliable measure of a firm's culture or overall D&I, but should be set within a broader context of holistic D&I strategies, cultural change and the global industry.

Q11: To what extent do you agree that reporting should be mandatory for some demographic characteristics and voluntary for others?

We support the approach that reporting should only be mandatory for certain demographic characteristics, particularly given the data collection challenges and cost implications that we outline under Q10 above. Any future expansion of the mandatory metrics should be separately consulted on after a suitable implementation period for the initial requirements.

We also suggest that reporting on both religion and disability should be voluntary, given the limited usefulness of this information.

Q12: Do you think reporting should instead be mandatory for all demographic characteristics?

No, AFME does not believe that reporting should be mandatory for all demographic characteristics. As outlined in our response to Q10, data collection will be an extremely significant undertaking with a number of factors affecting the willingness of employees to share their personal information. AFME supports that reporting should only be mandatory for a small set of demographic characteristics.

Q13: To what extent do you agree with the list of inclusion questions we propose to include in our regulatory return?

Overall, AFME is supportive of the intention behind the inclusion questions, as they are more forward-looking than the data collection, which is necessarily reflective of the current or past shape of the firm. However, it may not be feasible or appropriate for firms to use the exact wording and scoring (agree, disagree etc.) of the FCA's questions. While we appreciate that mandating the exact language and scoring system would result in a more comparable data set across the industry, it would risk being duplicative of or inconsistent with existing efforts within firms, particularly where those are set at a group level and are more aligned to the individual cultural initiatives of the firms. It may also lead some firms to feel they must discontinue existing efforts, even where those have been carefully developed with a range of experts, such as D&I, people science and data analytics teams, and have been in place long enough to start delivering meaningful, comparative information on trends within the firm. Alternatively, should firms instead elect to establish a second supplementary inclusion questionnaire in order to reflect specific wording, this would likely have substantially lower response rates than established group-wide questionnaires (due to what might be termed "survey fatigue"), which could limit the usefulness of one or both initiatives. Ultimately, the cost associated with changing existing global processes or of establishing additional local processes may be disproportionate to the incremental increase in comparability achieved by the use of identical wording.

Furthermore, we feel that a key intention of the inclusion questions should be to allow the firm, and its supervisors, to analyse it own culture and any ongoing trends, rather than necessarily to promote comparability between firms. We ask the regulator to consider whether a greater role for the supervisory relationship in analysing a firm's approach to measuring inclusion could be more useful and achievable than full comparability.

In addition, we note that the current questions focus on elements that contribute to psychological safety. However, psychological safety relies upon a wide range of factors beyond having a culture of inclusion. Therefore, there is a risk that inferences about psychological safety may be drawn without a complete picture of those factors. There is also an argument that higher inclusivity scores may be achieved by firms with lower overall diversity, which would be amplified be lack of contextual information with this disclosure. We encourage the FCA to consider how these risks can be avoided.

We would also like to raise a concern about the question on individual experience of counter-inclusive incidents. This is a highly subjective data point which may provide little objective insight into a firm's actual culture. It would also be challenging for firms to investigate any issues that are reported, as they will not have sufficient information about the incident. In light of this, it would be helpful if the FCA could clarify the intention behind this question.

The inclusion questions apply to all individuals, including members of the board. However, board members are not employees and boards functions differently from the wider organisation. Issues of inclusiveness at board level should, in our view, also be addressed in existing board effectiveness reviews. If they are retained, we suggest making it clear that inclusion questions should be applied to employees and not to (non-executive) board members.

We also refer back to our comments under Q10 on the limitations of partial data sets.

Q14: To what extent do you agree with our proposals on disclosure?

As noted in our response to Q10, we believe that requirements such as public disclosures should be a means to an end rather than a goal in and of themselves and that there are limitations to their usefulness in conveying meaningful information about a firm's overall culture (including D&I).

In relation to the content of disclosures, we are concerned about the disclosure of inclusion metrics. Employees' responses on inclusion will be useful to firms and supervisors but appear to be beyond what should be necessary for public disclosure. We would request that the FCA considers whether disclosures could instead be focused on the diversity metrics alone.

Furthermore, the format of disclosures does not leave space for commentary on the data (for example, how the data compares to the wider talent market in a particular area, or how the firm's geographical context may factor in – differences between domestic UK firms and global groups, for example) and is not intersectional. This is a particularly important concern given the different audience of disclosures compared with regulatory reporting – those reading the disclosures are less likely to have the wider contextual view of those working within the regulated sector. This could ultimately amount to creating an unlevel playing field between domestic firms and international firms operating in the UK.

Similarly, we are aware that the financial services industry has some way to go in addressing diversity and that the disclosures made may unintentionally have negative effects on attracting talent to the sector. We encourage the FCA to consider this.

We do not seek to suggest that the disclosure requirements should be made more detailed or prescriptive in order to address these points, but seek reassurance from the FCA that the limitations of the disclosures are understood at a supervisory level. In line with our comments above, we also question whether annual disclosure is necessary or appropriate (or whether this could risk driving inappropriate behaviours to seek to demonstrate progress against prior years' disclosures and targets). Less frequent public disclosure would be consistent with the longer term nature of progress in this area.

Finally, we note that the FCA's proposals are extremely granular, which raises risks of individuals becoming identifiable particularly in firms with smaller employee populations. We encourage the FCA to consider how this risk can be avoided both in relation to regulatory reporting and even more so in relation to public disclosure. For example, it may be helpful if the FCA could provide guidance as to a minimum response rate below which identifiability could be considered a risk, while allowing firms to apply judgement as to other factors which may influence this.

Q15: To what extent do you agree that disclosure should be mandatory for some demographic characteristics and voluntary for others?

We support the approach that disclosure should only be mandatory for certain demographic characteristics, particularly given the data collection challenges we outlined under Q10 above. In addition, any future expansion of the mandatory metrics should be separately consulted on after a suitable implementation period for the initial requirements.

We also refer to our comments under Q10 on challenges with specific demographic characteristics. We suggest that disclosure on both religion and disability should be voluntary, given the limited usefulness of this information.

Q16: Do you think disclosure should instead be mandatory for all demographic characteristics?

No, AFME does not believe that disclosure should be mandatory for all demographic characteristics. As outlined in our response to Q10, data collection will be an extremely significant undertaking with a number of factors affecting the willingness of employees to share their personal information. AFME supports that disclosure should only be mandatory for a small set of demographic characteristics.

Q17: To what extent do you agree that a lack of D&I should be treated as a non-financial risk and addressed accordingly through a firm's governance structures?

AFME members have a spectrum of views about treating a lack of D&I as a non-financial risk. On the one hand, it supports our view that D&I should not be treated as a purely HR or Compliance issue, but instead addressed business wide. Nonetheless, we refer back again to our comments under Q10 on the limitations of relying on partial data sets – the conclusions that can be drawn from this data will be as limiting to the firm itself as to regulators, which will impact the extent to which that data can drive the implementation of the controls.

However, on the other hand, it it is difficult to assess *how* the risk appetite would be designed and whether any shortfall from targets or limited response rates would be considered a risk and how this would be assessed in terms of impact on the overall risk profile of the firm. The guidance in the consultation paper is very vague on what in practice, the treatment of D&I as a non-financial risk should have on the activities of second and third line functions, or indeed who should be considered 'first line' in relation to this risk.

Finally, it would be helpful if the FCA could more specifically define the manifestations of the risk of lack of diversity that firms should be managing. The FCA note that groupthink and lack of diversity of thought ultimately may amount to weakness in governance. If this is the primary risk that firms should be seeking to mitigate, the FCA should specifically state such, and any other ways in which they believe that the risk of a lack of diversity may crystalise.

Q18: Do you have any comments on the cost benefit analysis?

Further to our comments under several questions above on the challenges of applying these requirements on a UK-only basis, we are concerned that there will be significant costs for firms, including those with a global footprint, whose current arrangements do not align with the PRA and FCA proposals. Where D&I strategies and data collection are driven at a group level, specific processes will be have to be put in place solely for the UK region or entity in order to meet these requirements. This may result, for example, in employees being asked to respond to different but similar data requests on different timelines and to firms being required to

manage, analyse and report on multiple data sets. This is likely also to have an impact on clarity of messaging both within firms and between firms and the wider public.

In line with this, we continue to encourage coordination between regulators at a global level on D&I. Where requirements can be harmonised, for example via initiatives such as the ISSB Standards[10] or the EU's Sustainability Reporting Standards (ESRS)[11], this reduces conflicts and duplication of effort for firms and provides a clearer cross-border picture of the industry.

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[10] https://www.ifrs.org/groups/international-sustainability-standards-board/
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