



Financial Services Reward – PRA and FCA publish Consultation Papers on improving diversity and inclusion in the financial services sector

Overview

On 25 September 2023, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) published Consultation Papers on their plans to improve diversity and inclusion in the financial services sector (CP18/23 – diversity and inclusion in PRA-regulated firms and CP23/20 – diversity and inclusion in the financial sector – working together to drive change). The Consultation Papers cover a range of topics and proposals for firms to consider and follow a joint Discussion Paper on the same topic from July 2021 (DP2/21).

This alert provides a high level overview of the proposed changes within the Consultation Papers which will be of interest to reward teams and Remuneration Committees with a specific focus on the remuneration related provisions.

Firms in scope

Although not all firms would be subject to the same requirements (or have to comply with them in the same way), the two Consultation Papers broadly apply to the following categories of firm:

- **PRA Consultation Paper:** PRA regulated banks and insurance firms, building societies, PRA-designated UK investment firms, and their qualifying parent undertakings.
- **FCA Consultation Paper:** All FCA regulated firms (with a Part 4A FSMA permission).

Timing

The Consultation Papers were published on 25 September 2023, and responses are requested by 18 December 2023. It is anticipated that the final Policy Statements will be

published in 2024 and that the new rules will be brought into force 12 months following the publication of the relevant Policy Statements. This is to allow firms time to improve existing policies where necessary, or to develop and implement new policy, governance, as well as oversight and data collection processes.

Key Provisions

The Consultation Papers set out the UK regulators' proposed rules and expectations aimed at improving diversity and inclusion across the financial services sector. The regulators consider that improving diversity and inclusion across the sector would help to reduce 'groupthink', supporting more effective and prudent decision making and risk management. More broadly, the FCA considers that improving diversity and inclusion

should also promote greater understanding of, and provision for, diverse consumer needs and therefore support the Consumer Duty. The FCA notes that a lack of diversity and inclusion within firms can lead to poor outcomes for consumers by limiting a firm's ability to understand or fully meet their diverse needs.

The regulators note that whilst some progress has been made, there is more to be done to improve diversity and inclusion and that a holistic approach across the firm is required in order to develop and maintain diverse and inclusive cultures. As a result, the provisions within the Consultation Papers are wide-ranging and include proposals relating to diversity and inclusion strategies, targets, individual accountability, disclosure, reporting and Board governance.

Key proposals include requirements for certain firms to:

- **Establish, implement and maintain a diversity and inclusion strategy**, published on the firm's website, setting out the firm's core values and culture.
- **Determine and set appropriate diversity targets for** underrepresented demographic groups, including for women and ethnicity at a minimum.
- **Monitor diversity and inclusion data**, including demographic and inclusion data for different subsets of the workforce, and take appropriate actions where necessary.
- **Provide additional regulatory reporting** on diversity and inclusion data alongside information on targets set. The proposal includes mandatory

reporting for age, sexual orientation, sex or gender, disability or long-term health condition, ethnicity and religion, and voluntary collection of parental and carer responsibilities, gender identity, and socio-economic background.

- **Publish details** of the demographic diversity of the organisation, the targets set and the outcome of inclusion surveys on their website (to take effect for the second year after the rules come into force).

The Consultation Papers provide detailed proposals for each of the above, including the firms to which the proposals would apply, together with other proposals regarding board governance and individual accountability.

Key remuneration related provisions

In the original Discussion Paper, there were a range of potential approaches suggested for consideration, including linking diversity and inclusion to remuneration and monitoring as well as extending the Remuneration Committee's responsibilities. Following the Discussion Paper, the FCA Consultation Paper confirms that no changes to the remuneration rules are being proposed as part of this consultation. It notes that changes may be proposed alongside other changes to the Remuneration Codes at the next suitable opportunity and that a wider review of the remuneration regime may be undertaken in the future, subject to strategic priorities.

The PRA Consultation Paper also does not specifically propose any changes to the remuneration regulations in themselves. However, it includes other references to the role of remuneration, particularly incentive

arrangements, for consideration. These include:

- **Tone from the top:** The paper notes that Chairs of boards and board sub-committees have a particularly important role in creating an environment where the board can have open and effective discussions leading to quality decision-making. In addition, the paper highlights that an inclusive tone from the top can help embed inclusion throughout an organisation.

- **Using incentives to embed culture:** It is also noted that boards have a range of responsibilities, including monitoring progress and identifying obstacles that give rise to adverse diversity and inclusion outcomes. It continues that boards should consider appropriate incentives to embed culture across the firm and reinforces the PRA's opinion that incentives are appropriate tools for driving progress in this area, particularly for Senior Managers.

- **Individual accountability:** Whilst the PRA acknowledges that many individuals may have responsibilities for improving diversity and inclusion across the organisation, the PRA is proposing that for firms with an SMF with prescribed responsibility for culture for this to be expanded to include responsibility for the development and implementation of diversity and inclusion strategies. The paper sets out that the SMF would be expected to have this responsibility appropriately reflected in their performance objectives and remuneration scorecard, and their performance against these reflected in their remuneration decisions, including by way of risk adjustments (where applicable).

For firms outside of the scope of the culture prescribed responsibility, at least one SMF should have responsibility for the implementation of the firm's diversity and inclusion strategy reflected in their Statement of Responsibilities. As with the above, where this individual has an executive role, these responsibilities should be reflected in their performance objectives and remuneration outcomes.

The PRA notes that research has shown that efforts to establish clear responsibility for progress on diversity lead to the broadest increases in managerial diversity in firms and that these benefits can be further supported by setting appropriate incentives, including variable remuneration, and by holding individuals accountable for addressing barriers to progress.

- Risk and Control Environment: The Consultation Paper notes that poor diversity and inclusion can threaten a firm's risk management and control environment. It also emphasises the PRA's existing expectation that culture should be embedded in firms through the use of appropriate incentives and to encourage the right behaviours.

In addition, the new draft Supervisory Statement on diversity and inclusion sets out that the PRA expects the development, monitoring, and review of the diversity and inclusion strategy to be supported by appropriate risk and control functions, given the link between diversity and inclusion, effective decision-making, and risk management. The paper notes that the control functions can support accountability by ensuring that findings are being appropriately reported to senior leadership and the

board in order to monitor progress, inform improvements to strategy, address any deficiencies, and make targeted interventions as appropriate.

A link to the PRA Consultation Paper (CP18/23) can be found [here](#).

A link to the FCA Consultation Paper (CP23/20) can be found [here](#).

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