CP18/23 – Diversity and inclusion in PRA-regulated firms

Consultation paper 18/23

Updated on 11 October 2023: In relation to the scope of application, the CP and draft supervisory statement have been amended to make clear that the proposals apply to all CRR and Solvency II firms (including third country branches in the UK). The proposals do not apply to non-CRR firms (eg credit unions) and non-directive firms. The previous version of the CP and SS referred to friendly societies being excluded from the scope of the proposals – this was incorrect. Friendly societies are within scope if they are subject to Solvency II.

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Content

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Responses are requested by Monday 18 December 2023.

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Alternatively, please address any comments or enquiries to:
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1: Overview

1.1 This consultation paper (CP) sets out the Prudential Regulation Authority's (PRA) proposed rules and expectations aimed at improving diversity and inclusion in PRA-regulated firms, which can support better firm governance and decision-making, thereby advancing the PRA's objectives. The proposals in this CP have been developed in parallel with the Financial Conduct Authority (FCA), who are also **publishing** a CP on the same topic, alongside this CP, in relation to FCA-regulated firms.

1.2 The proposals in this CP build on the ideas discussed in the regulators' joint discussion paper (DP)2/21 – **Diversity and inclusion in the financial sector – working together to drive change**, which was published by the PRA, the FCA, and the Bank of England (the Bank) in July 2021. Responses to DP2/21 were supportive of the regulators having a role to play in helping to improve diversity and inclusion in the financial sector, as explained in the Background section below. The proposals in this CP have been informed by many of the suggestions made by respondents to the DP. As there is no single means of improving diversity and inclusion, the PRA considers that firms need to take a holistic approach. This is reflected in the proposals in this CP, which recognise that developing and maintaining a diverse and inclusive culture requires organisation-wide commitment.

Purpose of this consultation

1.3 The purpose of these proposals for consultation is to advance the PRA's objectives of safety and soundness and policyholder protection by improving diversity and inclusion outcomes in PRA-regulated firms. Diversity and inclusion are important to governance and firm-wide culture. The PRA considers that more diverse and inclusive firms would help to reduce groupthink,[1] supporting more effective and prudent decision-making and risk management. Diverse views, combined with inclusion, support the ability of staff to challenge, speak up, and raise concerns. Groupthink and lack of inclusion can lead to firms missing, underestimating, or even ignoring risks that could threaten firm safety and soundness and/or policyholder protection. A wider range of perspectives is likely to lead to a better understanding of the risks facing a firm, and more effective and prudent decision-making.

1.4 Diversity in organisations usually means three things: (i) demographic diversity, (ii) diversity of experience, and (iii) diversity of thought[2] (also called cognitive diversity), with the latter two particularly challenging to measure, but all being relevant for sound decision-making. The PRA considers that a combination of demographic diversity and diversity of experience are likely to foster greater diversity of thought in firms and help reduce groupthink. Diversity of thought is about bringing together different perspectives, knowledge, attitudes, and information styles, to help solve problems. Greater diversity can result in improved decision-making.[3]

1.5 However, simply adding demographically diverse individuals to a firm or board may fail to achieve greater diversity of thought. For example, they may bring similar perspectives and experiences as existing staff. Alternatively, the benefits of their addition may be muted if they are not comfortable sharing their insights with their colleagues or, in the case of boards, their fellow directors. It is also possible that even if individuals share their insights, they may not be adequately considered and/or incorporated into the decision-making process.[4] This is where inclusion comes in.[5]

1.6 Diversity without inclusion has a less beneficial impact: having different perspectives available within a firm is insufficient if individuals feel unable to express their views, or their views are not taken seriously. Therefore, it is important that firms, including boards where strategic decisions are made, are inclusive as well as diverse. An inclusive firm establishes a culture that welcomes and encourages the sharing of a wide range of perspectives and ideas, including from minority groups.[6]

1.7 Individuals chairing meetings have a crucial role in empowering their colleagues to speak up and challenge dominant opinions. 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 way meetings are organised can promote inclusion. An inclusive tone from the top can help embed inclusion throughout an organisation. Inclusion in day-to-day work and interactions may have an impact on how issues are identified and addressed, and how risks are mitigated.

1.8 The PRA recognises that changing organisational outcomes can be challenging and take time. In addition, diverse teams managed by skilled and inclusive leaders may be less agile than more homogenous teams in the early stages of working together, because greater debate and challenge can emerge when different perspectives, experiences, backgrounds, thinking, and communication styles are brought into a team. However, over time, a diverse team led by an inclusive leader is likely to reach more robust decisions supporting more effective and prudent outcomes.[7]

1.9 The PRA is aware that there are differing views about the strength of evidence, or conclusions, that can be drawn from some diversity studies, including some referenced in this CP. However, the PRA considers that there is enough evidence to warrant consulting on policy in this area because:

- on balance, the evidence indicates that improving diversity and inclusion across the financial services sector aligns with the PRA's primary objectives of safety and soundness and policyholder protection, as discussed throughout this CP;
- on competitiveness and growth, if firms do not understand the diversity profile of their firm and how inclusive their culture is, they are unable to target interventions that allow more effective participation of their staff resulting in better decision-making. As well as being good for safety and soundness, improved diversity and inclusion should improve the ability of firms to compete effectively. The PRA considers that the proposals may also help firms to attract and retain a wider range of high-quality staff in a competitive labour market, supporting UK competitiveness;
- responses to the regulators' joint discussion paper DP 2/21 evidenced a clear interest within industry in improving diversity and inclusion (see Background section) with the support of the PRA and FCA (the regulators); and
- the proposed policies would enable the regulators to gather more data and evidence in relation to diversity and inclusion within the sector. This information would provide a basis for policy evaluation, and any future updates to the proposed policy could be considered in the light of this and any other relevant evidence once it is gathered.

1.10 The PRA is aware that concepts within the domain of diversity and inclusion continue to evolve. Besides diversity and inclusion, there are also concepts such as equity,[8] belonging,[9] and accessibility.[10] These concepts are referenced within the CP text where relevant. Some DP responses noted the importance of considering equity as part of diversity and inclusion. Equity in the workplace can lead to more diverse leadership in the future, thus improving the quality of decision-making and safety and soundness within PRA regulated firms. DP responses also noted the importance of accessibility, particularly in relation to accessibility for those who suffer from a disability. The PRA considers that its package of policy proposals would help support equity and accessibility, as well as diversity and inclusion.

1.11 We are aware that recent cases of debanking have been linked in some commentary to the increasing prevalence of D&I and Environment, Social, and Governance (ESG) initiatives within the financial services sector. Nothing in our regulations or supervision, including the proposals in this consultation paper, provides a basis for firms to withhold services from customers based on their lawfully expressed opinions or beliefs. On the contrary, the PRA's proposed rules are aimed at improving diversity of thought and inclusion in PRA-regulated firms and this should enhance their ability to serve a wide range of customers effectively.

Background

1.12 While DP2/21 recognised that the financial sector has 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, making the UK an attractive place to do business;
- improve standards of conduct within firms in relation to their customers and markets that they serve; and
- understand the markets they operate in and the customers they serve, supporting innovation and developing new markets.

1.13 DP2/21 set out some ideas on how the regulators could make policies that would help improve progress on diversity and inclusion in support of these outcomes. This included suggestions on how data collection, monitoring, reporting, and disclosure could help firms use evidence to understand their starting point, set appropriate targets, identify areas for intervention, measure progress, and hold themselves to account. The DP also explored the role that the board and senior managers of a firm play, as key decision-makers, in making progress on diversity and inclusion. It also considered some levers that could help firms to develop their strategies, such as setting targets and having diversity and inclusion policies.

1.14 DP2/21 received 184 responses from firms, industry organisations, consultancy firms, think tanks, interest groups, academics and other individuals. There were 48 responses from dual-regulated firms, and in total 131 responses that were relevant to the PRA. Most respondents were very supportive of the ideas in the DP and the regulators' intentions to take action to help improve firms' diversity and inclusion. None of the responses from PRA-regulated firms expressed general concerns about the PRA making policy relating to diversity and inclusion. Many helpful responses and suggestions were received, which the PRA has considered when developing the proposals in this CP.

1.15 In October 2021, the PRA and the FCA conducted a **survey,** which received 278 responses from dual-regulated firms. The survey collected information on:

- how different types of firms currently approach diversity and inclusion, including what data they already collect, what they plan to collect in the near future, and whether they set targets;
- what the current diversity composition of those firms is, based on the data that they are already collecting;
- firms' current approaches to measuring inclusion; and
- costs and challenges in collecting diversity and inclusion data.

1.16 The PRA has considered these data in its policy proposals in two ways: (i) to help assess the costs and benefits of firms developing systems to collect data on various characteristics for regulatory reporting purposes; and (ii) as an indicator of the areas where it is important to improve data collection. The survey revealed that data on some characteristics were not widely collected, and this has been considered in the PRA's regulatory reporting proposals.

1.17 Further detail on how responses to the DP2/21 and pilot survey have informed the policies proposed in this CP is outlined in each chapter alongside the policy proposals to which they are most relevant.

Overview of proposals

1.18 Figure 1[11] summarises the key desired outcomes of the policy that is being proposed, showing how each proposal seeks to deliver these outcomes.

Figure 1: Policy outcomes and levers to make progress

Desired outcome	To improve diversity and inclusion (D&I) across PRA-regulated firms, as the PRA considers that it supports prudent decision-making and better risk management, through reducing the risk of groupthink		
How can this outcome be achieved?	Improved D&I for board and senior management, to support discussion & debate on prudential risk issues, reflecting a range of viewpoints and experiences	More inclusive and diverse firms, where individuals can speak up and raise concerns on issues relevant to the firm's business and risk profile	Accountability - at firm and individual level, to provide incentives to make progress
What levers will make progress?	• D&I embedded in firm culture and strategy • Board responsible for - D&I strategy - Targets - Succession planning	• Firm-wide D&I strategy • Monitoring D&I: using evidence to inform action	• Senior Manager accountability for D&I as part of firm culture • D&I as a risk considered by internal control functions • Regulatory reporting • Disclosure • Industry benchmarking

1.19 The policy proposals are interdependent, with the intention of linking:

- a firm's overall strategy to diversity and inclusion (covering values, goals, plans, ways of measuring progress, and the role individuals at the firm have to play in supporting the strategy);
- ways of embedding the strategy (through board governance, individual accountability, targets, and the role of risk and controls);
- the gathering of evidence (through internal monitoring and regulatory reporting) to identify successes and areas for improvement, which can then underpin the further development of the strategy over time; and
- an improved understanding of progress across the sector (through disclosure and industry benchmarking).

1.20 The CP is structured into the following chapters:

- **Firm-wide diversity and inclusion strategies (Chapter 2)** – This chapter proposes to require firms to have and publish a firm-wide diversity and inclusion strategy. It also proposes expectations on the role of risk and control functions in supporting the strategy.

- **Targets (Chapter 3)** – This chapter proposes that the largest firms would be required to set their own diversity targets where they identify underrepresentation subject to a minimum of targets for women and ethnicity, if underrepresentation is identified.
- **Board governance (Chapter 4)** – This chapter proposes to require firms to have and publish a strategy specifically promoting diversity and inclusion on the board. It also proposes to clarify expectations on succession planning and board/board sub-committee responsibilities for diversity and inclusion.
- **Individual accountability (Chapter 5)** – This chapter proposes an expectation that responsibility for diversity and inclusion be allocated to the relevant Senior Management Functions, with this reflected in Statements of Responsibilities, and that measures for accountability to be put into place. It also proposes to clarify that objective findings of patterns of behaviour such as bullying, discrimination, and harassment can be considered as part of fitness and propriety assessments.
- **Monitoring diversity and inclusion (Chapter 6)** – This chapter proposes to require firms to monitor diversity and inclusion internally and to take appropriate actions where necessary.
- **Regulatory reporting (Chapter 7)** – This chapter proposes to require the largest firms to report certain diversity and inclusion data alongside information on the targets they have set for themselves. The PRA and the FCA also propose to use this data to produce an aggregated industry-wide benchmarking report.
- **Disclosure (Chapter 8)** – This chapter proposes to require the largest firms to disclose information on the targets they have set for themselves, the demographic diversity of their organisation, and the outcome of inclusion surveys.

Scope of application

1.21 This CP is relevant to PRA-authorised banks and insurance firms, building societies, PRA-designated UK investment firms, and their qualifying parent undertakings, which for this purpose comprise UK-headquartered financial holding companies and mixed financial holding companies. The proposals in this CP would apply only to Capital Requirements Regulation (CRR) firms and Solvency II firms, which includes third country bank and insurance branches; this is summarised in Table 1 below. The proposals do not apply to credit unions and non-directive firms.

Table 1: Scope of application

Topic	Application
Firm-wide strategies	All CRR and Solvency II firms with respect to their establishment in the UK, including third country branches.
Monitoring diversity and inclusion	
Individual accountability	
Board governance	All CRR and Solvency II firms with respect to their establishment in the UK, excluding third country branches.
Targets	Only 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.
Regulatory reporting	
Disclosure	
No proposals apply to non-CRR and non-Solvency II firms (eg credit unions and non-directive firms).	

Territorial scope

1.22 For all policy areas, apart from fitness and propriety[12], the proposals in this CP apply only to employees that carry out their activities predominantly from an establishment in the UK. For third country firms, the proposals only apply in relation to activities of the firm that are carried out from an establishment in the UK.

Accountability framework

1.23a The PRA has a statutory duty to consult when introducing new rules or changing rules (s138J of the Financial Services and Markets Act 2000 (FSMA)). When not making rules, the PRA has a public law duty to consult widely where it would be fair to do so. In certain circumstances, consultation is also required with individuals whose data is subject to the proposals and/or with the Information Commissioner's Office.

1.23b In carrying out its policy making functions, the PRA is required to comply with several statutory obligations. The analysis in this CP explains how the proposals have had regard to the most significant matters, including an explanation of the ways in which having regard to these matters has affected the proposals.

1.24 'Have regard' considerations which were most significant in the PRA's analysis included consideration of proportionality, competition, different business models, competitiveness, and growth. The PRA considers that supporting effective and prudent decision-making in firms through improved diversity and inclusion is important for all the firms it regulates. However, it has carefully considered how to tailor the proposed policy package to apply proportionately in a manner that firms can tailor to their business model, size, and location. By encouraging increased disclosure and benchmarking of diversity and inclusion approaches and progress across the industry, the proposals should also improve market discipline and transparency for stakeholders.

Overview of costs

1.25 The PRA considers that firms would incur some additional costs as a direct result of the proposals. However, the PRA considers that the benefits of the proposals for firm safety and soundness and financial stability would outweigh these costs. The main costs are likely to be in initially implementing the policy, which would reduce over time as it becomes embedded in firms' processes, whereas the benefits are likely to be long-lasting. As good practice grows across the industry, there would likely be further efficiencies gained over time. It is also worth noting that some firms have already made considerable progress on diversity and inclusion. For such firms, the costs are likely to be relatively less. Finally, the PRA has sought to mitigate potential costs for smaller firms by excluding many from the scope of the proposals, and by making the policy more proportionate for the remaining small firms. The cost benefit analysis in Chapter 9 of this paper considers this in more detail.

Changes to PRA rules and policy materials

1.26 The proposals in this CP would result in a new supervisory statement (SS) – Diversity and inclusion in PRA-regulated firms. To support the PRA's approach, the PRA also proposes changes to other rules and SS that aim to support good governance outcomes. The changes are shown in Table 2, categorised by type of firm to which the policy material applies:

Table 2: Rules and Supervisory Statements proposed to change

Banks (CRR firms)	Insurance (Solvency II firms)	Cross-cutting
General Organisational Requirements Part of the PRA Rulebook ('Part')	Conditions Governing Business Part	Glossary Part

Banks (CRR firms)	Insurance (Solvency II firms)	Cross-cutting
Regulatory Reporting Part	Group Supervision Part	SS5/16 – Corporate Governance: Board responsibilities
Public Disclosure Part	Reporting Part	
SS28/15 – Strengthening individual accountability in banking	Third Country Branches Part	
	SS35/15 – Strengthening individual accountability in insurance	

Implementation

1.27 The PRA proposes that the new rules and expectations would come into effect one year after publication of the final policy. With respect to reporting and disclosure:

- The first regulatory reporting would be due during a three-month window following the rules coming into effect, with a reference date to be confirmed upon publication of the final policy.
- The first regulatory reporting would be on a 'comply or explain' basis, meaning if firms are unable to gather all the required data for reporting in the first year, they would be asked to explain why.
- The next time the reporting is due, firms would be required to report the full suite of mandatory data requested in the regulatory reporting return.
- The first mandatory disclosures would be required to be made alongside firms' annual reports, in the second year after the rules come into effect. Firms could also choose to make disclosures sooner, on a voluntary basis.

Responses and next steps

1.28 This consultation closes on 18 December 2023. The PRA invites responses to the proposals set out in this consultation, set out chapter by chapter if possible. Please address any comments or enquiries to **CP18_23@bankofengland.co.uk**. Please indicate in your response if you believe any of the proposals in this CP are likely to negatively impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be. In Chapter 9 of this CP, the PRA considers in more detail the expected impacts of the proposals on those who share protected characteristics under the Equality Act 2010.

1.29 Unless otherwise stated, references to EU or EU-derived legislation refer to the version of that legislation which forms part of **retained** EU law.

2: Firm-wide strategies

Firm-wide diversity and inclusion strategies

2.1 Responses to **DP2/21** demonstrated widespread support for a requirement for firms to have and publish a diversity and inclusion policy, which would cover firm diversity and inclusion strategies. However, there was a mix of views on how a policy should be shaped. Respondents to DP2/21 noted that it would not be helpful for the regulators to be prescriptive in what they require. However, many respondents requested guidance on good practice in terms of what the requirement should encompass. Most respondents recognised the benefits of publishing their approach to diversity and inclusion.

2.2 When asked in the diversity and inclusion survey, 76% of respondents already had diversity and inclusion policies. These may already include the operating principles of the policy, such as a clear statement of the organisation's core values, the employer and employee responsibilities for promoting and delivering the policy, as well as the legal and business context. In the more advanced cases, these have been specified in the context of particular firm-wide processes, such as recruitment and promotion.

2.3 There are existing rules in General Organisational Requirements 6.2–6.4 and Conditions Governing Business 2.7–2.9, which require CRR and Solvency II firms to have a board diversity policy (see Chapter 4 for more details on these rules, which are also proposed to change). The PRA proposes to build on these rules by introducing a requirement, in the General Organisational Requirements and Conditions Governing Business Parts, for firms to have, and publish on their website, a firm-wide strategy promoting diversity and inclusion among their employees.[13] The strategy would need to be reviewed regularly, and as appropriate, updated to reflect the firm's current position and planned approach. This rule would apply to all CRR and Solvency II firms, including third country branches, with reference to their UK operations only.[14]

2.4 While it is ultimately up to firms, and the board, to develop and own their diversity and inclusion strategy, the PRA expects a strategy to include:

- the firm's core values, the culture that it is trying to create, and its commitment to diversity and inclusion;
- clear objectives and goals for improving diversity and inclusion in the firm, and a plan for meeting these;
- ways of measuring progress against the objectives and goals; and
- the role of the firm and staff in fostering an open and inclusive environment, including empowering colleagues to speak up and express their views.

2.5 Firms could choose to combine board and firm-wide strategies, or keep them separate, but they would both be expected to be accessible on their website. Firms might also choose to publish a separate diversity and inclusion policy or include it in a diversity and inclusion annual report.

2.6 All firms would have the flexibility to tailor their strategy to meet their circumstances. For smaller firms, the PRA would expect their strategy to be proportionately simpler, and less comprehensive than those for larger firms. For third country branches that are covered by a diversity and inclusion strategy at international group level, it may not be practical for their UK-specific strategy to cover all the points above. However, the PRA would expect relevant aspects to be considered with regard to the UK operations.

2.7 These proposed expectations would be outlined in the new diversity and inclusion SS (see Appendix 6). The firm-wide strategy would help form the foundation of a firm's diversity and inclusion action plan. It would set out the framework to help firms foster effective challenge and prudent decision-making at all levels, supporting overall safety and soundness. The PRA would expect that the strategy would be owned by the firm's senior leadership and the board, and not be seen solely as a human resources issue. Senior leadership and the board would also be expected to clearly support and disseminate information about the strategy through internal communications channels, and to set the tone from the top.

2.8 Firms should consider how to ensure staff understand their roles in supporting the strategy and promoting an inclusive culture within the institution. This might be achieved via formal training or other methods, as appropriate to the firm's circumstances.

Risk and controls

2.9 DP2/21 asked how internal audit could best assist firms in monitoring diversity and inclusion. Most respondents agreed that internal audit has a key role to play, but also highlighted that it would not be helpful for the regulator to be prescriptive or stipulate a 'one-size-fits-all' approach. Proportionality for smaller firms was seen to be important, taking into account that their internal audit function may be outsourced. Most respondents advocated weaving diversity and inclusion into internal audits of other key processes, such as governance, board effectiveness, and culture.

2.10 Many responses to DP2/21 noted the role of internal audit in assessing a firm's risk management and controls framework around diversity and inclusion. The PRA proposes to clarify in the new SS that not only internal audit, but also risk management and compliance functions, have a role to play.

2.11 The PRA would expect development and review of the diversity and inclusion strategy to be supported by appropriate risk and control functions at the firm, and for these functions to play a role in ensuring the risks involved in having poor diversity and inclusion are managed alongside other business risks. Risk and control functions can not only help ensure compliance with regulatory and legal requirements, but also can consider how effectively diverse and inclusive practices are embedded. They can support accountability by ensuring that findings are being appropriately reported to senior leadership and the board such that they can be used to monitor progress, inform improvements to strategy over time, address any deficiencies, and make targeted interventions as appropriate. The PRA does not intend to be prescriptive as to how firms should achieve this.

2.12 As noted in PS24/15 – **Whistleblowing in deposit-takers, PRA-designated investment firms and insurers**, 'firms may encourage speaking up internally by creating a culture that welcomes criticism: they should not seek to force people to raise concerns through one channel only.' The PRA therefore added a rule, within PS24/15, to prevent firms instructing their employees to raise concerns through their internal whistleblowing channel before contacting the PRA or the FCA. The ability to speak up via whistleblowing without fear of repercussion is also an important aspect of risk management and indicative of an inclusive culture. Risk and control functions have an important role to play in ensuring there are systems and processes in place to support whistleblowing.

3: Targets

3.1 There were 89 responses to DP2/21 questions relating to target-setting, 63 of which agreed that targets were important for driving progress on diversity and inclusion. A further 14 respondents had a balanced view as to the pros and cons of setting targets. Many respondents considered that it would be useful for regulators to set out consistent principles for setting targets. However, they also noted that firms should have autonomy to set their own targets, and that targets should be data-driven to be most effective. Respondents suggested that it could be most effective to hold firms to account for progress against targets through dialogue with the regulators, rather than simply looking at whether they were being met.

3.2 There was some support for stipulating that targets should be set for the board and senior leadership populations, as this may have positive knock-on effects for the pipeline into senior positions across the sector, and because this would be consistent with existing initiatives such as **FTSE women leaders: Hampton-Alexander review** Some firms supported transparency on target-setting and progress. There was some concern that target-setting could drive a 'tick-box' culture and could lead to a narrow view of diversity, but respondents saw this risk to be less if firms set targets themselves. The data from the pilot survey shows that 34% of respondents already set targets at board level, 45% at senior management level, and 23% set targets across the entire firm.

3.3 Under Rule 6.2(4) in the General Organisational Requirements Part of the PRA Rulebook, CRR firms with a nomination committee are already required to set a target for the underrepresented gender on the board. The PRA proposes to change 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. It also proposes to change the terminology, which currently states that a nomination committee 'decides on a target'. The PRA considers that a nomination committee would 'recommend' targets to the board, rather than 'decide' the targets on its own.

3.4 To define which are the largest firms for the purpose of diversity and inclusion proposals, the PRA proposes to introduce a new term to the Glossary Part of the PRA Rulebook: 'diversity and inclusion employee number threshold' (hereafter referred to as 'the employee number threshold'). This term refers to firms (including third country branches) with 251 or more employees predominantly carrying out activities from an establishment in the UK. The PRA proposes that these firms would have wider-ranging requirements for diversity and inclusion than those with smaller employee populations. The definition in the proposed rule instrument explains how to calculate employee numbers to determine whether a firm falls above or below the employee number threshold.

3.5 Firms above the employee number threshold would be required to set diversity targets for the board, senior leadership, and throughout the employee pipeline, for demographic characteristics identified by the firm, as appropriate for their circumstances. The reason for the proposal to set targets at different levels of seniority is that in order to achieve diversity at senior levels, it is important for firms to consider the progression of their employees, from the time of entry to the top of the organisation. Setting targets at these different levels can help firms focus on the areas that matter most for them.

3.6 Firms would be expected to set targets for women and ethnicity at a minimum, if the firm identifies underrepresentation in these areas. The reason that the PRA proposes an expectation in relation to these two characteristics is because there is evidence that women are under-represented within financial services, particularly at the more senior levels[15] and people of some ethnicities are under-represented in FTSE boards, with the great majority of ethnic minority directors in NED **roles** It would be up to firms to decide what underrepresentation looks like for their context and as a result firms could also choose to set targets for other demographic characteristics should they wish to do so. These firms could also choose to set qualitative targets, such as undertaking desk-based reviews or audits on aspects of diversity and inclusion.[16] Firms could also set targets to improve their inclusion metrics, in addition to the targets they choose in relation to demographic characteristics.

3.7 For the purposes of setting targets, regulatory reporting (see Chapter 7), and disclosure (see Chapter 8), the PRA proposes to add a definition of 'senior leadership' to the Glossary Part of the PRA Rulebook (see Appendix 1).

3.8 The PRA would expect targets to be set in relation to firms' individual contexts, recognising that diversity could look different for firms with different strategies, sizes, locations, complexity, business models and (where applicable) home jurisdiction. The PRA would also expect targets to have a defined timeframe, be regularly reviewed, and that firms consider the progress that has been made and assess what yet needs to be done. Firms would be expected to analyse evidence collected on the state of diversity and inclusion to help inform the targets set, update the targets over time, and consider where further development and interventions might be needed (see Chapter 6 for more information).

3.9 Beyond the expectations summarised above, the PRA does not propose to be prescriptive about the specific types of targets that firms set for themselves. This helps avoid a one-size-fits-all approach and allows for proportionate application. Firms are best placed to judge what would be most meaningful in their context, helping to avoid a 'tick-box' exercise. However, the PRA expects that the targets firms set should be both realistic and stretching.

3.10 The PRA would not consider it appropriate for firms to cite their diversity targets as a sole reason for increasing the size of their boards, as larger boards are not always more effective. Firms would be expected to have broader reasons beyond just diversity, should they seek to increase the size of their boards. Targets could be achieved through a combination of natural turnover, good succession planning, and inclusive promotion and recruitment practices. While firms might not necessarily meet their targets within the timescales set, the PRA would expect firms to seek to understand the barriers faced and adjust their approach as a result. Requirements to set targets, and work towards achieving such targets, do not require firms to breach any of their obligations under the Equality Act 2010 or any other relevant legislation (for more details, see Chapter 9 under **Equality and diversity**).

3.11 The board, and those senior managers responsible for diversity and inclusion, would be expected to be able to explain the rationale for setting the targets that the firm has chosen. It would be important to understand how and why this supports the implementation of their diversity and inclusion strategy and corresponding policies.

3.12 As part of the proposals, firms in scope of the targets rule would also be required to prepare and disclose a strategy on how to meet their targets, which builds on the existing requirements for CRR firms with nomination committees that pre-existed the publication of this CP (although the terminology is proposed to change from 'policy' to 'strategy'). Targets would also need to be disclosed publicly, alongside the firm's rationale for setting them and, over time, the progress made towards the targets.

4: Board governance

4.1 Responses to DP2/21 indicated that diverse board composition was considered important and seen to align with existing PRA policy. Firms widely supported being held accountable to their own board policies by their regulator, and the notion that boards should collectively oversee diversity and inclusion strategy.

4.2 Embedding diversity and inclusion into board succession planning was also seen by respondents as an important way to drive progress. In the short term, the available talent pool for boards was highlighted as a challenge by some. However, the PRA does not consider that this is necessarily the case. Initiatives like the Hampton-Alexander Review and the **Parker Review** have shown that female board members and minority ethnic members can be found with the right recruitment methods in place. It is likely to be more difficult to diversify the executive in the short term, given current levels of demographic diversity among senior executives in many financial sector firms. The PRA considers that this can be supported by firms focusing on the employee pipeline, effective succession planning, and the employee lifecycle by using data to help decide where and when to intervene and holding executives to account. Many firms have already found such strategies to be successful, including in their promotion process and Environment, Social, and Governance (ESG) strategy.

4.3 CRR and Solvency II firms have an existing requirement to consider a broad set of qualities and competences when recruiting to the board, and to put in place a policy to promote board diversity. They are also required to explain on their website how they comply with these requirements.[17] For banks, these requirements also apply to holding companies on a consolidated or sub-consolidated basis.[18]

4.4 The PRA proposes to change the rules referring to 'a policy promoting diversity' on the board, to 'a strategy promoting diversity and inclusion'. It also proposes to update SS5/16 to expect firms to apply board diversity and inclusion strategies to board sub-committees as appropriate, particularly as they relate to inclusive practices in and around sub-committee meetings.

4.5 The PRA proposes to update its rule requiring firms to explain on their website how they meet the board diversity requirements. Instead, the board diversity and inclusion strategy itself would need to be published on a firm's website (rather than only a statement of how a firm complies with the requirement), alongside the firm-wide strategy. The firm-wide and board strategies would be expected to be complementary and easily accessible to stakeholders, to help them understand the firm's approach holistically.

4.6 SS5/16 highlights the importance of boards having robust succession plans that consider the skills, experience, and effectiveness of their members, and that recognise current and future business needs and requirements.[19] The PRA proposes to clarify that when considering succession planning, upcoming appointments should also be considered in the context of diversity. This might include planning how to use appropriate avenues of recruitment when seeking candidates for future directorships.

4.7 The PRA proposes that boards would be expected (with, where appropriate, support from the relevant board sub-committee) to have an explicit collective responsibility to set and oversee the firm's strategy on diversity and inclusion, including developing talent internally, in line with their existing responsibility for overall firm strategy and culture, as outlined in **SS5/16**.[20] As with overall firm strategy, it would be important that all directors, including non-executives, have adequate time and opportunity to contribute to the development of the strategy and provide independent challenge before it is signed off.

4.8 The PRA proposes that boards would be expected to monitor progress on diversity and inclusion, identifying obstacles that give rise to adverse diversity and inclusion outcomes, and targeting interventions where needed. Boards would also be expected to hold management to account for promoting diversity and an inclusive culture that fosters open exchange of ideas, constructive debate, and sound decision-making. In line with existing expectations that the board should consider appropriate incentives, including but not limited to remuneration, to embed culture across the firm,[21] the PRA proposes to clarify that such incentives are also appropriate tools for driving progress on diversity and inclusion, in particular among responsible Senior Managers (see next section).

5: Individual accountability

Senior manager responsibility for diversity and inclusion

5.1 Efforts to establish clear responsibility for progress on diversity and inclusion can lead to the broadest increases in diversity and inclusion in firms.[22] DP2/21 respondents widely agreed that senior leaders should be accountable for the firm's diversity and inclusion strategy, and that the best approach would be to expand the scope of existing Prescribed Responsibilities (PRs) rather than create new ones. One area of concern was whether it was appropriate, in terms of the Senior Management Function (SMF) responsibilities for overseeing implementation of a firm's diversity and inclusion strategy, for individuals to be held to account for progress against targets for demographic characteristics. The PRA acknowledges this concern, appreciating the possibility of creating unintended consequences such as encouraging a 'tick-box' approach to targets. Therefore, this CP aims to make clear that SMFs would not be held to account for a failure to meet diversity targets, but rather proposes expectations on how SMFs should understand, and be able to discuss with the PRA, the reasons that firms set certain targets and, if they are not going to be met, the reasons why.

5.2 Responses to the survey indicated that 57% of firms surveyed already include diversity and inclusion in the objectives of one or more members of senior management. Of that number, 35% also reflect this in their variable remuneration. While 76% of respondents to the DP supported the notion of linking diversity and inclusion to non-financial performance metrics for variable remuneration, many firms were seeking flexibility and wanted to avoid a box-ticking culture driven by financial incentives being linked to quantitative diversity metrics. Some responses suggested that it would be most effective to link performance objectives to the delivery of diversity and inclusion strategy more generally. This could then be embedded into remuneration scorecards.

5.3 Rules 4.1(6) and (14) in the Allocation of Responsibilities Part of the PRA Rulebook (for banks), and Rules 3.1(2) and (3) in the Insurance – Allocation of Responsibilities Part (for insurers), specify PRs for firm culture. **SS28/15** and **SS35/15** explain that the PRA expects firms to have a culture that supports prudent management which embeds the principle of safety and soundness across the organisation.[23]

5.4 For those firms in scope of the PRs for culture,[24] the PRA proposes to clarify in the respective SSs that these PRs include responsibility for the development and implementation of diversity and inclusion strategies. PR I, usually held by the chair of the board, sets out the responsibility for leading the board's development of the firm's culture. PR H, usually held by the CEO, includes responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm. These SMFs would be expected to have their responsibilities for diversity and inclusion reflected in their Statements of Responsibility (SoRs).

5.5 While the responsible SMFs would have leading roles to play according to their respective PRs, and be ultimately accountable, business areas across the organisation would be expected to contribute to firm culture and the implementation of diversity and inclusion strategies. The SMF holding Prescribed Responsibility (PR) I[25] would be responsible for ensuring the board sets, approves, and adopts an appropriate diversity and inclusion strategy. Consequently, that SMF would be expected to ensure all members of the board have adequate time and opportunity to contribute to the development of the strategy and provide independent challenge.

5.6 The SMF holding PR H[26] would be responsible for ensuring that the strategy set by the board is implemented across the firm. This SMF would be expected to ensure all business areas understand the role they play in implementation. The SMF holding PR H would be expected to have their responsibility for diversity and inclusion appropriately reflected in their performance objectives and remuneration scorecard, and their performance against these reflected in their remuneration decisions, via the application of risk adjustments (where these apply).

5.7 For firms that are not in scope of culture PRs,[27] the PRA proposes that at least one SMF should have responsibility for the implementation of the firm's diversity and inclusion strategy reflected in their SoR. Where this is assigned to an executive SMF, diversity and inclusion responsibility should also be reflected in their performance objectives, as well as their variable remuneration where this exists.

5.8 Responsible SMFs would be expected to deliver results, be transparent about success and failure, and to identify the barriers hindering progress on diversity and inclusion, making targeted interventions to support effective implementation of diversity and inclusion strategies. Progress would be expected to be measured qualitatively as well as quantitatively. Failure to achieve quantitative targets related to diverse representation of demographic characteristics would not necessarily amount to failure in meeting their responsibilities overall if there was clear evidence of 'reasonable steps'. 'Reasonable steps' would include demonstrable efforts to implement a well-developed and evidence-based strategy, and an understanding of how a firm should address strategic shortcomings on diversity and inclusion over time.

Fitness and propriety assessments

5.9 Many respondents to DP2/21 noted that they already consider non-financial misconduct in fitness and propriety assessments. There was support for clarification on the regulators' approaches to this area.

5.10 Paragraph 3.8 of SS35/15, and paragraph 5.6 of SS28/15, explain that the conduct rules only apply to an individual in relation to the activities of the firm at which they are employed or are approved to perform a SMF. While the conduct rules therefore do not relate to a person's actions in their private life, existing expectations in SS35/15 and SS28/15 also state that an individual's wider behaviour could affect their ability to comply with the rules. In that manner, the way in which a person behaves in their private life may be relevant in fitness and propriety assessments.

5.11 The PRA proposes to update SS35/15 and SS28/15 to clarify that the PRA may take into consideration established patterns of behaviour of an individual that would, or would be likely to, affect the firm's safety and soundness, when considering whether the individual meets the PRA's standards of fitness and propriety. Examples of such conduct include bullying, discrimination, and harassment which would, or would be likely to, have the effect of hindering individuals within an institution from speaking up and providing effective challenge as part of the firm's decision-making processes. Firms would be expected to ensure that individuals subject to allegations of such behaviour are given an opportunity to respond to the allegations, and that both are assessed objectively and independently by an appropriately qualified person.

6: Monitoring diversity and inclusion

6.1 DP2/21 respondents generally considered that diversity and inclusion interventions, such as setting firm-wide strategies and target-setting, would be more effective if based on evidence about the current profile of the firm. Without understanding the current profile of the firm, it would be difficult to assess where improvement might be needed.

6.2 The PRA therefore proposes a new rule, in the General Organisational Requirements and Conditions Governing Business Parts of the PRA Rulebook, requiring CRR and Solvency II firms, including third country branches, to internally monitor diversity and inclusion for the purposes of taking appropriate actions to improve diversity and inclusion where necessary.

6.3 This rule has been designed with proportionality in mind, to ensure that firms with 250 or fewer employees are still monitoring diversity and inclusion, despite being out of scope of the proposals on regulatory reporting. The PRA considers the ability to monitor outcomes to be an important factor in making progress on diversity and inclusion and has set out expectations in the proposed new Diversity and Inclusion SS on how this could be achieved. Firms with 251 or more employees would have more specific requirements for monitoring in line with the data they would be required to collect as part of the proposed regulatory reporting requirements outlined in Chapter 7. All firms would need to determine which of these aspects are most relevant for their business, and to also consider their own position regarding compliance with data protection law, employment law, and equality legislation, in complying with the PRA's requirements and expectations.

7: Regulatory reporting

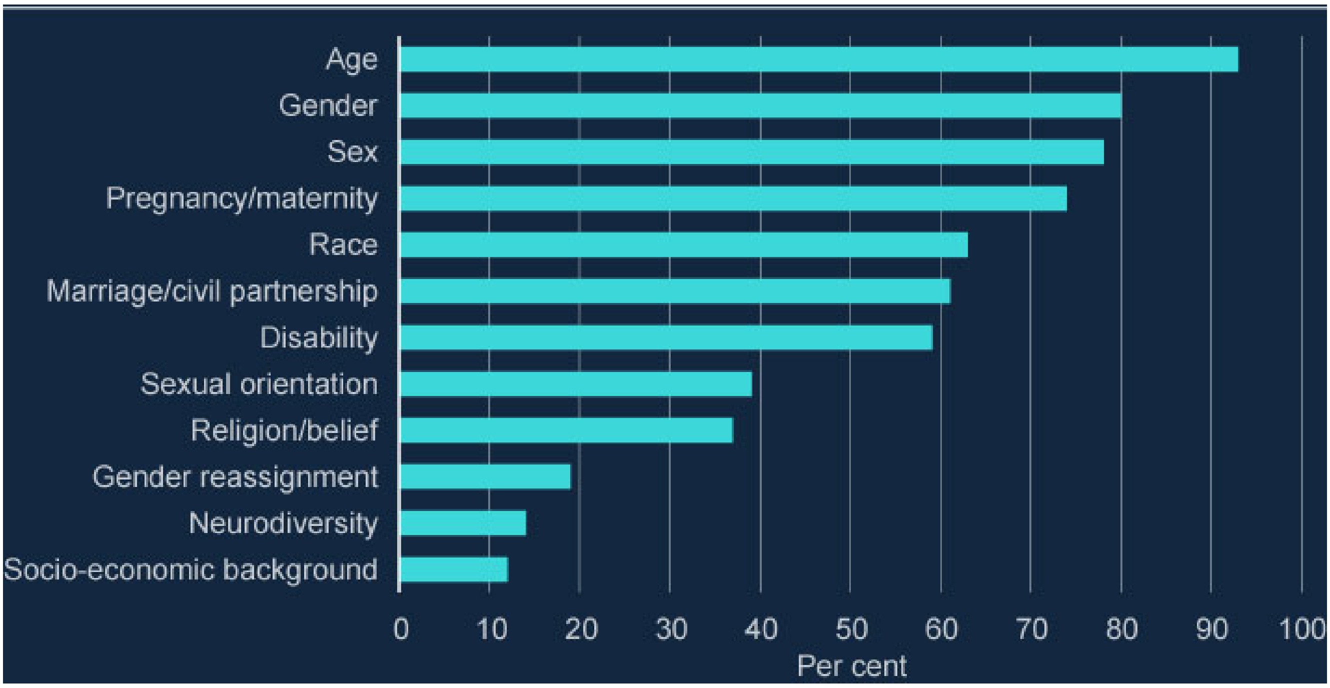
7.1 The DP2/21 questions relating to data and regulatory reporting received the most interest from respondents, with a total of 104 responses to at least one of the three questions on this topic.[28] There were 83 respondents that replied, 'yes' to the question 'Do you agree that collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector?'. In describing the role of data for furthering progress on diversity and inclusion, respondents used words such as 'fundamental', 'vital', 'essential', and 'the first step'.

7.2 A further 18 respondents were broadly supportive, taking a balanced view to the pros and cons of regulatory reporting on this topic, identifying some caveats and areas where they would like clarification. Only three respondents broadly disagreed with the notion of regulatory reporting on diversity and inclusion, only one of which was a regulated firm, which thought that participating in existing voluntary disclosure initiatives such as the Women in Finance Charter were sufficient.

7.3 DP2/21 responses indicated the importance of creating an objective evidence base to inform the further development of diversity and inclusion practices in the sector. Collecting data can help show where action may need to be taken to avoid the risks associated with a lack of diversity and organisational cultures which are not inclusive.

7.4 DP2/21 respondents had a range of views on whether the regulators should collect data on a wide range of the characteristics protected under the Equality Act 2010 ('protected characteristics'), and beyond, or just a subset. Many firms that responded to the survey were already collecting some data on demographic characteristics, as shown in Figure 2, although the PRA is aware that these are self-selecting respondents, and the progress among the wider population of regulated firms may not be as advanced.

Figure 2: Proportion of surveyed firms that collect various demographics



7.5 Many respondents to the DP noted the importance of measuring inclusion, with some survey respondents already using some metrics. Approximately 64% use employee surveys to help measure inclusion, with a further 10% planning to start doing this soon. Nearly half were collecting/reviewing data on culture or diversity through a dashboard (with just over 20% planning to do this soon), and 44% measure career progression with reference to some demographic characteristics (with just over 20% also planning to do this soon). Answers varied as to whether this information was reported regularly to the board or senior management, and at what intervals.

7.6 Respondents offered many helpful suggestions regarding the best way to design regulatory reporting proposals, and the PRA has aimed to make the proposals in this CP reflect these as much as possible. This included careful consideration of:

- the importance of reporting information on inclusion as well as diversity;
- the notion that data only supports progress as part of wider initiatives, and that reporting should not encourage a 'tick-box approach', which has informed the linkages between data and other proposals in this CP;
- how burdensome the requirements might be, including which firms would be in scope, when the requirement would be implemented, and how often the reporting would occur;
- which information to collect, aiming to provide, at a minimum, a useful picture of diversity and inclusion for supervisors and for preparation of a benchmarking report;
- the privacy implications of reporting the data;
- what firms are already collecting as part of their internal systems, existing legislation, or voluntary initiatives, to avoid duplication; and
- research and examples of good practice from other initiatives.[29]

All CRR and Solvency II firms (including third country branches)

7.7 The PRA proposes to require all CRR and Solvency II firms (including third country branches) to report their total UK employee numbers at an individual level, to ensure that the PRA can assess which firms should be in scope of the different parts of the proposed policy package. However, for proportionality reasons, firms with 250 or fewer employees in the UK would not be required to complete any of the other information requested on demographics, targets, and inclusion. That said, these smaller firms are welcome to complete the regulatory return on a voluntary basis to support broader benchmarking work and publication by the regulators.

Firms with 251 or more employees

7.8 Firms with 251 or more employees based in the UK would be required to report on certain diversity and inclusion metrics in terms of the number of board members,[30] senior leadership, and total employees falling within different categories. To improve diversity, it is important for firms to consider not only board diversity but also the progression of their employees from entry to executive level, which is why the PRA proposes that firms report on the different levels of seniority within the firm: Board, senior leadership and all employees (including the Board and senior leadership). Data can help firms understand which areas to focus on when planning strategy and setting targets. Firms would also be required to report information on the targets they have set for themselves.

7.9 The PRA considers that organisations which use data to drive action and accountability on diversity and inclusion are more likely to be able to make progress on the goals they set for themselves.[31] For this reason, the PRA proposes that firms collect and report certain demographic data and inclusion data, which can support effective board oversight of diversity and inclusion in their firms. Diversity data are essential for organisations to assess the current composition of their workforce, which in turn would help in setting relevant targets for the different role categories at the organisation (see Chapter 3), and in identifying potential gaps and pockets where intervention may be required.

7.10 The PRA would also use the data to produce and publish an aggregated benchmarking report in relation to regulated firms. This would benefit firms by giving them an insight into how they compare to their peers and wider sector. The regulators would then be able to observe commonalities in problem areas and highlight these to industry to support collective action and sharing of good practice.

7.11 The reporting on demographic characteristics that the PRA is proposing includes data on how many individuals with different characteristics are employed and in what different levels of the organisation. These metrics, sometimes termed ‘outcome’ metrics, are important as they are a useful potential indicator of broader diversity performance. They are important for establishing a baseline against which progress can be measured and are necessary for assessing the effectiveness of various interventions. However, outcome metrics indicate only whether firms may have issues to address, and not what the issues might be, or how to make progress. The PRA would expect that firms also develop ‘process’ metrics, which can help to identify potential challenges in employee-management processes such as performance measurement, recruitment, promotions, attrition, disciplinary proceedings, and dismissals within a firm.

7.12 The PRA also proposes to require firms with 251 or more UK employees to report on workplace inclusion. Reporting on inclusion can be seen as a measurement of the culture of a firm and whether it is inclusive. Inclusion can be understood from an organisational and individual perspective.[32]

7.13 The employee inclusion experience can be more challenging to identify and quantify than measuring diversity, because employee inclusion is about how welcoming and safe an environment is for all, which among other aspects captures whether individuals are comfortable to speak up, raise concerns, and provide challenge without fear of repercussion. Firms can learn a lot about how valued, included, and supported employees feel through employee surveys, exit interviews, or formal grievance reporting, and any other feedback that employees might provide on a regular basis. As part of this, firms may want to consider what the wider data indicates about their culture and progress against measures of inclusion.

7.14 It is also important to recognise that individuals from underrepresented groups might have a different experience from the majority, so firms could consider, when collecting inclusion data, asking individuals to voluntarily declare their demographic characteristics as well, so that firms can get an insight into how individual experiences may differ. This would allow firms to assess whether there are any discrepancies that should be addressed by targeting interventions.

Regulatory reporting period

7.15 The PRA proposes that firms would report yearly during a three-month window following a reporting reference date that would be specified upon publication of the final policy. Firms would be required to report every year on their position as at the specified reference date, reflecting data collected over the preceding 12 months. The first reporting period is proposed to take place in the year following publication of final policy, but the first report would be on a 'comply or explain' basis. This means that, within three months of the rules coming into effect one year after publication of the final policy, firms would be expected to fill in the regulatory reporting return (hereafter 'return') to the best of their ability. However, the PRA recognises that many firms have legacy systems that might hinder effective collection of diversity data, [33] and they may not have had enough time to build all the systems to enable them to report. In such situations, firms would be required to explain why they are not yet able to report against the full suite of mandatory data, and how they plan to address any remaining gaps. From the following year onwards, firms would be required to provide the full suite of mandatory data requested on the return.

Regulatory reporting return: Demographic questions

7.16 The PRA proposes that firms with 251 or more UK employees would be required to collect and report demographic data to measure diversity outcomes. Firms with 250 or fewer UK employees would not be required or expected to collect and report any particular demographic data, although the PRA considers it good practice for firms to collect at least some demographic characteristics where firms judge it relevant for their circumstances, to enable monitoring and where they are satisfied to do so would be in compliance with data protection law.

7.17 Firms would only be required to make a single reporting submission to the regulators to fulfil the PRA's and the FCA's reporting requirement.[34] This would be achieved via the FCA's RegData system, using the usual submission methods. The draft reporting template in

Appendix 7 indicates the questions that the PRA and FCA propose to ask firms as part of the regulatory reporting requirement. We propose to introduce a joint FCA and PRA regulatory return covering the following metrics:

Mandatory

- age
- sexual orientation
- sex or gender
- long term health condition
- ethnicity
- religion

Voluntary

- gender identity
- parental responsibilities
- carer responsibilities
- socio-economic background

7.18 While DP2/21 generally supported collection against all nine protected characteristics under the Equality Act,[35] the PRA considered carefully how to collect information on demographic characteristics that (a) impact the working experience of employees; (b) firms can act upon to some degree; (c) are supported as relevant by research; (d) are indicative of inclusiveness and (e) balance the likely costs and benefits of data collection. Taking such an approach should reflect the diversity of employees that are potentially able to move through the pipeline and become part of the senior leadership of the firm, thus facilitating diversity of thought and helping to avoid groupthink. Collecting this information allows firms to aggregate employees together so that they can understand whether any issues are isolated or systemic. Receiving this information would allow the PRA to monitor diversity and inclusion in firms from a supervisory perspective and facilitate its aim of publishing a diversity and inclusion benchmarking report. While the PRA has broadly followed the list of protected characteristics from the Equality Act, in some cases it has proposed to depart or go beyond these. At the same time, for reasons of proportionality given the current level of data collection by firms, the PRA has decided to make collection of data on some characteristics voluntary rather than mandatory. The rationale for selection of some of the specific characteristics, including the allocation as mandatory or voluntary reporting, is set out below in this chapter.

7.19 It is common for diversity initiatives to focus on women and ethnicity[36]. The PRA considered it relevant for its objectives to go beyond these characteristics. As well as including some of the protected characteristics we have included additional characteristics that the PRA considers can impact the work experiences of employees.

7.20 It is important to be clear that under these proposals, the PRA is not creating a requirement for employees to disclose information to their employers. On the regulatory reporting return, for all data points, it allows the reporting of data on how many employees in each category said ‘prefer not to say’ in response to certain questions or did not answer at all. The PRA considers that it is still valuable to collect data on those who ‘prefer not to say’ or do not respond to the request for the information. If firms were receiving high numbers of these responses relative to their peers, this could possibly indicate a lack of inclusiveness. Such firms would be expected to explore whether firm culture might be discouraging people from self-disclosure. Firms could also explore whether their internal communications about diversity and inclusion were making clear the firm’s position and the reasons for collecting diversity and inclusion data from employees. Where firms use employee data that they already hold within their systems to complete the reporting, they can decide how to map the data to ‘prefer not to say’ and ‘did not respond’ categories as relevant.

Mandatory reporting

7.21 The regulators propose to introduce mandatory reporting for age, sexual orientation, disability or long-term health condition, ethnicity and religion. These are each protected characteristics which the pilot survey indicated are collected by the majority of firms. In addition, the regulators are proposing that firms should be required to report on the basis of either sex (a protected characteristic) or gender but can choose to report on both.

7.22 Both sex and gender are important and distinct datapoints that can affect an individual’s experience at work in different ways. A large majority of firms who responded to the PRA’s and FCA’s pilot data survey in 2021 reported that they were already collecting data on the demographic characteristics of sex and gender, so the PRA proposes to introduce reporting against either of these characteristics, with firms able to choose which characteristic to use. In proposing to offer firms the choice to report against sex or gender the PRA has sought to take a similar approach used in the FCA’s **Listings Rules** which has already established an approach whereby listed firms disclose on the basis of sex or gender identity. There would also be costs in requiring all firms in scope of the proposals to enhance data collection to enable reporting on both of these areas. On balance the regulators have decided to propose an approach that allows firms flexibility in reporting data that firms consider to be most meaningful for their employee population. At the same time, the regulators encourage firms to report on both characteristics if they have the data available, as this would provide further data to identify the extent of underrepresentation of women in the financial services sector, and to allow more complete monitoring and benchmarking of progress across firms. The PRA has adjusted the style of the questions to account for the fact it proposes to collect aggregated data from firms rather than directly from individuals. We welcome feedback on the approach taken in this area from CP respondents.

Voluntary reporting

7.23 For the reasons given below, the PRA also proposes to collect data on parental and carer responsibilities, gender identity, and socio-economic background. For reasons of proportionality given the current level of data collection by firms, the PRA has decided to make collection of data on some characteristics voluntary rather than mandatory. Specifically, firm responses to the regulator's 2021 pilot data survey indicated that less than 50% of large firms (firms with 251 or more employees) currently collect data against parental or carer responsibilities, gender identity, or socio-economic background.

7.24 The PRA proposes to collect data, on a voluntary basis, on parental and carer responsibilities. While not directly protected by the Equality Act, studies have shown those with parental and/or carer responsibilities can face associative discrimination and barriers to inclusion due to caring for those with certain protected characteristics, such as the elderly, young, and people with a disability. One **study** noted that one in five working parents has faced unfair treatment at work since Covid-19, while **carers** are more likely to work part-time or stop working altogether. Furthermore, OECD **research** shows that caring responsibilities fall disproportionately on women, with them spending 2 to 10 times more time on unpaid care work than men. Potential discrimination and lack of inclusion for parents/carers leads to less participation from women in the workforce. This has the potential to hinder firms' ability to achieve targets in relation to women, and, therefore, reduce the benefits that improved diversity in relation to women can bring by reducing groupthink and supporting safety and soundness.

7.25 While collecting data on sex or gender may reveal whether a firm is achieving the relevant outcomes, it would not necessarily reveal the barriers to doing so. Collecting parent and carer data can help with this. It would assist in identifying whether there are barriers to achieving gender targets imposed by a lack of effective approaches to recruiting, retaining, and promoting parents and carers.

7.26 The PRA also proposes to collect information on gender identity, on a voluntary basis, as opposed to gender reassignment (which is the protected characteristic as set out in the Equality Act 2010). In 2015, a House of Commons Women and Equalities Committee report noted that 'the use of the term 'gender reassignment' in the [Equality] Act [2010] is outdated and misleading'.[37] The suggested gender identity question for voluntary reporting is closely aligned with the 2021 England and Wales Census question 'Is the gender you identify with the same as your sex registered at birth?' which was decided by the ONS after extensive research and public **consultation** [38] The PRA also notes that the **Solicitors Regulation Authority** uses the same question in its reporting template.

7.27 The PRA also proposes to collect information on socio-economic background on a voluntary basis. The Government noted in 2018 that establishing common measures of socio-economic background is a core component of the Government's efforts to understand and address **barriers** to social mobility. Measures of socio-economic background, can help employers' to identify barriers to social mobility and measure and benchmark progress.[39] In addition, a survey in the City of London's Building the Baseline report showed that at senior levels, the UK financial and professional services sector is not in line with the rest of the economy and is unrepresentative of the communities it serves.[40] There is also research from the legal sector which notes that individuals from lower socio-economic backgrounds may be higher performers in their firms, but appear on average to be less likely to progress in their early career.[41]

7.28 Research has shown that women and people from minority ethnic backgrounds may also come from more disadvantaged socio-economic backgrounds, and that this can amplify inequalities in the rates of progression within firms. Making appropriate adjustments to support those from disadvantaged socio-economic backgrounds to progress can have benefits for business performance, talent pool, and reputation.[42] The City of London Bridge Group **report** recommends collecting and analysing data on socio-economic background, pointing out the benefits of this for firms, the financial system, and society. The PRA has considered the work of the **Social Mobility Commission** in generating its proposal for voluntary reporting on socio-economic background, as split into three groups (professional backgrounds, intermediate backgrounds, and lower socio-economic backgrounds). The PRA recommends that firms reporting in this area use the **Social Mobility Commission's Financial and professional services toolkit** to measure how their employees fit into these three groups.

7.29 Over time, the PRA anticipates that increasing numbers of firms may choose to report data against the voluntary metrics. To that end, the PRA may consider moving to mandatory reporting against these demographic characteristics at a later date. However, the PRA recognises that good quality data also depends on firms having well-developed systems in place, and on employees feeling comfortable providing this data. The PRA's proposed approach seeks to address those concerns by giving firms the necessary time and flexibility to improve their data collection processes.

Other protected characteristics

7.30 The PRA considers that collecting data on demographic characteristics is most meaningful for the purpose of monitoring progress on diversity where it enables a time-series analysis. For this reason, the PRA does not propose to collect data on marriage or civil partnership, or pregnancy and maternity. This is because such data, compared to some of the other characteristics proposed for the regulatory return, would be difficult to use to create a time-series analysis through which a firm's diversity and inclusion outcomes could reasonably be measured.[43] Given this, and taking proportionality into account, the PRA has excluded these characteristics from its reporting proposals. However, firms still have a legal responsibility to avoid discrimination based on any protected characteristics, including these ones.

7.31 The PRA would expect firms to assure themselves of their adherence to applicable privacy legislation in collecting data from their employees and reporting it to the regulator, including by ensuring their employees understand the purpose for which the data is being collected and reported. Firms would be advised to consider their data protection, employment law, and equality obligations when implementing the PRA's requirements and expectations. Firms would be expected to tell individuals how their data will be used and who will have access to it.

Regulatory reporting return: Questions on targets

7.32 The PRA also proposes to use the regulatory reporting return to collect data on what targets the firm has set for itself, to inform supervisory discussion about target-setting and progress. The PRA would also be able to use this information to benchmark the way different firms are setting their targets. As explained in Chapter 3 of this CP, failure by a firm to achieve its numerical targets would not be considered as a failure to comply with the proposed rules on targets. Instead, where targets are not achieved, firms should be able to explain why and set out what they are doing to address this (either by targeting interventions in the firm to improve likelihood of achieving the targets in future, or by changing the targets to set a more achievable goal, based on a clear understanding of where the firm is and where it aspires to be).

Regulatory reporting return: Questions on inclusion

7.33 The proposed reporting on inclusion would be based on firms asking their employees (for example via an anonymous survey), to what extent they agreed they:

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

7.34 The return would require numbers of employees in the board, senior leadership, and total population, respectively, who answered under each level of agreement with the statements.[44]

7.35 The PRA considers that by measuring inclusion, firms would be able to assess how inclusive their organisational culture is and take action if needed. Where firms are collecting and monitoring their inclusion data, it would be useful for them to also consider their people management practices, the employee experience, and firm values.

7.36 It also might be useful for firms to consider the effects of intersectionality in the workplace where employees experience additional challenges as a result of sharing multiple diversity characteristics; diversity cannot be considered fully with reference only to single demographic characteristics. In addition, inclusion data from underrepresented individuals may highlight a more negative experience, for example due to them not feeling a sense of belonging, feeling that they must conform or change themselves to fit in, and/or experiencing conscious or unconscious bias. Good practice in relation to analysis of inclusion data would take these various factors into account. Therefore, the PRA considers that collecting both demographic and inclusion data, analysing it, and evaluating it, provides an important and objective fact base on which potential diversity and inclusion issues can be identified.

7.37 The PRA considers that the importance of inclusion in progressing diversity is well documented, and has considered carefully, in light of existing good practices, which questions can be asked in order to get a picture of inclusion at firms. However, the PRA considers that there are likely to be alternative valid approaches, and this is an area where good practice is continually developing. The PRA's proposed approach is only a starting point, which could evolve over time as the policy matures and understanding of inclusion good practice grows.

Voluntary data collection template

7.38 The PRA proposes to provide a voluntary data collection template, for internal use, which would be entirely separate from the regulatory reporting return. Firms could use this template to collect the data they would be required to report to the PRA. The PRA considers that using this voluntary data collection template would assist firms in collecting high quality data and has provided it in response to requests in some DP feedback for the regulators to provide tools and examples of good practice. It may also support firms' analyses of areas where they need to focus. However, using the template would not be required or expected, and firms would be able to choose how best to collect the data needed for reporting purposes.

7.39 Where firms already hold certain demographic information, they can use this rather than collecting it afresh. Where information is liable to change over time, the PRA would generally expect such information to be collected annually.

8: Disclosure

8.1 The DP responses were broadly positive about requiring the disclosure of diversity and inclusion data, as long as this was supported by appropriate guidance on good practice.

8.2 The PRA therefore proposes to introduce a requirement for CRR and Solvency II firms, including third country branches, that have 251 or more employees in the UK, to disclose data on the percentages of employees that are representative of different demographic characteristics, as well as inclusion metrics, in line with what is requested in the regulatory reporting return (see Chapter 7). As with reporting, firms can choose whether their disclosure is based on sex or gender or both. As gender identity, parental and caring responsibilities and socio-economic background are voluntary metrics, disclosure on these demographic characteristics is also voluntary.

8.3 For sex, gender and ethnicity, firms would usually be expected to group their disclosures (as relevant) into three categories: board,[45] senior leadership, and the employee population. Firms would not be expected to disclose demographic data where to do so would contravene data protection legislation or other privacy laws applicable to them; for example, where sensitive information relating to an individual could be identified via the data disclosed. Therefore, for the remaining characteristics (and if necessary for sex, gender or ethnicity) firms can group the board and senior leadership into one category to increase the number of individuals in the group and reduce the risk of identification. If there is still a risk of identification after these categories are aggregated, firms could also aggregate further and disclose only on all employees as a group. It is the responsibility of firms to undertake a risk assessment of their disclosures related to demographics and assure themselves of their adherence to data protection laws. Where firms judge that certain disclosures would not be lawful, they are expected to disclose the reasons for this decision.

8.4 The new draft SS in Appendix 6 outlines the full set of diversity and inclusion disclosures that the PRA is proposing. Firms would be required to disclose:

- diversity and inclusion data;
- board and firm-wide diversity and inclusion strategies;
- targets that the firms set for themselves, and their policy for achieving their targets;
- a narrative of the reasons why firms have set certain targets; and
- progress against the targets over time.

8.5 The PRA does not intend to be prescriptive on the specific format of these disclosures. However, all the disclosures should be in an electronic format and accessible from a single point on a firm’s website, even if the information is spread across several documents.

8.6 The PRA proposes that the published versions of the firm-wide and board diversity and inclusion strategies should be updated from time to time as strategies change. For disclosures of targets and diversity and inclusion data, the PRA proposes that these should be updated annually. Disclosure should occur at the same time the firm publishes its annual report and accounts, or if the firm does not produce these, within 6 months of the end of its financial year. Firms would be able to choose where to publish their targets and data disclosures: for example, they could present them in their annual reports, in a dedicated diversity and inclusion report, or on their website.

8.7 The timeline for disclosures of targets and diversity and inclusion data, following implementation of final policy, would differ from the rest of the implementation of this policy. Firms should be able to use the data they collect for regulatory reporting for the disclosures, but the PRA recognises that they need additional time between gathering and reporting the data and releasing it publicly. Therefore, the PRA proposes that annual disclosure of targets, and diversity and inclusion data, should not be mandatory until the second year after the rules come into force. Firms are encouraged to make disclosures during the first year after the rules come into force on a voluntary basis. There will be a one-year gap between publication of the policy statement and the rules coming into force. Therefore, all firms will be required to have published their first disclosures within 3 years of the publication of the PS.

9: The PRA's statutory obligations

PRA objectives analysis

Primary objectives: Safety and soundness and policyholder protection

9.1 The PRA considers that improving diversity and inclusion through the proposals in this CP would advance its objectives of promoting the safety and soundness of the firms it regulates and securing an appropriate degree of protection for those who are or may become insurance policyholders. Primarily, the PRA expects these outcomes would be achieved through its potential beneficial impact on decision-making across all levels of the organisation, promoting good governance and risk management.

9.2. As set out in SS5/16, the PRA expects boards to 'articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goals', and that all members of the board are expected to provide appropriate challenge.[46] Boards are expected to set the risk appetite and tolerance for their institutions, and without sufficient diversity of thought, skills, experience, and effective challenge among members, they are more likely to miss or underestimate key risks posed by their strategic decisions.

9.3 The Walker review of corporate governance in UK banks (2009) noted that lack of appropriate challenge on boards was a key shortcoming leading to bank failures during the 2008 global financial crisis.[47] For insurance, a 2018 European Insurance and Occupational Pensions Authority report cites corporate governance and 'the risk that management or staff lack the necessary skills, experience or professional qualities' are the two most common general causes of failures and near-misses.[48] In addition, some research has found that some financial services firms' failures have been a result of groupthink.[49]

9.4. Some of the symptoms of groupthink that are relevant to the PRA's objectives include: a high level of group cohesion; homogeneity of group members' social background and ideology; and leadership that does not encourage debate. Demographic and experiential diversity, and likely associated diversity of thought, helps disrupt group cohesion, helping to break down groupthink. However, diversity alone is not enough; an inclusive culture is also essential to facilitate more effective decision-making, by ensuring that people can speak up and share their differing perspectives.

9.5 While research on the impact of diversity and inclusion in organisations continues to expand, a growing body of research suggests that diverse teams are likely to make better decisions. The Harvard Business Review notes that 'diverse teams are more likely to constantly re-examine facts and remain objective'.[50] Some research has found that decision-making improves as team diversity increases,[51] and that 'diverse teams enable organisations to consider a wide range of perspectives and ideas throughout decision-making processes'.

9.6 Government and industry reports, and voluntary initiatives, also point to the benefits of diversity and inclusion. Examples include:

- **Ethnic diversity of UK boards: The Parker Review**
- **Race in the workplace: The McGregor-Smith Review**
- **The Women in Finance Charter**
- **FTSE women leaders': The Hampton-Alexander review** and
- **Who gets ahead and how? Socio-economic background and career progression in financial services: a study of eight organisations**

9.7 At the same time, the PRA recognises that while there is evidence on the benefits of diversity, not all of it is conclusive, and some studies are more mixed, in part due to lack of consistent and accurate data. The PRA considers that the proposals in this CP on gathering data and monitoring the effects of actions that firms take to improve diversity and inclusion can help build that evidence base and provide the basis for future evaluation and refinements in policymaking.

9.8 While improved effectiveness in decision-making – including at board-level – is a key aim of the proposals in this CP, and the subject of much focus in existing research, the PRA's proposed policies aim to increase diversity and inclusion across organisations – not just at board level. The reason for this is that board and senior management decision-making is ultimately informed and supported by analysis and judgements made by staff throughout an organisation. In addition, without improving diversity across the entire industry at all levels, and building a pipeline of skilled financial services personnel, there would not be a diverse talent pool from which to recruit suitable board members.

9.9 Poor diversity and inclusion in firms can also pose operational and reputational risks in addition to groupthink, including but not limited to:

- firms being more likely to overlook key risks, which in turn could have reputational damage in the eyes of stakeholders, future employees, consumers, and investors;[52]
- failing to recruit and retain talented individuals through a lack of an inclusive culture and progression opportunities, and the related negative effect on the effectiveness of risk management;
- conduct risk posed by poor corporate culture, including employee disenfranchisement related to lack of inclusion; and
- the risk of prosecution and litigation for engaging in discriminatory practices.

9.10 In the proposals, in line with some of the prominent theories on how to effect change in this area, the PRA has adopted a multi-pronged approach to achieve the desired outcomes with respect to its objectives. Figure 2 below sets out how this approach can be mapped into the 'Theory of Change' model – which can help provide a framework against which the success of the PRA's policy proposals could be evaluated at a future date.

Figure 2: Diversity and inclusion policy proposals – Theory of Change

Risks

- Absent or poorly designed and coordinated diversity and inclusion strategies leading to failure to effect change
- Low level senior and/or wider employee buy-in of diversity & inclusion strategies
- Poor or non-inclusive culture

Measures

- Introduction of well-designed, holistic diversity and inclusion strategies
- Improved senior accountability and responsibilities
- Target-setting
- Monitoring effectiveness of strategies, targeting interventions where needed
- Assessment of individual conduct
- Collection of diversity and inclusion data
- Reporting of data to the regulator
- Disclosure of diversity and inclusion strategies, targets, demographics, and inclusion information

Output

- Firms update their diversity and inclusion strategies, considering progress made
- Firms analyse and evaluate their diversity metrics and target interventions where needed
- Firms consider their inclusion metrics, and consider how to address these with a view of improving engagement, therefore encouraging individuals to speak up and provide effective challenge

Outcomes

- Firms improve diversity with the organisation by accessing wider talent pool
- Firms have more inclusive cultures, demonstrated through evidence of improving inclusion metrics

Impact

- Improvements in recruitment, retention, inclusive culture, and progression throughout all levels of the organisation.
- Improvements in quality of decision-making, consumer outcomes, safety and soundness, and policyholder protection.

Secondary objectives: competition, competitiveness, and growth

9.11 The PRA has a secondary objective to facilitate effective competition in the markets for services provided by PRA-regulated firms. The PRA is also required (in discharging its general functions in a way that advances its primary objectives and so far as is reasonably possible) to act in a way that facilitates (subject to aligning with relevant international standards) (a) the international competitiveness of the economy of the United Kingdom (including in particular the financial services sector through the contribution of PRA-authorised persons) and (b) its growth in the medium to long term.

9.12 The PRA considers that the proposals in this CP facilitate effective competition, competitiveness, and growth because:

- there is evidence to suggest that enhanced diversity among employees can help support greater innovation, enabling firms, particularly new entrants, to be more competitive;[53]
- customers are more likely to choose firms that can offer services that meet their various needs, and their needs are likely to be better understood where the composition of firms at all levels reflects the society they serve;[54]
- greater innovation, and the development of products and services that better meet consumer needs, can in turn support the UK's competitiveness and growth;
- considering diversity in recruitment practices, and improving the working environment through inclusiveness, can help firms access and retain a wider pool of candidates, potentially making them more competitive in the labour market;[55]
  - countries that access the full range of their talent pool have better economic growth potential; and
  - inclusive UK firms can support competitiveness, as they are more likely to access the global labour market by being more attractive to highly skilled workers.[56]

Engagement with Statutory Panels

9.13 The Practitioner Panel has been consulted in relation to these proposals.

Objectives analysis by policy proposal

Firm-wide strategies (Chapter 2)

9.14 The PRA considers that the proposals set out in Chapter 2 would drive progress on diversity and inclusion by providing information that firms, regulators, and other stakeholders could use to hold the responsible Senior Managers and the board to account for progress, as well as failure to take action, in particular where it impacts firms' safety and soundness.

9.15 The PRA considers clearly documented and published diversity and inclusion strategies help explain firms' commitment to, and accountability for, a diverse and inclusive culture where everyone has opportunities to progress (supporting a diverse pipeline that can combat groupthink at the top of the organisation), and to express a wide range of viewpoints (supporting effective and prudent decision-making).

9.16 The proposed expectations for what to include in the strategy are the key areas firms should consider as a basis for improving diversity and inclusion, and which are designed to help to drive lasting change. Clear objectives, goals, and plans form a basis for a wider institutional strategy, while diverse and inclusive recruitment, progression, and retention practices would support the achievement of these goals. Publishing the firm-wide strategy would both demonstrate the firm's commitment and allow stakeholders, including the regulators, investors, consumers, and employees, to hold firms to account.

9.17 Clear documentation of policies and procedures by firms is an important feature of good governance, strong risk management, and effective controls. In the context of the diversity and inclusion strategy, it can help if firms set out clear expectations on what employees' respective roles are in fostering an open and inclusive environment and empowering their colleagues to speak up, express their views, and raise concerns. It can support the board in demonstrating how it is meeting the PRA's expectations in **SS5/16** on being able to 'articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goals,'[57] and can also form a basis for review and challenge from the firm's internal control functions and from the regulators. The expectation that risk, compliance, and internal audit support the implementation of diversity and inclusion strategy would contribute to the firm's controls around the strategies, helping them to measure progress and assess how to improve over time.

9.18 The proposed requirements on firms to regularly review and update, as appropriate, their diversity and inclusion strategies would help ensure these remain relevant and reflective of changes in the firms' employee profiles (eg as a result of staff turnover), and would also act as a prompt for firms to update their approach in light of changes in culture (eg poor scores in inclusion surveys) and/or material events that could be linked to poor governance, risk management, and/or groupthink.

9.19 Disclosure of the firm-wide strategy would allow external stakeholders to hold firms to account on their practices, which can help drive improvements. Given the growing focus of investors and other stakeholders on diversity and inclusion (and other environmental, social, and governance (ESG) metrics), requiring firms to publish their approach and setting out minimum expectations on what good looks like will allow relevant stakeholders to use this information to make decisions, which should contribute to market discipline, a key driver of effective competition, as well as competition in the market for services.

Targets (Chapter 3)

9.20 The PRA considers its proposals on targets advance safety and soundness of firms through firms setting concrete goals to support the embedding of their diversity and inclusion strategies. Target-setting by firms helps to focus minds, which in turn helps to embed other policies and practices on diversity and inclusion, motivating long-term progress. Targets encourage firms to set up initiatives around career progression and improving the talent pipeline.

9.21 The setting of targets can be important as research has shown that potential board members are often identified through networks[58] and that there can be a tendency for boards to select in their own image.[59] The downside of this is that it can result in a similarity of views.

9.22 The proposal to require firms to disclose their targets, alongside a narrative on its rationale and latest progress, supports market discipline and accountability, and enables stakeholders to compare firms against their peers, thereby facilitating effective competition. Explaining their approach to diversity and inclusion may also help firms attract and retain talent.

9.23 A number of the proposals are focused on demographic diversity. While these are an important driver of diversity of thought, the PRA acknowledges that they are not the only driver. Demographic diversity is one enabler of the outcomes the PRA is seeking in terms of avoidance of groupthink and better risk-management, including a greater ability for board members and employees to speak up, challenge, and contribute with the aim of being heard by the majority group.

9.24 The proposal not to be prescriptive about the targets firms set, and to exclude smaller firms from being required to set targets, has been developed with the aim of not posing barriers to effective competition, competitiveness, or growth, which might result from a one-size-fits-all approach.

Board governance (Chapter 4)

9.25 The PRA considers that its proposals related to board governance support safety and soundness and policyholder protection by aiming to reduce groupthink on boards and their sub-committees, where most key decisions that impact the safety and soundness of firms are made.

9.26 Expanding existing requirements on board diversity to also capture inclusion recognises that diversity on its own may not lead to benefits in governance if boards and their sub-committees do not maintain an inclusive culture that allows for constructive challenge and debate as part of the decision-making process. Given the importance of ‘tone from the top’ – a theme widely recognised in DP feedback – boards’ approach in this area can impact the behaviours of other individuals within the firm, including those with the ability to take decisions that can have a material impact on a firm’s risk profile, and the effectiveness of control functions. The proposals outline several measures that the PRA considers would help firms set an appropriate ‘tone from the top’, which in turn supports diverse and inclusive practices, which can help foster a healthy and prudent risk culture across the wider organisation.

9.27 Placing greater emphasis on succession planning, including through the lens of diversity, complements the PRA’s existing expectations on succession planning, in particular that boards have ‘robust succession plans that recognise current and future business needs and requirements’ (see Chapter 10 of SS5/16). The PRA’s expectations set out in the SS also reflect concerns identified in the PRA’s 2020 evaluation of the **Senior Managers and Certification Regime**, namely that ‘firms might be tempted to put forward candidates with similar characteristics to past candidates to facilitate regulatory approvals'. Providing clarity on the PRA's expectations with respect to succession planning, including encouraging firms to consider a diverse pool of applicants, can help dispel misconceptions in this area. Combined with considering diversity within the internal pipeline, the proposals could help support greater diversity at senior positions over the medium term, for both executive and non-executive positions, within individual firms and the industry as a whole.

9.28 Requiring firms to publish their board diversity and inclusion strategies, rather than set out publicly how they comply with the relevant rules, supports comparability – and therefore transparency and accountability within firms – which may facilitate effective competition through market discipline.

Individual accountability (Chapter 5)

9.29 A key principle of the Senior Managers & Certification Regime (SM&CR) is that the most senior decision-makers should be accountable for specific actions falling into their area of responsibility that affect prudent management of the firm. The PRA considers improved diversity and inclusion to be part of building a culture that supports prudent risk-taking, in support of safety and soundness. Assigning SMF responsibility for diversity and inclusion creates accountability for this outcome, and therefore supports the PRA's primary objective. Some research shows that efforts to establish clear responsibility for progress on diversity lead to the broadest increases in managerial diversity in firms.[60]

9.30 These benefits of individual accountability can be further supported by the setting of appropriate incentives, including via variable remuneration, to progress diversity and inclusion strategy, and by holding individuals accountable for addressing the barriers to progress. This, alongside clarity on how misconduct and certain patterns of behaviour could drive against the objectives of the policy package, would support firms in making progress towards the diversity and inclusion objectives they set for themselves, and can help discourage behaviours that can have adverse impacts on a firm's risk culture and its safety and soundness.

Monitoring diversity and inclusion (Chapter 6)

9.31 The PRA considers that monitoring diversity and inclusion is necessary for assessing the state of play and progress, and for formulating proposals around the targeting of interventions. The PRA is aware that monitoring by itself has not been demonstrated to be effective enough to drive change;[61] however, combining it with other initiatives and interventions, including those proposed in this CP, can support measurable change.

Regulatory reporting (Chapter 7)

9.32 Without diversity and inclusion data, firms would be less able to ascertain when they have met, or are progressing towards, their targets and desired impact of their interventions. It would be important for firms to also consider how to use the data they collect to analyse potential intersectionality of employee experiences, to understand where practices could be hampering or indeed benefiting diversity of thought and effective decision-making.

9.33 The proposal to require regulatory reporting would support supervisory information relevant to the effectiveness of firms' governance and risk management arrangements, by providing data on firms' progress on diversity and inclusion related outcomes. Reporting diversity and inclusion data would allow supervisors to understand firms' progress against their policies and targets. As these data also form part of **culture measurement** such data can also act as an early indicator for certain prudential (and conduct) outcomes.

9.34 By requiring firms to complete a regulatory return, the PRA would be ensuring that firms are collecting information that would help them monitor their own progress. Collecting data on diversity and inclusion is central to the proposed policy package as it can help monitor progress, treating diversity and inclusion like any other strategic business issue.

9.35 Standardised reporting also allows for data to be aggregated and analysed across the sector. In relation to the voluntary reporting, and the reporting on the basis of sex or gender, the PRA has considered the fact that the voluntary reporting of some characteristics may make it more difficult to draw firm conclusions across the sector, but has weighed this up against the additional costs that would be incurred by firms if mandatory reporting was adopted more widely. The PRA intends to use the data reported by firms to create an industry benchmarking report outlining the state of diversity and inclusion across the banking and insurance sectors. In this way, collecting data would support effective competition and transparency over time, by offering firms a public basis for comparison against an industry average.

Disclosure (Chapter 8)

9.36 Firms' disclosure on diversity and inclusion is a clear statement of intent. It sends a strong message about how it is approached, where improvement is sought, and what is being done to deliver change. Such transparency is likely to be of interest to a range of stakeholders, including investors, customers, and potential future employees.

9.37 The PRA considers that disclosure also supports its secondary objective of facilitating effective competition through encouraging market discipline and stakeholder scrutiny. It may have some positive effect on growth and competitiveness by creating additional transparency for potential employees, customers, and investors.

‘Have regards’ analysis

9.38 In developing these proposals, the PRA has had regard to the FSMA regulatory principles, and the aspects of the Government’s economic policy set out in the HMT Recommendations letter of December 2022. Where the proposed new rules are CRR rules (as defined in section 144A of FSMA), or rules applying to holding companies (section 192XA of FSMA), the PRA has also taken into consideration the matters to which it was until recently required to have regard to when making such rules[62]. The Financial Services and Markets Act 2023 includes a measure to amend the FSMA regulatory principles. This adds a regulatory principle relating to the UK’s net zero emissions target. The PRA has had regard to this matter. The factors shown in Table 3, to which the PRA is required to have regard, were significant in the PRA’s analysis of its proposals.

Table 3: ‘Have regards’ significant to CP proposals

Have regard(s)	Proposals
Proportionality and/or business models	The PRA considers that diversity and inclusion is important across the whole financial services sector but has carefully considered how to tailor the proposed policy package to apply to firms as relevant and proportionately to their business model, size, geographical reach, and location. **Firm-wide strategies:** Requiring firms to produce a diversity and inclusion strategy, but not being overly prescriptive as to what this must contain, allows firms to tailor their strategies as appropriate for their circumstances. The proposed expectations on the frequency of updating the strategies also consider proportionality and the potential costs for different firms, setting out a less regular frequency for small firms and third country branches. **Targets:** A higher standard applies to more significant firms, and proportionality is also applied by allowing firms to set targets for themselves (rather than stipulating what targets to set) with reference to their different sizes, locations, and business models. The PRA also responded to feedback received to the DP, which discouraged regulators from mandating specific targets, given the differences in business models, size, and geographical spread of the firms. **Board governance:** The proposals in this area build upon existing rules and expectations, mainly working to clarify that diversity and inclusion is an important consideration for governance and ‘tone at the top’. The use of high-level rules supported by expectations allow firms to adjust their compliance with regard to their size, location, and business models. The proposals go further for significant firms than they do for smaller firms. Most of the proposals set out in the chapter on board governance are not applicable to third country branches, recognising they do not have a stand-alone board in the UK. **Individual accountability:** By following existing thresholds and application to firms subject to the SM&CR, many firms would already be reflecting diversity and inclusion in SMF responsibilities. This proposal merely makes the PRA’s expectations explicit where they were previously only implied in its narrative on firm culture. **Monitoring diversity and inclusion:** This proposal is designed to support proportionality. While firms within scope of the regulatory reporting proposals in Chapter 7 would have to collect data on a minimum set of specific diversity and inclusion metrics, the PRA considers it is not proportionate to apply these measures to smaller firms. This proposal aims to ensure that all firms take an evidence-based approach, while allowing more flexibility for smaller firms to monitor diversity and inclusion in ways that are appropriate to their size and business.

Have regard(s)	Proposals
	Regulatory reporting: The PRA has chosen to apply the core proposals only to CRR and Solvency II firms with 251 or more employees to reflect proportionality, given the costs of data collection and regulatory reporting. Firms with 250 or fewer employees would only have to submit their employee numbers to establish they are out of scope of the remainder of the reporting and disclosure obligations. In response to DP feedback from smaller firms and those less advanced on diversity and inclusion work, the PRA developed the voluntary template that firms could (but are not required to) use to survey their employees. Such an approach provides firms varying degrees of flexibility while also reducing costs of needing to create their own template (should they not have one already). For firms with 250 employees or less, the voluntary template can also support them in meeting their monitoring obligations. **Disclosure:** The PRA considers that there may be unintended consequences of firms publicly disclosing information on small groups of employees and has tailored the proposed rules accordingly so that firms with 250 [UK] employees or less do not have to disclose these data.
International standards / Basel Committee on Banking Supervision (BCBS) standards	Diversity and inclusion policies are on the international agenda, and the PRA has considered the work of international bodies and interacted with regulators and international organisations across jurisdictions in the process of forming the proposals. For example, the BCBS considers diversity in its '**Corporate governance principles for banks**' The International Association for Insurance Supervision (IAIS) has also committed to deepening and strengthening its work on diversity, equity, and inclusion (DEI). In November 2021, it published a statement on the importance of DEI considerations in insurance supervision, and in December 2022, it published a stocktake report on actions IAIS member supervisors, international organisations, and the insurance industry are taking to advance **DEI** in the insurance sector.
Growth, provision of finance to the real economy, trade, and innovation	The PRA considers that improvements to diversity and inclusion would help firms understand the markets they operate in and the customers they serve, supporting innovation through a mix of ideas (compared to a more homogenous group of individuals). This is likely to have benefits for growth, trade, and the provision of finance to the real economy.

Have regard(s)	Proposals
Competition, competitiveness, and a better outcome for consumers	Competition has been considered above under discussion of PRA objectives. Related to the benefits for competition, the same factors would support competitiveness and a better outcome for consumers: firms being able to recruit from the widest talent pool and retain their best people makes the UK an attractive place to do business (particularly through the proposals on targets and board governance). When financial institutions better reflect the needs of their customers and reflect the society that they serve, there is likely to be a better outcome for consumers. Publication of board diversity and inclusion strategies, and publicly setting out the commitment on inclusive cultures, provides greater transparency for potential job applicants (in the UK and overseas), which can further strengthen the candidate pool for key roles. These factors are likely to support the relative standing of the UK as an attractive place to do business.
Transparency	While there are already some existing PRA rules related to diversity, the PRA considers that the additional rules and expectations proposed in this CP would aid transparency for industry, allowing for a better understanding of regulatory requirements and expectations in this area. In particular, the proposal to publish an SS that brings together all of the PRA's diversity and inclusion policies would aid transparency.
Efficient and economic use of resources	The use of a dedicated SS, the requirement for firms to create and disclose their diversity and inclusion strategies, and the allocation of responsibilities for diversity and inclusion and related risk management, would enable efficient supervisory interaction in this policy area. **Firm-wide strategies:** The PRA considers that a firm's diversity and inclusion strategy would form an efficient and clear basis for supervisory dialogue between the firm and the regulator. **Board governance:** the proposed changes in this area are adding inclusion to the diversity and inclusion policy and the remaining are clarifications, which would make it easier for firms to understand the requirements and expectations, in turn making supervision more efficient. **Individual accountability:** the responsibility for diversity and inclusion is proposed to be encompassed within the existing prescribed responsibilities for culture, as opposed to a new responsibility being created. This should support a more efficient use of firm and PRA resources. **Regulatory reporting:** In constructing the proposals, the PRA considered how to efficiently use resources by only collecting on a mandatory basis the minimum amount of data it considered necessary to support its objectives, and by considering the most efficient format for collecting that data.

Have regard(s)	Proposals
Climate change and energy security	The PRA does not consider that diversity and inclusion in regulated firms would have any adverse or avoidable effects on carbon emissions or play any material role in supporting the government's energy security strategy. However, to the extent that it helps foster innovation and supporting emerging markets, and helps disrupt groupthink in decision-making, it could potentially have some positive effect on investment in and growth of low- and zero-carbon alternatives, including, where relevant, the evolving UK hydrocarbon industry.

Impact on mutuals

9.39 The PRA considers that the impact of the proposals on mutuals would not differ from the impact on other firms. The use of high-level requirements, supported by supervisory expectations, allows firms to tailor their compliance as appropriate for their size, location, and business models, particularly in how they produce, implement, and monitor their diversity and inclusion strategy. Recognising that the geographical location of institutions may make it more difficult to increase diversity among certain demographic characteristics, as per feedback to the DP, the PRA has placed strong emphasis on the importance of inclusion across several of the proposals in the policy package.

Equality and diversity

9.40 The PRA considers the policy purpose underpinning this CP directly aligns with the objectives of the public sector equality duty set out in section 149 of the Equality Act 2010 (Equality Act), which requires public bodies, in the exercise of their public functions, to have due regard to the need to eliminate discrimination, to advance equality of opportunity, and to foster good relations between different people who share relevant protected characteristics and those who do not. The PRA considers that the proposals in this CP would have an overall positive impact on reducing discrimination and on improving equality and diversity and would assist in fostering good relations between people who share relevant protected characteristics and those who do not, in the firms that it regulates and the industry as a whole.

9.41 The Equality Act prohibits discrimination against anyone because of their protected characteristics, which include age, gender reassignment, being married or in a civil partnership, being pregnant or on maternity leave, disability, race including colour, nationality, ethnic or national origin, religion or belief, sex, and sexual orientation. However, the Equality Act permits employers to take proportionate 'positive action' measures where they reasonably think that persons sharing a protected characteristic suffer a disadvantage, have a different need, or have disproportionately low participation in a particular activity, due to their protected characteristic(s). The measure in question must be a proportionate means of addressing the relevant disadvantage, need, or lack of participation.[63]

9.42 The proposals in this CP would not require firms to take action that amounts to unlawful positive discrimination. They require the gathering of evidence, so that firms can assess where there is relevant disadvantage, need, or lack of participation, including where there are unequal opportunities connected to, for example, unconscious bias, discriminatory practices, or inequalities in wider society. Firms could then set their own strategies based on these assessments, targeting interventions where they are most required in a proportionate way – for example by changing hiring practices to attract a wider range of applications, creating new programmes to support career progression, or via inclusion measures that support all employees to speak up and participate fully in the workplace.

9.43 The PRA's proposed requirements and expectations have been designed to ensure that compliance would not put firms in breach of data protection or employment laws. The PRA will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them in light of responses to this consultation when making final rules.

Cost benefit analysis (CBA)

9.44 The PRA considers that firms would incur a number of costs to comply with the proposed requirements and expectations set out in this CP. Section 138J(7) of FSMA requires that the cost benefit analysis produced by the PRA includes 'an analysis of the costs together with an analysis of the benefits that will arise if the proposed rules are made'. Many of the proposals in the CP make amendments to existing requirements (eg on governance) to reflect diversity and inclusion considerations; in these cases, the Cost Benefit Analysis aims to assess the impact of these changes, rather than the existing rules in their entirety. The PRA must have regard for proportionality, and appropriate considerations with regard to firms' sizes and business models are reflected in the proposed rules and expectations (eg firms with 250 or fewer employees are not subject to the proposed reporting, disclosure, and targets rules). Therefore, the PRA expects that the resulting operational burdens arising from the proposals – both upon implementation, and on an ongoing basis – will be proportionate to the size of the firms.

Case for regulatory intervention

9.45 While there has been progress on diversity and inclusion in financial services firms over the past decade, as set out in DP2/21, the rate of change has been slow, with varying progress in different organisations (see Chapter 1 of the DP). While many firms recognise the benefits of diversity and inclusion and are already developing beyond what is in the PRA's existing requirements (and in some cases possibly beyond what is being proposed), there is external recognition that further steps are needed (for example, 'changing organisational cultures and structures to facilitate diversity and inclusion is a massive task'[64]). There are varying views on how progress can be made, and on which areas it is most appropriate to focus. DP responses suggested that a consistent industry approach would be likely to help improve diversity and inclusion outcomes by facilitating a common framework, providing for benchmarking and sharing of good practice.

9.46 This is where the PRA considers that regulatory intervention can play a useful role. The proposed policies would set clear standards and help drive improvements across the banking and insurance sectors, particularly for those institutions which have more progress to make in improving diversity and inclusion outcomes. In developing its proposals, the PRA has focused its approach on those areas where it considers there to be a clear case for policy intervention based on its statutory objectives of safety and soundness and policyholder protection. Support for regulatory intervention in this space was highlighted by a substantial majority of respondents to the DP.[65] The PRA has also designed its proposals to take into consideration the difficulties of implementing successful strategies for the improvement of diversity and inclusion.

Benefits

9.47 The PRA expects that several benefits would emerge from the proposed new set of requirements and expectations set out in this CP. While some of these estimated benefits are specific to the implementation of particular policies, most are expected to arise from the policy package as a whole. These can be placed into two groups: (i) financial stability benefits; and (ii) firm-specific benefits. Both are predominantly assessed on a qualitative basis, as due to data limitations and the many other factors that affect decision-making (eg governance structures, incentive setting, etc), it is very difficult to quantify the benefits of the proposed measures.

Financial stability benefits

9.48 Groupthink has been highlighted as a factor in the 2008 financial crisis and, as this paper has discussed, lack of diversity and inclusion can be key factors that contribute to groupthink in financial institutions. Some research points to the high costs of crises, which can have permanent effects on GDP. Estimates from Brooke et al. (2015) on the cost of banking crises point to a 5% peak loss in GDP, with a long-run negative impact of 4% on GDP.[66] The Office of Budget Responsibility estimated that, as at the end of January 2018, UK government interventions to support the UK banking sector following the crisis had cost the public £23 billion.[67] It is impossible to quantify how much of the cost was attributable to poor decision-making (as opposed to, for example, external factors), or how much of that poor decision-making was attributable to groupthink arising, for example, from a lack of diversity of thought or demographic diversity (due to lack of data or a counterfactual). However, as discussed earlier, there is a growing body of evidence that suggests that diversity, when combined with inclusion, can be beneficial in reducing the risk of groupthink, and in turn be beneficial for the decision-making process and risk management within firms.

9.49 Another potential benefit from greater diversity and inclusion within regulated firms relates to scope for greater innovation within the financial services sector. Some research suggests that while diverse teams can have differences of opinion, they are more likely to be **innovative** and better at solving problems **creatively** While inclusion is currently not well measured, it has been shown to correlate positively with business performance outcomes, and can mitigate impact from the greater task conflict and lower social integration that can be caused by greater diversity.[68] The potential for innovation by these and other individuals joining the financial services sector will require them to feel encouraged to speak up and share their ideas within the firms they work in, so they are able to bring the **benefits** of their differing experiences and perspectives. The regulators' proposals could help promote industry-wide change in diversity and inclusion, which could also help attract a more diverse set of individuals to the sector.

9.50 A third potential benefit is that greater focus on diversity and inclusion can support the development of a larger talent pool in the financial services sector. Firms that look to recruit from diverse backgrounds would have access to a wider range of talent, and inclusive firms are more likely to retain staff. This, in turn, could help support the UK as an attractive place to do business. Accessing and unlocking more of the UK's talent may also in turn support economic growth in the medium- to long-term, and competitiveness.

9.51 While there is a lot of research around the benefits of diversity (some examples provided in this consultation and in DP2/21), it should be noted that not all of it is conclusive, and indeed in some cases mixed. This is in part due to lack of historical, comparable, and accurate data on both diversity at different levels of the organisation (including among decision-makers) and inclusion metrics, which can provide insight into whether all individuals are able to speak and provide challenge, thereby enabling the benefits of diversity to materialise. The proposals to introduce reporting and disclosure of targets and diversity and inclusion metrics can help support such research and support the PRA in producing evidence-based policy evaluations.

Firm-specific benefits

9.52 As noted throughout the CP, a greater focus on diversity and inclusion, and taking action to make progress where it is needed, can help firms attract a wider talent pool and also gain more from their employees, as successful efforts to improve inclusion can support employee retention. The PRA's focus is to support the industry in working together to make this possible, as a qualified talent pool can best grow when it is developed by the sector as a whole.

9.53 As noted above, although some firms already recognise the benefits of diversity and inclusion and are taking action, making progress can still be difficult – and progress across the industry varies. Firms which have made less progress may benefit the most from having a regulatory basis on which to take further action. Respondents to DP2/21 also suggested that smaller firms, which have more limited resources, would particularly benefit from clear regulatory guidance. Other firms may particularly benefit from the proposals on publishing firm-wide strategies and targets, and disclosure of diversity data, as this can help them compare their practices with that of their peers. Having a basis for comparison may help firms to plan their own diversity and inclusion strategies. Where firms are seen to be doing more on diversity and inclusion, this could also bring benefits through attracting greater investment, particularly those investors focusing on ESG **factors**

9.54 The PRA's proposals which clarify that responsibility for diversity and inclusion should be incorporated into PRs for culture can support accountability. This can help ensure that firms' diversity and inclusion strategies are sufficiently considered and implemented. The requirements around monitoring and regulatory reporting would provide objective evidence around firms' progress on diversity and inclusion, raising awareness of metrics that may need closer monitoring. Many DP responses noted that good quality data was an essential first step in enabling further progress, and that it was important that this data be comparable among peers. The PRA considers that its regulatory reporting proposals would provide a common basis for measuring diversity and inclusion and thereby enable such comparability.

9.55 The industry report that the PRA and FCA propose to jointly produce would then support firms by providing a picture of the average levels of diversity and inclusion across the industry. This could help firms benchmark their position against peers and inform further consideration of where focus is most needed.

Costs

9.56 Firms are at different levels of progress on diversity, as well as on inclusion, with some having taken action through involvement in voluntary initiatives and/or following publication of DP2/21. Therefore, the costs (and in particular the one-off implementation costs) are expected to vary for firms depending on their starting point, as well as the nature, scale, and complexity of the firm. The PRA also considers that given the growing international interest in diversity and inclusion (see 'international standards' in the have regards analysis earlier in this chapter), there may be synergies and future savings if wider international standards are introduced in the future, particularly for internationally active firms.

9.57 The PRA anticipates that firms would incur costs in setting up a system for collecting and reporting diversity and inclusion data. Costs would vary from firm to firm, as they are dependent on several factors, such as the existing IT infrastructure of the firm, and whether the firm already partakes in voluntary disclosures of diversity and inclusion metrics. Nevertheless, the PRA provides some estimates below, based on responses to the cost survey carried out by the FCA, in which firms were asked to provide cost estimates – both one-off implementation costs, and ongoing costs – for different policy buckets.

9.58 The PRA anticipates that firms would incur a one-off implementation cost in setting up a system for reporting and disclosure. For firms in scope of these proposed requirements, implementation costs include: the IT cost for the project (namely system changes to collect the data, taxonomy, implementation, and testing); staff cost (staff involved in building and implementing new systems, additional hiring, and training); service provider cost (software vendors system updates); and, where applicable, work outsourced to external providers (eg consultancy services or legal advice). As with the cost of setting up monitoring information systems, the costs of these are likely to be less for those already subject to certain PRA diversity requirements;[69] firms in scope of the **FCA's Listing Rules** and voluntary initiatives that involve aspects of reporting and disclosure (eg Women in Finance Charter, the Parker Review, etc).

9.59 Data reporting and disclosure will lead to ongoing costs for firms in scope of the proposed rules. The PRA considers that the ongoing costs would fall into four broad categories: IT systems (ongoing/routine systems maintenance); staff cost (internal data quality assurance by members of the relevant teams); review and governance (internal sign-off as part of the firm's governance); and any external service providers (eg if subscribed to a Software as a Service data collection solution).

9.60 Other costs relate to the implementation of the remaining proposed policy measures in the package; for example, development of diversity and inclusion strategies (at board and/or firm-wide level), consideration and development of targets, the assessment of these by the relevant control functions, and reviewing approaches to succession planning.[70] The key costs would arise from staff cost, and in particular the role and time of the board and relevant sub-committees in developing the firm's approach for the first time. While the majority of these costs would, most likely, be incurred upon implementation, reviewing, and updating these measures – arguably a less burdensome process – would still imply some ongoing costs. In particular, the majority of these ongoing costs is anticipated to be around recruitment (including for succession planning) – as firms may be looking to a wider pool of candidates. In these areas, the PRA's proposals are more high level, providing flexibility to take account of proportionality, with the aim of reducing undue burden for firms. Ultimately however, as the pipeline of a diverse talent pool grows across the sector, and diversity and inclusion becomes incorporated into business as usual, these costs are expected to reduce over time.

9.61 Finally, the PRA considers there may be additional residual costs relating to the impact on team dynamics. One meta-analysis suggests that 'cultural diversity leads to process losses through task conflict and decreased social integration'.[71] In particular, the study finds more conflict for more complex tasks, for co-located rather than dispersed employees, and among those with longer tenure. Diversity in teams may have an impact on team cohesion, particularly where conflicting views on difficult issues are present, and increase the length of time necessary to arrive at a decision that is agreed on by the whole team. The dimension of these costs is hard to estimate, particularly where evidence on the impact of diversity and inclusion is mixed. However, the PRA considers that this cost would in many cases be balanced by the benefits for creativity, satisfaction, and innovation that this study (and other research cited throughout this CP) indicates is likely to occur once these initial challenges are overcome.

Quantitative cost estimations – per firm

9.62 Table 4 below contains an estimate of how much it will cost firms on average to follow the proposals as outlined in this CP. These estimates represent both ongoing operational compliance costs and the one-off implementation costs related to the changes to the rules and expectations proposed in this CP. The quantitative figures are based on data provided to the FCA by 358 respondents to the cost survey it sent to firms in May 2022. The PRA used this data but removed data provided by solo-regulated respondents and credit unions because these firms are not in scope of the PRA's proposals. The remaining dataset that informs the PRA figures includes 83 respondents. Based on the employee numbers that the firms reported as part of their survey response, 42 firms in the sample have 251 or more employees, and the remaining 41 have 250 or fewer employees.

9.63 Significant effort has been made by the regulators to create alignment between the proposals that the PRA and the FCA are making in their respective CPs, to reduce additional regulatory costs for dual-regulated firms. This should help reduce both the implementation and ongoing costs. While a small number of differences between the PRA's and FCA's proposals remain, these are reflective of their different statutory objectives and the different types and number of firms that they regulate.

9.64 In Table 4, the PRA has listed estimates of the average costs per firm, per proposal. The PRA calculated average costs separately for large and small firms (defined by whether they have more or less than 251 employees). The estimations do not necessarily represent the costs that each firm will incur, as these will vary based on a firm's precise size, structure, and its existing diversity and inclusion activities.

Table 4: PRA average costs, per firm(a)

Policy Area	Large firms (>251 employees)		Small firms (<250 employees)		Overlap with FCA costs
	One-off costs	Ongoing costs (annual)	One-off costs	Ongoing (annual) costs	

Firm-wide strategies(b)	£23,000	£11,000	£23,000	£11,000	Costs from PRA and FCA are one and the same.
Risk and controls / internal monitoring	£19,000	£9,000	£4,000	£2,000	The PRA is applying this to all dual-regulated firms, while the FCA only to large firms.
Targets	£21,000	£21,000	N/A	N/A	Costs from PRA and FCA are one and the same.
Board governance(c)	£18,000	£29,000	£4,000	£6,000	PRA cost only.
Individual accountability	£39,000	£25,000	£8,000	£6,000	PRA cost only.
Fitness & Propriety	£4,000	£2,000	£200	£200	Costs overlap but PRA costs are 80% lower than FCA's.(d)
Regulatory reporting	£48,000	£29,000	N/A	£25(e)	Costs from PRA and FCA are one and the same.
Disclosure	£23,000	£34,000	N/A	N/A	Costs from PRA and FCA are one and the same.
Total	**£195,000**	**£160,000**	**£39,200**	**£25,225**	

Source: The FCA's survey of affected firms and the PRA's calculations based on its proposals and dual-regulated respondents only.
Notes: (a) For regulatory reporting, disclosure, and targets, the average listed in the table is the raw average of survey responses based on costs reported by 42 'large' firms (with 251 or more employees) that responded to the FCA's survey. The raw average is used because the final policy proposals closely resemble that which were put forward in the survey. For the remaining policy areas, an adjusted average was used. As part of the cost survey, respondents estimated their current level of compliance with the indicative policy concepts. The PRA took this existing level of compliance into account when calculating the averages for these policy concepts. This was done by using a coefficient to correspond to different levels of compliance, and then using this to calculate an upper and lower bound for the average compliance costs. The PRA considers that the final proposals are less costly than the indicative concepts outlined in the FCA's survey. This is because they are either less prescriptive than proposed in the survey, or because the PRA has proposed only a rule and not an expectation. In these cases, the PRA lists here the lower bound average costs. The figures have been rounded up to the next thousand. (b) The FCA survey only collected estimates from large firms on the costs of D&I strategies. The PRA considered it prudent to therefore assume that small firms would incur the same costs as large firms, although this may not be the case since small firms may require less complex strategies than large firms. (c) The costs for board governance would not apply to third country branches regardless of size because third country branches do not have boards in the UK. (d) Fitness & Propriety maps onto the FCA's 'Non-Financial Misconduct' policy bucket. The PRA estimates that the costs of its proposals in this area are significantly lower than those of the FCA's because the PRA is not making any new rules regarding fitness & propriety or non-financial misconduct. It has only clarified its existing expectation that conduct such as bullying, discrimination, and harassment could be relevant to fitness & propriety assessments.(e) The FCA has estimated the rough cost of a small firm submitting its employee numbers on RegData, which the PRA presents here rounded to the nearest 5.

9.65 The PRA estimates that there are 494 small and 279 large dual-regulated firms in scope of its proposals. It has used these numbers and the figures in Table 4 to calculate the aggregated costs to industry presented in Table 5. The FCA has also published a table of aggregate costs, which shows a higher amount as the FCA regulates a larger number of firms. Most of the costs listed in Tables 4 and 5 are associated with the PRA and FCA's joint requirements, which are also included in the FCA's cost estimates.

Table 5: PRA aggregate costs for all dual-regulated firms in scope(a) (b)

	One-off costs	Ongoing costs (annual)
Firms with 250 or fewer employees	£20m	£13m
Firms with 251 or more employees	£55m	£45m
Total costs to all dual-reg firms	£75m	£58m

Notes: (a) To estimate the number of firms in scope of the proposals, the PRA used the list of firms subject to the SM&CR, and removed solo-regulated firms, credit unions, and non-Solvency II firms from the list, because they are out of scope of this proposed policy package. To estimate the number of firms that are large (251 or more employees) or small (250 or fewer employees) within the PRA's population of firms, it used data on the total number of employees for firms that submit the Retail Mediation Activity (RMA)-G (training and competence) regulatory return (c11,000 firms), and based its estimate on the proportion of small and large firms in the sample. The FCA used the same approach to estimating firm populations and employee numbers. (b) The figures shown are a result of multiplying the totals in Table 4 with the estimated amount of large and small firms. All the figures have been rounded up to the next million.

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1. Groupthink is commonly understood as a phenomenon that occurs when a group of well-intentioned people makes irrational or non-optimal decisions spurred by the urge to conform or the belief that dissent is impossible. Janis (1991) popularised the term and suggested that groupthink can happen when there is: a high level of group cohesion, a lack of impartial leadership, and stressful situational characteristics. He noted that homogeneity of social background and ideology between group members can contribute to this phenomenon. Source: Hart, P (1991): **https://www.jstor.org/stable/pdf/3791464.pdf** Political Psychology 12(2), pages 247–278.
2. Diversity of thought is commonly understood as bringing together a range of different styles of thinking among members of a group. Factors that could lead to diverse thinking could include, but is not limited to, different perspectives, abilities, knowledge, attitudes, information styles, and demographic characteristics, or any combination of these.
3. Galinsky, A D, Todd, A R, Homan, A C et al. (2015) Maximizing the Gains and Minimizing the Pains of Diversity: A Policy Perspective: **https://journals.sagepub.com/doi/full/10.1177/1745691615598513** Perspectives on Psychological Science 10(6), pages 742–748.
4. Landaw, J (2020), Maximizing the Benefits of Board Diversity: Lessons Learned from Activist Investing: **https://tinyurl.com/ycxaavy9** Harvard Law School Forum on Corporate Governance.
5. Korn Ferry, The Importance of Inclusion in the Workplace: **https://tinyurl.com/mrye7m8x**
6. Ashikali, T, Groeneveld, S and Kuipers, B (2021), The Role of Inclusive Leadership in Supporting an Inclusive Climate in Diverse Public Sector Teams: **https://journals.sagepub.com/doi/full/10.1177/0734371X19899722** Review of Public Personnel Administration 41(3), pages 497–519.

7. For more information on inclusive leadership, please see Sweeney, C. and Bothwick, F. (2016) Inclusive leadership: Defining guide to developing and executing an impactful diversity and inclusion strategy (London: Pearson Education), page 171.

8. Equity in the workplace is commonly understood to be the idea that all employees are provided with fair and equal opportunities based on their individual needs.

9. Belonging is commonly understood to mean 'having a voice and being valued for your unique and authentic individual skills and abilities'. CIPD (2019), Building inclusive workplaces: Assessing the evidence: **www.cipd.co.uk/knowledge/fundamentals/relations/diversity/building-inclusive-workplaces#gref** page 6.

10. Accessibility at work is about removing barriers to make sure nobody is excluded from taking an active part in working life. Employers should make sure their workplace, and the way they work, is accessible to as many people as possible. Acas (2022): Accessibility at work: **www.acas.org.uk/accessibility-at-work**

11. Readout of text in Figure 1 for screen readers: Desired outcome: To improve diversity and inclusion (D&I) across PRA-regulated firms, as the PRA considers that it supports prudent decision-making and better risk management, through reducing the risk of groupthink. There are three ways this outcome can be achieved, and levers that will turn the dial for each. 1. Improved diversity and inclusion for board and senior management, to support discussion and debate on prudential risk issues, reflecting a range of viewpoints & experiences. Levers that will turn the dial are: (a) diversity and inclusion embedded in firm culture and strategy; (b) board responsible for diversity and inclusion strategy; (c) targets; and (d) succession planning. 2. More inclusive and diverse firms, where individuals can speak up and raise concerns on issues relevant to the firm's business and risk profile. Levers that will turn the dial are: (a) firm-wide diversity and inclusion strategy; and (b) monitoring diversity and inclusion and using the evidence collected to inform action. 3. Accountability - at firm and individual level, to provide incentives to make progress. Levers that will make progress are: Senior Manager accountability for diversity and inclusion as part of firm culture; (b) diversity and inclusion as a risk considered by internal control functions; (c) regulatory reporting; (d) disclosure; and (e) industry benchmarking.

12. The territorial scope for the fitness and propriety requirements remain unchanged by the proposals in this CP.

13. While the DP specifically suggested requiring 'policies', many respondents pointed out that the term 'strategy' would better reflect what the DP was suggesting. A strategy is focused on the firm's long-term plan of action, whereas a policy reflects how a firm will go about undertaking certain functions. The PRA has considered this feedback and settled on the term 'strategy'.

14. If a third country branch is already covered by a group diversity and inclusion strategy, then this would be acceptable.

15. FCA Research Note: Gender diversity in UK financial services: **www.fca.org.uk/publications/research/research-note-gender-diversity-uk-financial-services** found that gender diversity is low with women making up just around 17% of FCA-approved individuals. They comment that this figure is remarkably unchanged since 2005.

16. Examples of questions that could be asked when doing a desk-based review or audit for diversity and inclusion include: Are diversity and inclusion being treated as a key long-term business objective? Are D&I objectives integrated into business plans throughout the organisation? Do corporate social responsibility efforts take account of diversity? Is diversity and inclusion mentioned in firm literature? Are all employees committed, encouraged, and made responsible for supporting, adhering to, and respecting your diversity and inclusion corporate values and behaviours? Are there any dedicated resources for diversity and inclusion activities/initiatives?

17. For CRR firms, see General Organisational Requirements 6.2(1), 6.3, and 6.4. For Solvency II firms, see Conditions Governing Business Part 2.7–2.9.

18. General Organisational Requirements 7.1 outlines that Article 109 undertakings are subject to General Organisational Requirements 6. The Glossary defines an Article 109 undertaking.

19. Paragraphs 10.1–10.2.

20. Ibid, chapters 2-3.

21. Ibid, paragraph 3.1.
22. Kalev, A, Dobbin, F and Kelly, E (2006), **‘Best practices or best guesses? Assessing the efficacy of corporate affirmative action and diversity policies’** American Sociological Review 2(7).
23. Paragraph 2.43 and paragraph 2.54.
24. CRR firms with assets greater than £250 million and Solvency II firms, but not third country branches.
25. PR I – Responsibility for leading the development of the firm's culture by the governing body as a whole
26. PR H Responsibility for overseeing the adoption of the firm's culture in the day-to-day management of the firm
27. CRR firms with assets less than £250 million and third country branches.
28. For a full list of the questions asked in the DP, please see Appendix 1 of DP2/21: **www.bankofengland.co.uk/prudential-regulation/publication/2021/july/diversity-and-inclusion-in-the-financial-sector**.
29. For example, the Parker Review: **www.gov.uk/government/publications/ethnic-diversity-of-uk-boards-the-parker-review** The McGregor Smith review: **www.gov.uk/government/publications/race-in-the-workplace-the-mcgregor-smith-review** Women in Finance Charter; **www.gov.uk/government/publications/women-in-finance-charter** FTSE women leaders: **www.ftsewomenleaders.com** Hampton-Alexander review: **www.gov.uk/government/publications/ftse-women-leaders-hampton-alexander-review** the Solicitors Regulation Authority: **www.sra.org.uk/sra/equality-diversity** City of London/Bridge Group; **www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/who-gets-ahead-and-how** the Social Mobility Commission: **www.socialmobilityworks.org/toolkit/measurement** Business Disability Forum: **www.businessdisabilityforum.org.uk** Government guidance on gender pay gap reporting: **www.gov.uk/government/collections/gender-pay-gap-reporting** and EBA Diversity benchmark 2018: **www.eba.europa.eu/eba-calls-measures-ensure-more-balanced-composition-management-bodies-institutions**
30. Third-country branches would not be required to report on their board due to them not having a stand-alone board in the UK.
31. Chilazi, S and Bohnet, I (2020): How to Best Use Data to Meet Your DE&I Goals: **hbr.org/2020/12/how-to-best-use-data-to-meet-your-dei-goals**
32. CIPD (2019) – Building inclusive workplaces: Assessing the evidence: **https://www.cipd.co.uk/knowledge/fundamentals/relations/diversity/building-inclusive-workplaces#gref** page 6.
33. Chinwala, Y (2020) – Radical Actions: A forensic approach to diversity data: **https://newfinancial.org/wp-content/uploads/2020/01/A-forensic-approach-to-data.pdf**
34. Note that the reporting would be undertaken on the FCA’s RegData system rather than using the Excel document in Appendix 7, which is provided for indicative purposes. RegData allows firms an option to make their submission by (a) inputting the data into a web form; (b) uploading an .XML file; or (c) setting up a web service account for system-to-system submissions.
35. The nine protected characteristics are age, gender reassignment, marriage or civil partnership, pregnancy or maternity, disability, race, religion or belief, sex, and sexual orientation.
36. See, for example, the Hampton-Alexander review: **www.gov.uk/government/publications/ftse-women-leaders-hampton-alexander-review** the Parker Review: **www.gov.uk/government/publications/ethnic-diversity-of-uk-boards-the-parker-review** Women in Finance Charter; **www.gov.uk/government/publications/women-in-**

finance-charter and the 30% Club: https://30percentclub.org

37. Women and Equalities Committee (2015) Transgender Equality: https://publications.parliament.uk/pa/cm201516/cmselect/cmwomeq/390/390.pdf page 27.

38. The PRA has adjusted the style of the question to account for the fact it proposes to collect aggregated data from firms rather than directly from individuals.

39. Ibid, paragraph 1.3.

40. City of London Socio-Economic Diversity Taskforce (2022) Building the Baseline: Breaking the Class Barrier: Measuring socio-economic diversity at senior levels in UK financial and professional services: www.cityoflondon.gov.uk/supporting-businesses/business-support-and-advice/socio-economic-diversity-taskforce/building-the-baseline-report page 6.

41. Bridge Group (2020), Socio-economic background and progression to partner in the law: www.thebridgegroup.org.uk/news/partner-law page 4. 'Those from lower socio-economic backgrounds are more likely to be the highest performers in their firms, compared to their more advantaged peers, though the data in this regard have some limitations. Amongst state school trainees, 14% receive the highest review ratings compared to 8% of independently schooled trainees; similarly 14% of first generation university trainees receive high performance review ratings compared to 10% of their non-first generation university peers […] Despite this, those from lower socio-economic backgrounds appear on average less likely to progress in their early career […] For example, the proportion of first generation early career solicitors falls from 30% of trainees to 27% of associates.'

42. Social Mobility Commission (2021) Navigating the labyrinth: socio-economic background and career progression in the Civil Service: www.gov.uk/government/publications/navigating-the-labyrinth Bridge Group (2022) Bridging the Gap: Socio-economic diversity in the engineering sector: access, pay and progression: www.thebridgegroup.org.uk/research-1/2022/8/3/socio-economic-diversity-in-the-engineering-sector-access-pay-and-progression-jjmlg-bk4h7 Social Mobility Commission, Why focus on socio-economic background? www.socialmobilityworks.org/strategic-approach/why-use-a-strategic-approach and Bridge Group (2020) www.thebridgegroup.org.uk/news/partner-law.

43. For example, given pregnancy only lasts for around 9 months, it would be difficult to draw conclusions from how many pregnant employees worked in a firm when the data collection is undertaken on an annual basis. That data would not illustrate whether the firm was retaining and promoting individuals who had been pregnant. Instead, data on parental responsibilities does not change so frequently and so provides a better long-term indicator. Parental-responsibilities are also more inclusive in that it recognises paternity in addition to maternity. Whether individuals at a firm are married or in civil partnerships will also fluctuate for reasons that are extraneous to how people are treated in a firm. Aggregate data on sex, gender, age brackets, and sexual orientation fluctuate less frequently and are more likely to indicate whether people might be at a disadvantage due to their marital status (as this is usually intersectional with other protected characteristics). However, while the PRA does not propose to collect data on pregnancy/maternity and marriage/civil partnership, these are still protected characteristics, and firms have a legal duty to ensure individuals are not disadvantaged in any way in relation to these characteristics.

44. The levels of agreement are strongly agree, agree, neither agree nor disagree, disagree, strongly disagree, prefer not to say, did not respond.

45. Third-country branches are not required to make disclosures on the board due to them not having a stand-alone board in the UK.

46. SS5/16, paragraphs 2.3 and 3.1.

47. Walker, D (2009) A review of corporate governance in UK banks and other financial industry entities: Final recommendations: https://tinyurl.com/bdhmva3y paragraph 4.3, page 53.

48. Ibid, page 3; EIOPA (2018) Failures and near misses in insurance: Overview of the causes and early identification: **https://tinyurl.com/49bwn6uh** page 3.

49. See Cass Business School/Airmic (2011) Roads to Ruin: A study of major risk events: their origins, impact and implications: **https://tinyurl.com/yvpenxer** – where a number of situations were identified that predisposed the leadership to groupthink.

50. Rock, D and Grant, H (2016) Why Diverse Teams Are Smarter: **hbr.org/2016/11/why-diverse-teams-are-smarter** Harvard Business Review.

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62. Although no longer obliged to have regard to these matters, the PRA considered them when developing these proposals and they are included, amongst the other ‘have regards’, in Table 3 where the PRA considered them to be significant.

63. For details on what is meant by 'positive action', please see the EHRC website: 'Employers: what is positive action in the workplace?' – **www.equalityhumanrights.com/en/advice-and-guidance/employers-what-positive-action-workplace**

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65. Only a small minority (<10%) of respondents that were relevant to the PRA's mandate did not see benefits of regulatory intervention; none of these were PRA-regulated firms.

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69. See Rule 6.2 in the General Organisational Requirements Part of the PRA Rulebook.

70. Although as noted in Chapter 4, CRR and Solvency 2 firms are already required to have a diversity policy in place for the Board and significant firms to set targets for the under-represented gender. These firms constitute the majority of firms in scope of the proposals set out in the CP, so depending on the approach taken, the additional costs mentioned here would be more limited.

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Appendices

Appendix 1: Draft instrument: PRA Rulebook: CRR Firms, Solvency II Firms: Diversity and Inclusion Instrument 2023

Appendix 2: Draft amendments to supervisory statement 5/16 – Corporate governance: Board responsibilities

Appendix 3: Draft amendments to supervisory statement 28/15 – Strengthening individual accountability in banking

Appendix 4: Draft amendments to supervisory statement 35/15 – Strengthening individual accountability in insurance

Appendix 5: Draft amendments to supervisory statement 34/15 – Guidelines for completing regulatory reports

Appendix 6: Draft new SS: Diversity and inclusion in PRA-regulated firms

Appendix 7: Draft regulatory reporting return: REPxxx – Diversity and Inclusion

Appendix 8: Draft regulatory reporting guidance notes

Appendix 9: Draft voluntary data collection template

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