DIVERSITY AND INCLUSION IN THE FINANCIAL SECTOR – WORKING TOGETHER TO DRIVE CHANGE (CP23/20)
and
DIVERSITY AND INCLUSION IN PRA-REGULATED FIRMS (CP18/23)

Response from the Employment Lawyers Association

15 December 2023

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1. INTRODUCTION

1.1 The Employment Lawyers Association ("**ELA**") is an unaffiliated and non-political group of specialists in the field of employment law. We are made up of about 6,000 lawyers who practice in the field of employment law. We include those who represent Claimants and Respondents/Defendants in the Courts and Employment Tribunals and who advise both employees and employers. ELA's role is not to comment on the political merits or otherwise of proposed legislation or calls for evidence. We make observations from a legal standpoint. ELA's Legislative and Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes, including to consider and respond to proposed new legislation and regulation or calls for evidence.

1.2 A working party, chaired by Alistair Woodland and Amy Bird of Clifford Chance LLP (the "**Working Party**"), was set up by the Legislative and Policy Committee of ELA to respond to the FCA's Consultation Paper entitled "Diversity and Inclusion in the Financial Sector – Working Together to Drive Change" (the "**FCA Consultation Paper**"), and the PRA's Consultation Paper entitled "Diversity and Inclusion in PRA-Regulated Firms" (the "**PRA Consultation Paper**"). Together these shall be referred to as the "**Consultation Papers**" and the "**Regulators**." Members of the Working Party are listed at the end of this paper.

1.3 References in this paper to the views of ELA are intended to be inclusive of the views of the minority as well as the majority of ELA members. Whilst not exhaustive of every possible viewpoint of every ELA member on the matters dealt with in this paper, the members of the Working Party have striven to reflect in a proportionate manner the diverse views of the ELA membership.

2. EXECUTIVE SUMMARY

2.1 ELA is broadly supportive of the proposals set out by the Regulators. As practitioners in the field, we value any measures that will increase certainty for firms and employees. Many of us regularly advise on matters which highlight that many firms would benefit from additional support in their relationship with diversity and inclusion ("**D&I**") (and approach to non-financial misconduct) as part of their wider culture. The provisions that are intended to give firms license to focus on these areas in a transparent and proportionate way are welcomed.

2.2 We consider, however, that there are some areas where improvement upon the proposed measures and draft text are required. These can be grouped into the following, by reference to the Consultation Papers' themes:

(a) **Scope and overall approach:** We consider that generally the Regulators' approach is proportionate (for example, by adopting a solo entity approach). However, more broadly, we consider that the Regulators need to give further clarification as to how the proposed provisions should sit with existing provisions and principles of employment law (for example, the Equality Act 2010 (the "**EQA**"), vicarious liability, and due process), and an acknowledgement of the tension between these and regulatory provisions. We consider the Regulators could look further to equivalent provisions from the Solicitors Regulation Authority ("**SRA**") to address this;

(b) **Individual accountability and responsibility:** We would question the lack of real or tangible individual responsibility or accountability in the Consultation Papers for making progress against D&I objectives and goals, especially when it comes to senior managers. We consider that this may lessen the effectiveness of the proposals in practice. Regarding individual accountability amongst certified and Conduct Rules population, the additional guidance on non-financial misconduct (while welcome) should not focus exclusively on diversity and inclusion related matters, should not create "strict liability" offences in these areas, and should not confuse individual repercussions with the Regulators' desire to illustrate why these matters fall within the regulatory perimeter (and, importantly, where there is a desire by the Regulators to expand beyond the existing legal position this should be acknowledged). Given the potential impact on employees, there are some areas where additional drafting clarity and consideration of the intersection with other regulatory principles (e.g. interaction of "serious" with regulatory reference approach) would be welcome. We have made some specific drafting recommendations for how the existing provisions may be clarified;

(c) **Diversity and inclusion firmwide strategies and approaches:** We support the suggestion that responsibility should not sit with one function (e.g., audit). However, we consider that the Regulators could do more to explain how strategies will involve firms as a whole, how the effectiveness of a D&I strategy will be measured and assessed, how employees can be involved in the formulation of a strategy, and an acknowledgement that firms should not stray from lawful positive action to unlawful positive discrimination if a target-based approach is to be adopted. We consider that the Regulators could do more in their proposals regarding neurodiversity and wellbeing (given the linkage with psychological safety; and

(d) **Monitoring and reporting of D&I data:** We consider the proposals for mandatory and voluntary reporting of data will support and justify a firm's request for information on demographic characteristics. The call for inclusion data and reporting will likely also support the Regulators' move to broaden the range of functions involved in D&I. However, we consider that firms may welcome additional guidance in relation to some areas of data (for example, social mobility data) and how to encourage employees to provide their data.

2.3 We consider that if these suggestions are taken into account, the subsequent policy statements are more likely to contain the rigour and clarity that will allow firms consistently to apply them – and therefore for effective implementation by firms and a greater likelihood that the Regulators' objectives in this important policy area will be achieved.

2.4 Members of the Working Party would be happy to speak to the Regulators about the feedback in this response, if that would be helpful (ELA have previously done this in relation to other responses).

QUESTION 1 OF FCA CONSULTATION PAPER / CHAPTER 1 OF PRA CONSULTATION PAPER

3. **TO WHAT EXTENT DO YOU AGREE THAT OUR PROPOSALS SHOULD APPLY ON A SOLO ENTITY BASIS?**

3.1 ELA supports a solo entity approach for the reasons set out below. However, this does not mean that the impact of the group context in which some firms are operating can be disregarded by the Regulators (and this needs to be taken into account in the final policy statements).

3.2 For the purposes of calculating the employee number threshold, we consider application on a solo entity basis is a proportionate approach.

3.3 We agree that applying the quantitative proposals (target setting, data reporting[1] and disclosure[2]) on a solo basis will increase transparency on areas of underrepresentation at individual firm level and the progress made at addressing it. However, solo firms may be subject to a group policy on D&I that may be driven by legal/regulatory requirements in other jurisdictions that are inconsistent with the approach mandated by the Regulators. Although the FCA Consultation Paper states that: "firms may decide to apply a consistent approach across a group if they wish to do so." [3] there does not appear to be any scope for deviating from the mandatory reporting/disclosure obligations even if the group approach is different, other than if compliance with the disclosure obligations under SYSC 29.5 would result in the firm breaching any laws applicable to it in the UK or another jurisdiction.[4]

3.4 The proposals envisage a degree of flexibility[5] in relation to target setting,[6] what data is reported, and what data is disclosed. This would enable firms in some cases to adopt a consolidated approach across a group. However, this may not always be the case and will potentially give rise to a firm operating a dual approach and having to put in place internal reporting systems, policies and practices to address each of the solo firm and group requirements.

3.5 For example, para 5.25 of the FCA Consultation Paper states: "We propose that firms are required to consider the context in which they operate by having regard to available data on the diversity

[1] SYSC 29.4.9

[2] SYSC 29.5.1

[3] Para 3.23

[4] SYSC29.5.15

[5] SYSC 29.3.1: (2). A firm should use its judgement in deciding which demographic characteristics it sets targets for.

[6] The demographic characteristics the targets must cover and the targets themselves will not be mandated [para 5.26 of the FCA Consultation Paper/SYSC 29.3.3] and may relate to demographic characteristics beyond those covered by the reporting and disclosure obligations.

profiles of the UK population and the geographical area in which they carry out regulated activities." A group approach may not in practice be consistent with this requirement.

3.6 The PRA Consultation Paper states: "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." This appears to mandate consideration of only those aspects of the international strategy relevant to the third country branch's operations in the UK regardless of whether there are strategies/targets in relation to women and ethnicity (regarding which the PRA Consultation Paper states that Firms would be expected to "set targets in relation to women and ethnicity as a minimum unless they can demonstrate that there is no evidence of underrepresentation").[7] Further clarification on whether this interpretation is correct would be helpful.

QUESTION 2 OF FCA CONSULTATION PAPER / CHAPTER 1 OF PRA CONSULTATION PAPER

4. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSED PROPORTIONALITY FRAMEWORK?**

4.1 **Proportionality:** in general, our view is that the Regulators' proposed approach of avoiding a prescriptive "one size fits all" approach giving firms relative flexibility is sensible.

4.2 The large firm threshold of 250 employees based on a rolling 3-year average is straightforward and is a familiar threshold for firms to understand given that it aligns with the thresholds used in other contexts such as gender pay gap reporting and the Companies Act 2006 threshold for a "large" firm.

4.3 The demographic characteristics identified for voluntary reporting are appropriate given that many firms do not currently collect data of this nature. It is noted that the intention is to review, and potentially expand, the list of mandatory demographic characteristics against which reporting must be made.[8] It is suggested that a clearer indication of the timeframe over which data collection practices will need to be altered and improved would be helpful to assist firms to put the appropriate planning, policies and communications in place.

4.4 **Proportionality - Territorial scope:** it is intended that the Regulators' proposals (other than in relation to non-financial misconduct) will apply to employees who carry out their work predominantly from an establishment in the UK. In this regard clarification of the following would be of assistance:

4.4.1 What does "predominantly" mean – is this a concept that firms readily understand from the existing application of rules/approach of Regulators?

[7] Draft SS 28/15 para 3.14

[8] Para 5.42 FCA Consultation Paper "Our proposed approach addresses those concerns by affording firms the necessary time and flexibility to improve their data collection processes."

4.4.2 Is physical presence required – how does teleworking impact if at all?

4.5 **Jurisdictional scope of what COCON applies to:** the FCA Consultation Paper states at para.3.11 "Whilst our proposals would amend FIT, COCON, and COND, we are not proposing to change their scope. This means that if a firm is not currently in scope of these rules and guidance, then the proposed changes would also not apply to them."

4.6 Paragraph 4.24 of the FCA Consultation Paper rehearses the provisions of COCON 1.1.9R and 1.1.10R in respect of the scope of application of COCON to conduct outside the UK. COCON 1.1.9R10/12/2018 provides that COCON applies to the conduct of SMF managers and Material Risk Takers (as defined in the Remuneration Codes) wherever it is performed.

4.7 COCON 1.1.10R10 provides that for all other Conduct Rules staff COCON applies to conduct of the person performed from an establishment maintained in the UK by the SMCR firm or when dealing with a client of the firm in the UK from an establishment overseas.[9]

4.8 The FCA has not stated an intention in its Consultation Paper to deviate from this approach in respect of any non-financial misconduct coming within the scope of COCON. However, the extent to which the territorial reach of COCON will apply to conduct outside the UK is perhaps not as clear as it could be. The proposed new SYSC 1.3 is intended to set out the scope of COCON and non-financial misconduct and proposed SYSC1.3.6G sets out a table with examples of non-financial misconduct and whether it comes within the scope of COCON.

4.9 Bearing in mind that COCON 1.1.10R10 provides that for Conduct Rules staff (other than SMFs and MRTs) COCON only applies to conduct of the person performed from an establishment maintained in the UK;[10] the following examples appear to expand the ordinary understanding of what "from an establishment" means and could conceivably cover situations where the conduct occurs outside the UK:

4.9.1 Misconduct by A in relation to a fellow member of the workforce while A is working remotely for their firm.

4.9.2 Misconduct by A in relation to a fellow member of the workforce when both are travelling to a meeting in which they will represent their firm.

4.9.3 Misconduct by A in relation to a client at a business meeting in which A is representing their firm.

4.9.4 Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by their firm.

4.9.5 Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by a client of their firm in which they will represent their firm or where the main reason for the invitation is their working for their firm.

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[9] **COCON 1.1.10R10/12/2018*RP***

(1) This *rule* applies to members of a *firm's* *Conduct Rules staff* apart from *Conduct Rules staff* in *COCON 1.1.9R*.

(2) Subject to (3), *COCON* only applies to the conduct of *persons* to whom this *rule* applies (as set out in (1)) if that conduct:(a) is performed from an establishment maintained in the *United Kingdom* by the *SMCR firm*; or (b) involves dealing with a *client* of the *firm* in the *United Kingdom* from an establishment overseas.

[10] or when dealing with a client of the firm in the UK.

4.10 It would be helpful if the FCA could clarify whether it intends to extend the jurisdictional reach of COCON in respect of non-financial misconduct and/or provide further clarification on what "performed from an establishment maintained in the UK" means and whether any of the suggested in scope conduct by Conduct Rules staff (other than SMFs and MRTs) that takes place outside the UK would be in scope of COCON and thus extend its territorial application.

QUESTION 3 OF FCA CONSULTATION PAPER / CHAPTER 1 OF PRA CONSULTATION PAPER

5. **ARE THERE ANY DIVERGENCES BETWEEN OUR PROPOSED REGULATORY FRAMEWORK AND THAT OF THE PRA THAT WOULD CREATE PRACTICAL CHALLENGES IN IMPLEMENTATION?**

5.1 ELA notes that whilst both Regulators impose an obligation to create and maintain a D&I strategy, the minimum requirements described in both Consultation Papers differ from one another. Both Regulators refer to a) the setting of objectives and goals, b) the need for a plan in relation to those objectives and goals, and c) ways to measure progress.

5.2 However, the FCA Consultation Paper requires a D&I strategy to include the following two elements, which are not required in the PRA Consultation Paper:

5.2.1 "a summary of the arrangements in place to identify and manage any obstacles to meeting the objectives and goals;" and

5.2.2 "ways to ensure adequate knowledge of the D&I strategy amongst staff".

5.3 Similarly, the PRA Consultation Paper requires a D&I strategy to include elements not referred to in the FCA Consultation Paper:

5.3.1 "the firm's core values, the culture that it is trying to create, and its commitment to diversity and inclusion" and

5.3.2 "the role of the firm and staff in fostering an open and inclusive environment, including empowering colleagues to speak up and express their views".

5.4 ELA recognises that 5.2.2 and 5.3.2 both relate to a firm's staff, however whilst the FCA focuses on knowledge amongst staff of the D&I strategy, the PRA focuses on the role that staff can play in encouraging D&I.

QUESTION 4 OF FCA CONSULTATION PAPER / CHAPTER 1 OF PRA CONSULTATION PAPER

6. **TO WHAT EXTENT DO YOU AGREE WITH OUR DEFINITIONS OF THE TERMS SPECIFIED?**

6.1 The definitions of "senior leadership" and "D&I employee number", used by the Regulators in their respective Consultation Papers, do not conflict, nor do the definitions adopted of "employee". ELA has no other observation to make on this point.

6.2 It is proposed that "Discriminatory Practices" will be defined as follows: "**includes** discrimination against, or the harassment or victimisation of, a person or group **due to their demographic characteristics**, where these behaviours would be a breach of the EQA **if they related to** protected characteristics" (the "**Definition**"). ELA would encourage the Regulators to specify whether the Definition covers the following:

6.2.1 Direct and indirect discrimination as those terms are understood in the EQA?

6.2.2 Associative discrimination (in broad terms the right to claim indirect discrimination by association (if disadvantage is suffered alongside persons with a protected characteristic)?[11]

6.2.3 The concept of "discrimination arising from" which is a concept unique to the protected characteristic of disability (and replaced the old disability related discrimination concept)?

6.2.4 Equal pay?

6.2.5 If so, how will this work in terms of socio-economic background which the FCA envisages is a demographic characteristic?

6.3 The Definition seems to have two limbs: (i) discrimination against, or the harassment or victimisation of, a person or group **due to their demographic characteristics; and** (ii) the behaviours would be a breach of the EQA if they **related to protected characteristics**.

6.4 "Due to" is commonly understood to mean as a result of/because of. This would capture direct discrimination under EQA, but not indirect discrimination which has a different test[12].

6.5 Limb (i) of the Definition does not chime with the EQA concept of harassment i.e., "unwanted conduct related to a relevant protected characteristic that has the purpose or effect of violating individual's dignity or creating a hostile, degrading, humiliating or offensive environment."[13] Limb (ii) of the proposed definition does.

6.6 Limb (ii) of the Definition: "If they related to": what is meant here?

6.7 "Related to" is only used in the EQA in relation to harassment: s26 EQA "unwanted conduct related to a relevant protected characteristic."

6.8 Under the EQA: direct discrimination arises where someone is treated less favourably **because of** a protected characteristic. Is "related to" intended to be wider/different/add anything else to the test?

6.9 The EQA definition of indirect discrimination[14] would not meet limb (ii) of the Definition.

6.10 Take as an example: a firm has a provision, criterion or practice ("**PCP**") of giving direct

[11]The EQA will be amended to expressly add this form of protection to reflect the current status quo derived from European case law.

[12] S19 EQA indirect discrimination where a PCP applied neutrally puts individuals with a protected characteristic at a particular disadvantage and the employer cannot show it was a proportionate means of achieving a legitimate aim.

[13] S26 EQA

[14]where a PCP applied neutrally puts individuals with a protected characteristic at a particular disadvantage and the employer cannot show it was a proportionate means of achieving a legitimate aim.

client access to junior employees who speak "the King's English," this would arguably put employees from an intermediate or lower socio-economic background at a particular disadvantage. If socio-economic background was a protected characteristic for the purposes of the EQA a claim for indirect "socio-economic" discrimination would succeed if it is shown that there is group disadvantage and individual disadvantage from the application of the PCP and the employer cannot show that the PCP was a proportionate means of achieving a legitimate aim. Here the PCP is neutral and applied to all, it is not a policy "related" to the protected characteristic of socio-economic background. Neither is the application of the PCP **due to their demographic characteristic.**

6.10.1 Under the EQA victimisation arises where an individual is treated unfavourably because they have done a "protected act,"[15] not where they have been treated unfavourably because of a protected characteristic.

6.11 The use of the word "includes" in the Definition indicates that the actions/behaviours listed are intended to be illustrative but not to limit the actions that may be in scope. If that is the Regulators' intention what else is envisaged might come within the meaning of Discriminatory Practices? The fact that the Definition is intended to be illustrative does not cure the problems identified above that the legal test applicable to each of the various forms of discrimination prohibited by the EQA may not meet the two-limb test in the Definition.

6.12 It is not clear why the PRA has not followed the FCA's approach of defining "Discriminatory Practices", but this is a small point given the FCA would be the appropriate regulator for any conduct-related action against a firm.

6.13 The FCA clearly envisages that some meanings may evolve ("develop") over time; i.e. it wishes to future proof definitions and make them "broad and useful". Accordingly, it is considered unnecessary to define the term "***Demographic characteristics***".[16] There is however a risk that this will give rise to uncertainty for individuals and/or firms, as at present, where different approaches to the same issue may be taken. How are changes in approach by the Regulators (in terms of what they consider comes within such future proofed definitions) to be communicated so that firms develop their approaches and comply with their reporting and other obligations as appropriate?

[15] i.e. brought EQA proceedings, given evidence in such proceedings, done anything else for the purposes of or in connection with the EQA or made an allegation that the EQA has been contravene.

[16] Para 33 FCA Consultation Paper: "If we believe a term is well understood using its ordinary meaning, or where its meaning is likely to develop, we think it may be unhelpful to define it. An example of the former is 'demographic characteristics', which we have not defined in these proposals. This term has a commonly understood meaning (describing characteristics across a population) which includes the protected characteristics defined in the Equality Act 2010 alongside other factors, for example socio-economic background."

QUESTION 5 OF FCA CONSULTATION PAPER / CHAPTER 5 OF PRA CONSULTATION PAPER

7. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSALS TO EXPAND THE COVERAGE OF NON-FINANCIAL MISCONDUCT IN FIT, COCON AND COND?**

The tests introduced by the Consultation Papers

7.1 We note that the Consultation Papers result in the creation of a number of different standards which firms will need to apply regarding non-financial misconduct (including Discriminatory Practices and bullying and harassment). The existence of multiple standards may reduce the impact of the changes introduced by the Consultation Papers, as the number of standards may either affect the ability of firms to focus on the correct application of each individual standard, or (as a result of such focus) detract from a holistic approach to diversity and inclusion/ non-financial misconduct. Further, these regulatory standards will need to sit alongside (i) employment law principles; and (ii) the approach taken internally by a firm (or the group in which it sits) to these matters aside from its regulatory considerations. We address this in further detail in the following paragraphs.

7.2 There is a distinction between solo-regulated firms and dual-regulated firms. Solo regulated firms will have to comply with the various standards established by one Regulator and dual-regulated firms will need to comply with the various standards established by both Regulators. There will also be regulated and non-regulated individuals within a regulated firm, adding a further layer of complexity to the standards in force within a firm.

7.3 As a high-water mark, dual-regulated firms will need to consider and apply the following standards:

7.3.1 **COCON**: COCON will apply to "serious instances of bullying, harassment and similar behaviour towards fellow employees and employees of group companies and contractors" (paragraph 4.19 of the FCA Consultation Paper).

7.3.2 **Fitness and Propriety**: Conduct will be relevant if it shows "that the person lacks moral soundness, rectitude and steady adherence to an ethical code" and conduct that is "disgraceful or morally reprehensible or otherwise sufficiently serious" (suggested COCON rules 1.3.12.G(5) and 1.3.15.G(1) in the FCA Consultation Paper).

7.3.3 **Threshold condition in COND**: The guidance will be extended to include "offences relating to a person or group's demographic characteristics (such as sexual or racially motivated offences) and Tribunal or court findings that the firm, or someone connected with the firm (such as a director), has engaged in discriminatory practices" (paragraph 4.26 of the FCA Consultation Paper).

7.3.4 **Non-certified individuals:** Firms will have developed their own standards which they apply to non-certified individuals.

7.3.5 **PRA Supervisory statements:** At paragraph 5.11 of the PRA Consultation Paper, the PRA proposes to update SS35/15 and SS28/15 to make clear that it may take into account

"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."

Currently paragraph 3.8 of SS35/15 and paragraph 5.6 of SS28/15 state that the PRA's rules and standards "do not relate to a person's actions in their private life if those actions are unrelated to the firm's activities and the PRA would not generally expect to assess such actions". However, both paragraphs go on to recognise that "an individual's wider behaviour could affect their ability" to comply with certain rules and standards, and "may be relevant" to the question of whether an individual is fit and proper.

7.4 The PRA's approach appears to be focused on an individual's overall course of conduct which might undermine the firm's safety and soundness. In contrast, the FCA's guidance addresses both one-off instances of behaviour as well as continuing actions. While this is to be expected to an extent given that the FCA does by its nature have a more granular focus on conduct, we would encourage the PRA to expand upon its only brief guidance on fitness and propriety assessments: any expanded guidance should explicitly address whether or not the PRA will be interested in one-off conduct of any type, in addition to the aforementioned "patterns of behaviour."

7.5 Moreover, ELA considers that the Regulators should explicitly recognise that firms may, as a matter of good practice, apply a higher, consistent standard across the entirety of their population (regardless of the relevance of Conduct Rules or certification to some individuals).

7.6 The complexity of navigating these differing standards is exemplified at COCON 1.3.13 (3), (4) and (5) which gives examples of how differing members of one function may be caught by new COCON provisions. As will be discussed below, this illustrates that a one size fits all approach is not appropriate, as an individual's level of seniority, amongst other things, should be taken into account. Plainly this would not mean it is acceptable for other individuals not caught to be able to engage in (or be subject to) Discriminatory Practices with impunity. We consider that in order to ensure D&I and related non-financial misconduct are not seen only as a "must have" in certain areas of the business, and make other areas vulnerable to poor behaviours (in particular, valuable support functions), the FCA should make clear that (i) this does not remove wider considerations a firm may have legally or culturally in respect of those areas; and (ii) to expressly cross-link this with COND to emphasise that behaviour by or in respect of such staff may impact a firm's ability to comply with its threshold conditions. The PRA do this to an extent in the proposed revisions to SS35/15, but we consider this could be developed further. This might otherwise limit the effectiveness of the cultural change that the Regulators are trying to bring about.

7.7 This is not the only area where the Consultation Papers diverge or create multiple standards. As will be discussed elsewhere, the Consultation Papers also introduce different standards in respect of D&I governance provisions, as between the Consultation Papers.

<u>Objective vs subjective assessment</u>

7.8 According to the FCA Consultation Paper (at 4.23), the FCA will prioritise enforcement for particularly "serious" instances of bullying, harassment or similar behaviour, or multiple instances that are collectively particularly serious. The draft guidance at COCON 1.1.7G states that: "conduct within COCON 1.1.7FR is only a breach of COCON if it is serious" and COCON

4.1.1C states "not every lapse from that standard will involve a breach of COCON. Only a serious departure from it is likely to be a breach." We have stated elsewhere that further clarity is required as to the meaning of serious. We also consider that the guidance should clarify whether this is an objective or subjective test. In the employment law context when an Employment Tribunal is considering the fairness of re an employee's dismissal for misconduct the Tribunal must reach it decision by reference to the **objective** standards of the hypothetical reasonable employer and not by reference to the Tribunal's own **subjective** views of what they would in fact have done as an employer in the same circumstances.

7.9 In contrast, the PRA in its guidance makes clear that an objective assessment should be carried out independently by an appropriately qualified person. If the intention of the PRA is that this be a separate assessment, we consider that this could be quite an onerous and potentially impracticable obligation; many firms would build an assessment into a disciplinary process and a web of further processes would not be efficient for firms or employees. While disciplinary hearing managers and senior managers may have had some relevant training or briefing, the PRA guidance does not specify whether they would be considered "appropriately qualified"; further guidance would be welcome.

7.10 On a similar point, proposed COCON 4.1.1.I introduces an element of mens rea, adding that behaviour will only fall within rule 1 if it was intended to have a negative impact or there was not a good and proper reason for the conduct -we note this definition is perpetrator focused rather than victim focused, and differs to some degree with the test under employment law test.[17]

Types of non-financial misconduct

7.11 ELA considers that the Consultation Papers are very focused on harassment and bullying. This is understandable given the D&I context of the papers, however, seeing as guidance on non-financial misconduct is being provided, this leads to an imbalance/neglect in respect of other forms of non-financial misconduct such as fare dodging or theft (for instance of something belonging to a colleague). ELA recognises that perhaps this approach leaves a welcome amount of discretion available to firms, but considers that there is nonetheless a clear gap in the examples of non-financial misconduct discussed in the Consultation Papers.

7.12 Furthermore, ELA observes that the amount of guidance on non-financial misconduct breaches is disproportionate to the guidance that exists for other types of misconduct breaches.

7.13 ELA notes that the SRA, in its assessment of character and suitability rules, in relation to integrity and independence includes the following additional examples of misconduct:

- You have misused your position to obtain pecuniary advantage.
- You have misused your position of trust in relation to vulnerable people.

[17] *Section 26(1)* of the Equality Act 2010 provides that a person (A) harasses another (B) if A engages in unwanted conduct related to a relevant protected characteristic which has the purpose or effect of either: violating B's dignity, or creating an intimidating, hostile, degrading, humiliating or offensive environment for B.

Section 26(4) EQA provides that amongst other things in deciding whether conduct shall be regarded as having the **effect** referred to above, the perception of B must be taken into account.

- The SRA has evidence reflecting on the honesty and integrity of a person you are related to, affiliated with, or act together with where the SRA has reason to believe that the person may have an influence over the way in which you will exercise your authorised role.

The Regulators are encouraged to refer to additional types of non-financial misconduct in the Consultation Papers, in line with the approach taken by the SRA.

Retrospective application of the rules

7.14 The Regulators have indicated that the new rules will come into force 12 months after the publication of their policy statements. However, in our view, the Consultation Papers fail to address and provide clarity on how the guidance will apply to:

7.14.1 **Historical misconduct**: Conduct that comes to light after the new rules come into effect, but which occurred before the publication of the Consultation Papers.

7.14.2 **Misconduct in the intervening period**: Conduct that occurs between the publication of the Consultation Papers in September 2023, and the date at which the rules come into force, which will be in the second half of 2025 (12 months from the publication of the Policy Statement in 2024).

7.14.3 **Conduct that came to light prior to the Consultation Papers:** Conduct upon which a view has been taken based on previous guidance.

7.15 The new guidance will introduce a change to the law in some respects, insofar as it departs from the position previously taken by the Upper Tribunal (by which, as a matter of law, the FCA is bound). In Jon Frensham v FCA, the Upper Tribunal held that a distinction must be drawn between personal integrity and professional integrity, and that failings of personal integrity are only relevant insofar, as in the circumstances, they amount to failings of professional integrity as well.

7.16 The Regulators need to carefully consider whether the new guidance will have any retrospective application, as business decisions will have been taken on the basis of the regulatory position as it stood, making it potentially unjust to not treat historical conduct differently and to apply the new rules with immediate effect (i.e. in the intervening period).

7.17 That said, some historical conduct, or conduct occurring in the intervening period, may be so serious as to justify it being taken into account retrospectively. ELA would encourage the introduction of a threshold related to seriousness, however noting the critique made elsewhere in this response of the multiple different meanings attributed to the word "serious." Moreover, any unjust or disproportionate impact of the retrospective application of the new rules should be limited through the use of mitigating factors (for more detail see below). For instance, historical misconduct that was a one-off and has not re-occurred (a mitigating factor), or historical misconduct that has been followed by remorse and self-improvement (another mitigating factor), should fall outside of scope of the Regulators' rules.

7.18 ELA considers that the Regulators need to provide greater clarity on the application of their guidance to conduct that occurs before the new rules strictly come into force. In particular, the

PRA should clarify whether historical conduct and conduct that occurs during the intervening period, is relevant to establishing a pattern of behaviour.

Prescriptive guidance

7.19 ELA consider that the guidance in COCON 1.3.4G on the factors that are relevant to deciding whether conduct is within COCON is useful, without being overly prescriptive about whether any particular conduct is in or out of scope.

7.20 However, ELA considers that the content at COCON 1.3.6G, which is a table describing types of conduct and whether they "generally" fall within the scope of COCON, is in practice likely to be overly prescriptive, as it portrays these issues as overly black and white, in an area which is inherently grey. The table does not leave sufficient room for firms to consider the circumstances of an incident and is likely not to be in line with how firms currently apply their policies.

7.21 In our view, conduct that is always outside the scope of COCON should be clearly identified by the FCA. However, in line with the difficulties illustrated by relevant case law concerning vicarious liability, we consider that specific examples should not be given of conduct that is definitely within scope. The use of the word “generally” in the table at COCON 1.3.6G does not do enough to make clear that the table is an indicative list only, and that each situation is very fact-dependent. The table at COCON 1.3.6G could usefully be amended to show a) examples of conduct outside the scope of COCON, and b) factors tending to indicate conduct is within scope of COCON.

7.22 Additionally, the approach taken is out of sync with the law on vicarious liability, where the test is that of "close connection", such that a distinction is drawn between social gatherings that may be regarded as an extension of employment, and those which are a chance encounter outside of work.

7.23 We address vicarious liability and specific line by line drafting points in further detail below.

7.24 ELA notes that any behaviour falling outside of COCON may fall within the scope of FIT, in line with the proposed FIT 1.3.11G(1). We address detailed drafting points with some additional suggestions below.

Mitigating factors

7.25 We consider that the Guidance at COCON 4.1.1D provides a useful list of factors for employers to refer to when assessing whether there may have been a Conduct Rule breach.

7.26 FIT 2.1.1G does indicate that with regards to criminal convictions, mitigating circumstances should be taken into account when assessing fitness and propriety. It is stated: “conviction for a criminal offence will not automatically mean an application will be rejected. The FCA treats each candidate's application on a case-by-case basis, taking into account the seriousness of, and circumstances surrounding, the offence, the explanation offered by the convicted person, the relevance of the offence to the proposed role, the passage of time since the offence was committed and evidence of the individual's rehabilitation.”

7.27 ELA suggests that additional sub-paragraphs should be included in COCON 4.1.1D to make clear

that an employer would be acting appropriately in taking into account mitigating factors when deciding whether a breach of a Conduct Rule has occurred.

7.28 The Regulators should also consider addressing how mitigating factors may influence how a firm handles alleged behaviour overall and the discretion available to them (in line with wider employment law principles).

7.29 Such factors might include:

- contrition expressed by the individual concerned;
- the explanation offered by them;
- rehabilitation undertaken by them;
- steps taken to remedy the conduct;
- training undertaken (or committed to) by them;
- the individual's level of seniority;
- their mental health (potentially a protected characteristic under the EQA) and life events which may have caused them to act out of character; and
- the employer's considered opinion as to the likelihood of recurrence of the relevant conduct, for instance whether conduct was a "one off" lapse.

7.30 While we appreciate that some acts may not be excusable, we are also concerned that the FCA might, in effect, be creating new "strict liability" offences (in particular under COCON 4.1.11 (which states "bullying, sexual harassment or violence cannot be justified")).

7.31 As noted above, the FCA's guidance is focused on single acts of misconduct, whereas the PRA is more focused on patterns of behaviour. The question of mitigation is more relevant to the FCA's guidance, as mitigating factors may be less likely to explain/excuse ongoing patterns of behaviour. However, the PRA do appear to take into account the need to consider an individual's account: the proposed revision to SS35/15 states "Firms should ensure that individuals subject to allegations of such behaviour are given an opportunity to respond to the allegations, and that the allegations and responses are assessed objectively and independently by an appropriately qualified person." This alludes to mitigation but does not expressly reference it and so we consider this could be further developed. (Please also see our comments above regarding the "appropriately qualified person").

7.32 The SRA, in its assessment of character and suitability rules, includes a list of aggravating and mitigating factors. Accordingly, ELA would encourage the Regulators to align their approach with that taken by the SRA.

7.33 The SRA's aggravating factors include: no evidence of successful rehabilitation; no evidence of steps taken to remedy conduct; no (or little) evidence of remorse; repeated behaviour, or a pattern of behaviour, or event occurred very recently; individual was in a position of trust; individual held a senior position; vulnerability of those impacted by the behaviour; and behaviour likely to harm public confidence in the profession.

7.34 The SRA's mitigating factors include: evidence of successful rehabilitation; evidence of steps taken to remedy conduct; evidence of remorse; one off event, or event occurred some time ago; individual was in a junior or non-legal role; no evidence of harm being caused to individuals;

behaviour unlikely to harm public confidence in the profession; credible and cogent supporting references.

7.35 In particular, the taking into account of mental health factors as a mitigating factor may also positively contribute to D&I. More generally, the Working Group questions whether there is sufficient focus in the Consultation Papers on disability and in particular people who may be neurodiverse or experience neurological difference (which, in some but not all cases, may amount to a disability under the EQA (a mental impairment that has a "substantial" and "long-term" adverse effect on the individual's ability to carry out normal day to day activities)). This may in some cases require accommodations (or different ways to progress talent). The Discussion Paper ("**DP**") featured elements on cognitive diversity and diversity of thought but the Regulators are notably silent on this point in the Consultation Paper. While those previous references were in some respects problematic as ELA referenced in its response to the DP (for example, assuming that because a person has a particular characteristic, they will think in a particular way), we consider that the FCA could have considered this further given the current attention that many employers are giving to neurodiversity in their D&I work.

7.36 ELA notes that neurodivergence (and, where applicable, mental health conditions) should also be considered in relation to non-regulated individuals. ELA would encourage the Regulators to explicitly acknowledge this in any related material, so as to avoid contributing to the stereotype that neurodiverse individuals are mathematically gifted and normally sit within analytical functions of financial services firms.

7.37 ELA considers that the silence on this in the Consultation Paper is a missed opportunity to engage with neurodiversity, mental health and wellbeing – and that it would be in the Regulators' interest to do so, given the interaction with inclusion and psychological safety, and avoiding groupthink. By comparison, the SRA have considered wellbeing risks in their guidance to firms and their Code of Conduct. Specifically in relation to neurodiversity, ELA's response to the Buckland Review of Employment Prospects for Autistic People can be found in the December 2023 edition of the ELA Briefing:[18]

<u>Employment status and regulatory requirements</u>

7.38 As employment lawyers, we have observed that the Regulators tend to avoid commenting on the impact of regulatory measures upon the outcome of employment processes such as disciplinary proceedings.

7.39 This creates uncertainty and imposes costs on both firms and individuals. In some cases, the "costs" are extreme: the end of an individual's career (if a firm feels compelled to treat a matter as a Conduct Rule breach or as a matter of fitness or propriety, and therefore must include it in a regulatory reference), and/or enormously time-consuming and distracting litigation. Some might argue this creates a disproportionate impact on the competitiveness of financial services firms generally.

7.40 We consider it would be appropriate for the Regulators to provide express guidance addressing the question of whether or not an "integrity breach" or a finding of discrimination in all cases <u>must</u>

[18] https://www.elaweb.org.uk/law-and-practice/ela-briefing/response-buckland-review-autism-employment

mean that a person be dismissed from their employment. We consider that it is unlikely to be the case that firms must do so, but in order to avoid firms feeling compelled to act in this way, ELA considers that it would be useful for the FCA to provide clear guidance stating that it is not always necessary to reach that conclusion.

7.41 We are concerned that in the absence of any such guidance the Regulators risk (perhaps unintentionally) creating "strict liability" offences which in reality bind firms to certain employment outcomes, but with sufficient uncertainty for litigation to nevertheless ensue due, amongst other things, to the lack of guidance from the Regulators.

7.42 We have created the following two scenarios to illustrate some of the challenges that firms and individuals must navigate under the Regulators' proposals, which we invite the Regulators to consider. In our view, the guidance we encourage the Regulators to issue (set out above) would assist firms in coming to an appropriate outcome in each scenario, whether or not that is dismissal.

7.43 Scenario 1:

7.43.1 A male senior manager uses the word "darling" to refer to a female employee repeatedly over the course of months. It has a significant impact on the female employee, who feels belittled and discriminated against. She feels that her non-verbal reactions to this language have made clear that she finds it upsetting to be spoken to in this way, but the senior manager has failed to pick on this. The senior manager has used this language towards female employees for years without challenge, believing it was a term of endearment, and certain other senior managers put it down to him being "on the spectrum." The female employee raises a grievance and subsequently is unwell with work-related stress.

7.43.2 The firm's view is that he has clearly subject the female employee to sex-related harassment and sex discrimination, and the firm accepts that the impact on the female employee is serious.

7.43.3 The firm has recently published its D&I Plan on its website which sets out its commitment to taking strong action in "all cases of discriminatory treatment" and has stated that "there is no excuse for harassment at our firm," and includes extensive plans for increasing female participation and retention at the firm.

7.43.4 Should the firm assess that Conduct Rule 1 (Integrity) has been breached? What is the impact on the senior manager's fitness and propriety? Should the senior manager be dismissed; if not, what other sanction is appropriate (if any)? What should be said on any regulatory reference? What if:

(a) the senior manager is contrite and credibly agrees to change his use of language upon being challenged;
(b) most of the conduct referred to took place at informal after-work drinks at the pub, or some of it at a chance meeting at the supermarket at the weekend;
(c) the conduct is historic i.e. all took place in 2022 (or 2019) because the senior manager has worked in another area since 2023;

(d) the firm accepts that the senior manager has a disability and that there is a serious risk of a (successful) disability discrimination[19] claim by the senior manager upon any serious sanction being imposed?

7.44 Scenario 2:

7.44.1 A junior trader uses ChatGPT to cheat on his mandatory cyber-awareness test, and is caught.

7.44.2 The firm takes the view that this conduct was dishonest but does not amount to a Conduct Rule 1 breach meriting the sanction of dismissal. Is it open to the firm to take this view? The firm would, but for the regulatory issues, have issued a warning.

7.45 We further draw the Regulators' attention to difficulties relating to the nature of indirect discrimination, which may not be intentional. It is questionable whether such unintentional indirect discrimination should result in findings relating to integrity. We note that the Supreme Court held in Essop v Home Office [2017] UKSC 27 as follows in relation to the question of an employer having to justify a potentially indirectly discriminatory practice: "The requirement to justify a PCP should not be seen as placing an unreasonable burden upon respondents. Nor should it be seen as casting some sort of shadow or stigma upon them. There is no shame in it. There may well be very good reasons for the PCP in question - fitness levels in fire-fighters or policemen spring to mind. But, as Langstaff J pointed out in the EAT in Essop, a wise employer will monitor how his policies and practices impact upon various groups and, if he finds that they do have a disparate impact, will try and see what can be modified to remove that impact while achieving the desired result."

Vicarious liability - interplay between employment law and regulatory considerations

7.46 We agree with the position set out in proposed COCON 1.3 that COCON does not cover private or personal life. We do however have comments on where and how the proposed guidance sets the boundary in addition to the comments above, specifically due to the interaction with the legal position on vicarious liability. This is a further example of where there is a tension between relevant employment law and the draft regulatory guidance.

7.47 We are concerned that there is potential for an overly broad expansion of the boundary of application of COCON towards personal and private life to unjustifiably impact determinations made by courts in relation to vicarious liability of employers for the acts of their employees and equivalent persons.

7.47.1 In an employment relationship, vicarious liability involves an employer being liable for the wrongs committed by an employee where there is a sufficient connection between those wrongs and the employee's employment such that it would be fair to hold the employer to be vicariously liable.

[19] This may include a s15 EQA "arising from disability" claim (and/or a s19 indirect disability discrimination claim), with a possibility that dismissal would not be a proportionate means of achieving a legitimate aim in these circumstances.

7.47.2 It will usually be fair, just and reasonable to impose vicarious liability on the employer when the relevant criteria are satisfied. This is because:

(a) they are more likely to have the means to compensate the victim than the employee and can be expected to have insured against that liability;
(b) the tort will have been committed as a result of activity being taken by the employee on behalf of the employer;
(c) the employee's activity is likely to be part of the employer's business activity;
(d) the employer, by employing the employee to carry out the activity, will have created the risk of the tort being committed by the employee; and
(e) the employee will, to some degree, have been under the control of the employer. (Various claimants v Catholic Child Welfare Society and others [2012] UKSC 56, paragraphs 34 and 35).

7.47.3 Vicarious liability is a form of secondary liability and only arises where the primary wrongdoer is in breach of a relevant duty. It applies to:

(a) Common law torts;
(b) Equitable wrongs; and
(c) Breaches of statutory obligations.

7.47.4 We note that COCON Schedule 5 provides that there is no right of action for breach of statutory duty under section 138D FSMA for breach of the rules in COCON. Whilst vicarious liability for breach of statutory duty might not therefore arise, conduct of the nature envisaged could give rise to vicarious liability for tortious acts.

7.47.5 There is a two-stage test for determining vicarious liability:

(a) Stage 1: relationship between the defendant and the tortfeasor. The test is whether the relationship between them was one of employment or akin to employment.
(b) Stage 2: the link between the stage one relationship and the commission of the tort. The test is whether the wrongful conduct was so closely connected with acts that the tortfeasor was authorised to do that it can fairly and properly be regarded as done by the tortfeasor while acting in the course of their employment or quasi-employment. This is known as the "close connection" test. (Trustees of the Barry Congregation of Jehovah's Witnesses v BXB [2023] UKSC 15, paragraph 58.)

7.47.6 In our view there is a risk that the expanded COCON guidance has the potential to unjustifiably extend wrongful conduct deemed to be sufficiently closely connected with employment under stage 2 of the test, as the courts may choose to take it into consideration in their assessments.

7.47.7 In the Canadian Supreme Court case of Bazley v Curry [1999] 174 DLR (4th) 45 Can SC,McLachlin J noted that vicarious liability is generally appropriate where there is a significant connection between "the creation or enhancement of a risk and the wrong that accrues therefrom," but that incidental connections with the employment such as

time and place would not be enough on their own. The following further considerations were identified as relevant:

(a) the opportunity that the enterprise afforded the employee to abuse their power;
(b) the extent to which the wrongful act may have furthered the employer's aims (and hence be more likely to have been committed by the employee);
(c) the extent to which the wrongful act was related to friction, confrontation or intimacy inherent in the employer's enterprise;
(d) the extent of power conferred on the employee in relation to the victim; and
(e) the vulnerability of potential victims to wrongful exercise of the employee's power.

7.47.8 In Weddall v Barchester Healthcare Ltd; Wallbank v Wallbank Fox Designs Ltd [2012] EWCA Civ 25, the guidance set out included the following:

(a) while consideration of the time and place at which the relevant acts occurred will always be relevant, it may not be conclusive. For example, acts of passion and resentment or of personal spite may fall outside the scope of employment; and
(b) since vicarious liability is strict, it is important to keep the doctrine within clear limits. As against this, as a matter of loss distribution it may not be fair and just to deprive an employee of a remedy when assaulted by way of reaction to an instruction given by the employer. (This guidance now has to be read together with the decision in the Trustees of the Barry Congregation referred to above).

7.47.9 Case law has re-affirmed an additional element of sufficient connection with employment in cases of deceit, which requires distinguishing between:

(a) Cases where the employee was engaged, however misguidedly, in furthering the employer's business; and
(b) Cases where the employee was engaged solely in pursuing their own interests, or on a "frolic of his own."

7.47.10 Further, where an employee acts only in their own interests, an employer is likely to be responsible for loss occasioned by the fraudulent conduct of its employee acting within the scope of their apparent authority. In these circumstances the close connection test is likely to be regarded as satisfied.

7.47.11 Elements of the reasoning in the context of considering statutory discrimination claims are liable to be of assistance in applying the common law close connection test. Thus, for example, in the context of discrimination claims a distinction is drawn between:

(a) Social gatherings of work colleagues that may be regarded as an extension of employment; and
(b) Chance encounter outside work between work colleagues (Chief Constable of the Lincolnshire Police v Stubbs [1999] IRLR 81 (EAT)).

7.47.12 From an analysis of the relevant case law, it can be seen that whether there exists a sufficiently close connection with employment very much turns on the facts of the specific

case in question.

7.47.13 An obvious illustration of this is Shelbourne v Cancer Research UK [2019] EWHC 842 (QB), where the employer was not liable for injury at a Christmas party.

7.48 It seems clear that the proposed guidance at COCON 1.3.4G to 1.3.8G has been influenced by the case law and principles of vicarious liability. The case law approach elicits principles that are applied flexibly to the specific facts of any given case. In our view, this needs to be replicated in the proposed guidance. We note specifically as follows in relation to the scope provisions.

7.48.1 COCON 1.3.4G sets out a list of relevant factors. This is helpful in its approach, without being prescriptive about whether any particular conduct is in or out of scope. The content of the list is helpful, and could usefully be further expanded.

7.48.2 COCON 1.3.5G describes what is set out in COCON 1.3.6G[20]. However the content at COCON 1.3.6G is in fact set out in the reverse manner. In our view the approach at COCON 1.3.5G is the correct approach, and COCON 1.3.6G should be revised accordingly.

(a) In our view conduct that is clearly outside scope of COCON because it is part of a person's personal or private life should be expressly stated.
(b) However, in our view, in line with the difficulties illustrated by relevant case law concerning vicarious liability, specific examples should not be given of conduct that is definitely within scope. Rather, such examples should be in the form of an indicative list of examples of conduct that may be within scope of COCON.
(c) Use of the word "generally" in COCON 1.3.6G is unhelpful as it is not clear what it means.
(d) The table at COCON 1.3.6G could usefully be split into two, with the first section headed "Conduct outside the scope of COCON," and the second section headed "Factors tending to indicate conduct is within scope of COCON."
(e) More broadly, there is no regulatory need to artificially extend the scope of COCON beyond that which can justifiably be deemed to be sufficiently closely connected to an individual's employment and the business of the firm. Behaviour falling outside these parameters that should be captured will fall within the scope of FIT, in line with the proposed FIT 1.3.11G(1).

Diverging approaches to bullying

7.49 Under the EQA, harassment only includes unwanted conduct *related to a protected characteristic*. There are, therefore, numerous instances of bullying which fall outside the scope of the EQA because the bullying does not relate to a protected characteristic. Indeed, the term "bullying" does not feature in the EQA. Indeed "bullying" is not a legally defined term.[21] The Consultation

[20] i.e. "examples of when a person's conduct **is outside** the scope of COCON."

[21] Albeit that the High Court in the case of: R (FDA) v Prime Minister and Minister for the Civil Service [2021] EWHC 3279 (Admin), accepted that there was a broad consensus that conduct would fall within the description of 'bullying' if it can be characterised as: (1) Offensive, intimidating, malicious or insulting behaviour; or (2) Abuse or misuse of power in ways that undermine, humiliate, denigrate or injure the recipient. None of the constituent elements of this accepted characterisation of bullying is a legally

Papers therefore go further than the EQA, as behaviour can fall foul of the new proposals without amounting to harassment under the EQA. It is appropriate to "bridge this gap," as it would be counterintuitive for the Regulators not to be concerned with bullying. In this regard, we note that the Consultation Papers expressly use the word bullying, in common with equivalent SRA guidance.

7.50 The divergence between the employment law and regulatory positions is significant, and accordingly should be explicitly recognised in the Consultation Papers. ELA considers that the Consultation Papers should follow the example set by the SRA Guidance on the Workplace Environment, which states that "in a regulatory context, treating colleagues fairly and with respect is not the same as complying with employment law."[22] ELA notes that the Code of Conduct for Solicitors (and European and foreign lawyers) also refers to bullying.

Regulatory references

7.51 In ELA's response to the DP1/23 the review of the SMCR, ELA stated (amongst other things) that there should be further thought given to: additional clarity on a formal right of reply by the subject of the reference[23]; the ability of the subject to see a copy of the reference; and exercising due skill and care in allowing individuals an opportunity to comment, and these remarks remain relevant in the context of this paper. ELA also stated: Further clarity from the Regulators that an adverse regulatory reference does not, in and of itself, preclude a firm from recruiting and certifying a particular individual (i.e. comfort from the Regulators that firms should take a holistic approach to their recruitment due diligence and should not hold candidates to a standard of perfection). Guidance as to the relevant threshold to be applied (as mentioned above) may be one practical means of achieving such clarity. We consider that similar guidance should be given in relation to findings on non-financial misconduct (including in respect of "bullying, sexual harassment or violence"). While it may be rare for a firm to wish to make such a hire, and we appreciate the purpose of regulatory references in preventing rolling bad apples, we consider this should not be a roundabout way of banning individuals (e.g. as there may occasionally be mitigating factors) - if the FCA wishes to take enforcement action to prohibit individuals it may do so. We would refer the FCA to our fuller previous response here: https://www.elaweb.org.uk/sites/default/files/docs/ELAResponse_PRA_FCA_SMCRReview_FINAL_31May2023.pdf

7.52 According to the guidance, the FCA will only take action for particularly "serious" instances of behaviour. The word "serious" is also the threshold criteria for whether behaviour that occurred

defined term. All of the words used are capable of a range of interpretations. (As pointed out by Adam Tolley KC: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1152026/2023.04.20_Investigation_Report_to_the_Prime_Minister.pdf)

[22] https://www.sra.org.uk/solicitors/guidance/workplace-environment/

[23] It can also be difficult for firms to deal with the employment and regulatory interplay where an individual resigns or goes off-sick during an investigation (and how to deal with concluding an investigation and/ or handling this in a reference (and whether to state that this may go to an assessment of fitness and propriety)). The current proposals, including revisions to FIT 2.1.3. referring to "whether the person has been the subject of an upheld internal complaint related to discriminatory practices" will potentially exacerbate this.

over 6 years ago must be disclosed in a regulatory reference (SYSC 22, 22.2.2(3)(c)). We consider it likely that the FCA intended for different factors to be relevant to the question of seriousness in both contexts. If the same meaning is attributed to both instances of the word "serious," the effect will be that all non-financial misconduct breaches will need to be disclosed in regulatory references, beyond the usual 6-year time limit: the standard of seriousness for the purpose of regulatory references should likely be higher than the standard for non-financial misconduct breaches, as for less significant breaches the 6-year time limit will be suitable.

Interaction between new text of FIT and other elements of the handbook: detailed drafting observations

7.53 From a reading of the draft additional text for FIT 1.3, we understand the following overarching points:

7.53.1 behaviour in an individual's personal or private life is relevant to whether they are fit and proper in accordance with FCA regulatory requirements;

7.53.2 conduct that is out of scope of COCON may well still be in scope of FIT;

7.53.3 conduct within scope of COCON will also be in scope of FIT;

7.53.4 if an individual breaches COCON, that could also impact whether they are/remain fit and proper in accordance with FIT requirements;

7.53.5 that the FCA wish to set out a justification of why non-financial misconduct against individuals is relevant to fitness and propriety (although there is not any explanation in relation to or express inclusion of other forms of non-financial misconduct that it could be helpful to include);

7.53.6 that the FCA wish to reiterate that a firm acts through its staff and therefore may not be fit if its staff are not fit (although this point is expressly covered in existing guidance and posited significantly less clearly in this guidance); and

7.53.7 non-financial misconduct is relevant to limb one of fitness and propriety (honesty, integrity and reputation) and limb two (competence and capability)(despite no additional guidance being proposed for FIT 2.2) although this is not spelt out until the very end of the section at FIT 1.3.17G(7) (it seems to us there would be merit in putting this assertion up front).

7.54 Interestingly, whilst COCON individual rule 2 in relation to acting with due skill as a manager has been expanded in relation to non-financial misconduct, there is no proposal to update FIT 2.2 competence and capability in this regard. Presumably it must be the case that, without being expressly provided for, a due skill failing under COCON cannot translate into an honesty and integrity finding under FIT.

7.55 It appears that scope and substantive conduct provisions have been conflated. These would be better split out with scope provisions in 1.3 and substantive conduct provisions in FIT 2.1.3G. This would assist with clarity and make the text easier to follow. This split would align with the approach adopted across the FCA Handbook.

We have the following detailed drafting points on the proposed text. As an overall observation, we consider that the guidance in FIT is lengthy and in some cases duplicative, circular or potentially misconceived (which may lead to confusion in application) – the below points may assist in streamlining the guidance.

7.56 Draft FIT 1.3.6G makes the bare assertion that fitness and propriety should not be limited to conduct within the scope of COCON, without substantiation. The substantiation for this assertion does not appear until draft FIT 1.3.11G and draft FIT 1.3.12G(3) (see our comments on these provisions below). The substantiation for the assertion should be included within draft FIT 1.3.6G itself.

7.57 The matters covered in draft FIT 1.3.7G are not a consequence of draft FIT 1.3.6G. Those matters are the current position as reflected in existing FIT provisions referenced in draft FIT 1.3.7G. Draft FIT 1.3.7G does not add anything, may potentially create confusion, and detracts from the key points to be delivered. It should be clarified or deleted.

7.58 It appears that draft FIT 1.3.8G(2) should read "…set out some of the factors indicating why misconduct in (1) is relevant to assessment of fitness and propriety." The current drafting is unclear and does not appear to properly support the argument being advanced.

7.59 It appears that draft FIT 1.3.8G(3) should read "…then explains when misconduct in (1) will be in scope of FIT". The current drafting is unclear; the reader would only be concerned about how the factors apply to misconduct because it informs whether FIT will apply.

7.60 1.3.9G(1) this appears to be repetitive and tautological, and we query if it adds anything. Compliance with the requirements and standards of the regulatory system is already an express requirement under FIT 2.1.3G(13). COCON and APER clearly fall within requirements of the regulatory system. Either 1.3.9G(1) should be deleted, or a cross-reference to FIT 2.1.3G(13) should be included.

7.61 Draft FIT 1.3.9G(2) could be tightened from a drafting perspective and is potentially flawed in a number of respects. It appears to say that a firm will help itself to be fit if it has fit staff, therefore a member of staff may be unfit if their conduct would make the firm itself unfit (irrespective of whether their conduct made them themselves unfit). This is illogical/ circular in the context of FIT and appears (here) a weak attempt to bolster the FCA regulatory interest in behaviours outlined. If this is an attempt by the FCA to make the point that for COND, the totality of behaviour of staff (whether covered by FIT or COCON or not) could result in a failure to meet COND, the point should be expressed in that way (and would sit better in COND). The provision raises the following further issues set out at 7.62 and 7.63 below.

7.62 FIT does not directly apply to the assessment of firms themselves. Firms are subject to COND, including COND 2.5 on suitability. Firms must be fit and proper persons having regard to all the circumstances including their connection with any person. COND 2.5.3G provides that:

> "(1) The emphasis of the threshold conditions set out in paragraphs 2E and 3D of Schedule 6 of the Act is on the suitability of the firm itself. The suitability of each person who performs a controlled function will be assessed by the FCA and/or the PRA, as appropriate, under the

approved persons regime (in relation to an FCA-approved person, see SUP 10A (FCA Approved Persons in Appointed Representatives), SUP 10C (FCA senior managers regime for approved persons in SMCR firms) and FIT). In certain circumstances, however, the FCA may consider that the firm is not suitable because of doubts over the individual or collective suitability of persons connected with the firm."

7.63 There is a further concern if there is an attempt by way of draft FIT 1.3.9G(2) to apply FIT to Conduct Rules staff that are not currently subject to FIT. This would have broader ramifications and should be properly consulted on. In our view 1.3.9G(2) should either be deleted, or simply contain a cross reference to COND 2.5.3G and state that firms' ongoing satisfaction of the suitability threshold condition requires them to ensure that their employees comply with FIT including in relation to non-financial misconduct.

7.64 Draft FIT 1.3.10G does not appear to add anything and should be deleted.

7.65 It appears that the content of draft FIT 1.3.11G should in so far as necessary be included in draft FIT 1.3.6G.

7.66 We do not have any comments on draft FIT 1.3.12G(1). Draft FIT 1.3.12G(2) read in isolation would be fine. However, it follows sub-paragraph (1) which refers only to honesty, integrity and reputation and not competence and capability. It is then strange to refer to both qualities and abilities in sub-paragraph (2), rather than just to qualities. We note again here that there is no additional guidance proposed in relation to FIT 2.2 concerning competence and capability.

7.67 It appears that the reference in draft FIT 1.3.12G(3) to draft FIT 1.3.9G is unnecessary, and instead direct reference should be made to COCON and APER. However, to the extent not duplicative of draft 1.3.11G (see earlier comment above), the content of draft FIT 1.3.12G(3) should be included in draft FIT 1.3.6G.

7.68 The content of draft FIT 1.3.12G(4) does not follow the structure set out at draft FIT 1.3.8G. If a cross reference is required, it should be in draft FIT 1.3.17G(4) and not draft FIT 1.3.12G(4). It is not clear that draft FIT1.3.12G(4) adds anything and it could be deleted.[24] Honesty is already a key part of the fitness and propriety requirement in FIT 2.1, and it is a necessary consequence that needs no further clarification that if one is dishonest one is therefore not honest and would not satisfy the fitness and propriety criteria.

7.69 The first sentence of draft FIT 1.3.12G(5) does not appear to add anything to that already covered by draft FIT 1.3.6G and should be deleted. If indeed it is intended to broaden the scope of draft FIT 1.3.6G it should be included in that provision. It therefore appears that what draft FIT 1.3.12G(5) is in fact saying is that a person that lacks moral soundness, rectitude and steady adherence to an ethical code may not follow the requirements of the regulatory system and therefore may not be fit and proper. If that is the case, it should simply be so stated. Query whether this gives individuals sufficient certainty as to the standards to which they will be held. As we noted above, in Jon Frensham v FCA, the Upper Tribunal held that a distinction must be drawn between personal integrity and professional integrity, and that failings of personal integrity

[24] Although were this retained it would potentially be to make it easier for firms to spell out to individuals that conduct outside work such as fare dodging will impact on an F&P assessment.

are only relevant insofar, as in the circumstances, they amount to failings of professional integrity as well (and that the new guidance will introduce a change to the law in some respects, insofar as it departs from the position previously taken by the Upper Tribunal). Based on the current structure we suggest that (if included) the statement should instead be moved to draft FIT 1.3.17G, or FIT 2.1.3G(13) (on balance rather than draft FIT 2.1.3G(16)). (This may allow draft FIT 1.3.12G(5) to be deleted in its entirety.)

7.70 Draft FIT 1.3.13G(1) and draft FIT 1.3.14G(1) appear to be potentially misconceived in attempting to extend the application of statutory objectives that by definition apply to the FCA to individuals. We appreciate that the FCA wishes to demonstrate in the Consultation Paper why the provisions of FIT are relevant to its regulatory perimeter, and that embedding that in the guidance may help firms to understand the explanation.

7.71 However, it appears misconceived to attempt to impose the obligation in draft FIT 1.3.13G(2) on individuals by way of the FCA's statutory objectives. It would however appear reasonable to directly impose an obligation on individuals to not act in a way that "can damage" public confidence in the financial system and the financial services industry in the UK. This would be analogous to principle 2 of the SRA's principles applicable to solicitors to act: "in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons."

7.72 Draft FIT 1.3.14G(2) is not only potentially misconceived, but is also unnecessary and should be deleted. Fraud is already covered in FIT 2.1.3G(1) and FIT 2.1.3G(2).

7.73 Draft FIT 1.3.15G(1) – query whether the formulation "disgraceful or morally reprehensible or otherwise sufficiently serious" is correct to capture the intended misconduct (and we also suggest that this may be an extension of the position in Frensham referred to above and accordingly amount to a change in the law, and so the FCA may need to reconsider its approach here).

7.74 The following text should be deleted from 1.3.15G(2): "and consequently be inconsistent with the FCA's statutory objectives."

7.75 Draft FIT 1.3.16G(2) is potentially misconceived and should be deleted. It is worth noting that existing FIT provisions make no reference to the FCA's statutory objectives.

7.76 Draft FIT 1.3.17G – our general comment is that specific instances of misconduct should more appropriately be listed in draft FIT 2.1.3G(16).

7.77 Draft FIT 1.3.17G(2) – elements of this provision are repetitive and should be deleted.

7.78 The construction of draft FIT 1.3.17G(3) is hard to follow and understand. We repeat here our comments above in relation to draft FIT 1.3.9G(2).

7.79 In relation to draft FIT 1.3.17G(4), we repeat our comments above in relation to draft FIT 1.3.12G.

7.80 Draft FIT 1.3.17G(5) is misconceived and should be deleted. We repeat our comments above in relation to draft FIT 1.3.9G to draft FIT 1.3.13G.

7.81 Draft FIT 1.3.17G(6) – no comments.

7.82 The observations provided in draft FIT 1.3.17G(7) could usefully be provided much earlier in draft FIT 1.3. However, there is no substantiation for the misconduct covered in draft FIT 1.3 being relevant to competence and capability, and in our view this would not be the case unless the misconduct was also within scope of COCON. Further there are no proposed changes to FIT 2.2 to support this.

7.83 Draft FIT 2.1.3G(16) should not require cross reference to draft FIT 1.3.12G to draft 1.3.17G. Those provisions are densely drafted and it is challenging to decipher from those provisions what precisely is the misconduct in question. The specific misconduct caught by draft FIT 2.1.3G(16) should be listed in that sub-paragraph. From distilling draft 1.3.12G to draft 1.3.17G it appears that the specific misconduct in scope includes:

7.83.1 Conduct that lacks moral soundness, rectitude and steady adherence to an ethical code (albeit consider including this in FIT 2.1.3G(13) instead);

7.83.2 Conduct that can damage public confidence in the financial system and the financial services industry in the UK, including conduct that is disgraceful or morally reprehensible or otherwise sufficiently serious;

7.83.3 Violence or sexual misconduct against an individual; and

7.83.4 Very serious misconduct in relation to an individual.

Other potential examples of misconduct

7.84 We note at paragraph 4.18 of CP23/20 that the FCA considers that its proposed approach aligns with that of other regulators, including the SRA.

7.85 The SRA, in its assessment of character and suitability rules, in relation to integrity and independence includes the following additional examples of misconduct:

7.85.1 You have misused your position to obtain pecuniary advantage.

7.85.2 You have misused your position of trust in relation to vulnerable people.

7.85.3 The SRA has evidence reflecting on the honesty and integrity of a person you are related to, affiliated with, or act together with where the SRA has reason to believe that the person may have an influence over the way in which you will exercise your authorised role.

QUESTION 6 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

8. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSALS ON DATA REPORTING FOR FIRMS WITH 250 OR FEWER EMPLOYEES, EXCLUDING LIMITED SCOPE SM&CR FIRMS?**

8.1 This response should be read alongside the responses to questions 1 and 2.

8.2 While the scope of the application of the Regulators' proposals is more of a logistical issue, rather than a matter of employment law, ELA is broadly supportive of the regulatory proposals to limit the scope of the application of their data reporting proposals to larger firms (i.e. those with 251 or more employees).

8.3 Using a threshold that is already familiar to firms (e.g. by reference to the existing gender pay gap reporting obligations which apply to employers with 250 or more employees at the relevant snapshot date) should help to reduce the potential complexity for firms in understanding whether or not the data reporting requirements apply to them.

8.4 Imposing the regulatory reporting requirements on large firms only is, in our view, a proportionate approach that seems appropriate, at least initially, in order to reduce the administrative burden of additional regulatory reporting on small firms. We do, however, suggest that this approach is kept under review for the reasons outlined below.

8.5 According to data released by Statista in 2023, large businesses in the UK employed just over 9.3 million people which is only around a third of the private sector workforce.[25] Excluding small firms from the additional reporting requirements could therefore significantly limit the D&I data available to the Regulators and risk inhibiting their work and progress on improving D&I in the financial services sector.

8.6 It is worth noting that the SRA requires *all* regulated firms, regardless of size, to report data about the diversity make-up of their workforce every two years.[26] Interestingly, the smallest law firms tend to be most diverse[27] and so limiting the application of the data reporting requirements to large firms only *could* end up painting a misleading picture of D&I in the sector.

8.7 The contrary view to this is that the threshold of 250 is too low and will generate an unhelpful administrative burden on solo and group firms and also that the reporting will generate statistics which are so small that they will not be disclosable due to GDPR concerns.

QUESTION 7 OF FCA CONSULTATION PAPER / CHAPTER 2 OF PRA CONSULTATION PAPER

9. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSALS ON D&I STRATEGIES?**

9.1 As set out in our response to the Regulators' joint discussion paper (DP21/2) ("**DP**"), we consider that all firms should have and publish a D&I policy and that this would provide a good opportunity for firms and the Regulators to promote progressive change and improvement on D&I in the sector. We noted also that publication of a firm's D&I policy pursuant to a regulatory standard

[25] https://www.statista.com/statistics/676671/employees-by-business-size-uk/#:~:text=In%202023%2C%20large%20businesses%20in%20the%20United%20Kingdom,of%20the%20private%20sector%20workforce%20in%20this%20year.

[26] https://www.sra.org.uk/solicitors/resources/diversity-toolkit/your-data/

[27] https://www.sra.org.uk/sra/equality-diversity/diversity-profession/diverse-legal-profession/

would provide assurance to firms, investors and employees. Accordingly, we are broadly supportive of the Regulators' proposals on D&I strategies.

9.2 We note the change in terminology used by the Regulators – the DP referred to "D&I policies" whereas the Consultation Papers refer to "D&I strategies." The FCA Consultation Paper states that the reason for this change is to encourage firms to adopt a "*proactive approach to integrating D&I throughout their organisation*." The PRA Consultation Paper refers to the D&I survey conducted by the Regulators in October 2021 following publication of the DP which found that 76% of respondents already had diversity and inclusion policies[28]. Given the prevalence of D&I policies amongst firms, it seems evident that they have been insufficient in driving change and it may be that D&I strategies prove to be a more effective tool as suggested by the FCA.

9.3 However, a "strategy" risks being too abstract and lacking accountability. A policy, on the other hand, can be enforced because it may create mutual rights and obligations as between employer and employee.

9.4 In terms of accountability, the FCA proposes that a firm's Board would be responsible for maintaining and overseeing its D&I strategy. Paragraph 5.89 of the FCA Consultation Paper states that matters relating to D&I are to be considered as non-financial risk and treated appropriately within a firm's governance structures. It continues by stating that risk functions as well as internal audit can play an appropriate role, but it shouldn't be a tick box, and "support functions" such as HR, CSR and conduct professionals can also help firms embed D&I practices, monitor and identify issues. Whilst Board sponsorship and the designation as a non-financial risk may help drive improved D&I and lasting change within a firm, this may not be enough without individual responsibility. Taking small, incremental steps and actions each day to improve a firm's D&I drives real change. D&I should be seen as everybody's responsibility not least because people managers and employees below Board level are usually at the coalface of these issues especially when it comes to tackling inequality and underrepresentation through hiring practices and decisions on matters such as performance and promotion.

9.5 Paragraph 3.29 of the FCA Consultation Paper states that (our emphasis added): "Our work aims to ensure there are real and meaningful consequences for firms **and individuals** who do not follow our rules and requirements, and who cause actual or potential harm." We see little, however, within the FCA Consultation Paper or the draft rules to indicate that there will be any real or tangible individual responsibility or accountability for making progress against D&I objectives and goals other than at Board level, especially when it comes to senior managers. This is despite the Regulators having received feedback in response to the DP that: "tone from the top is essential," "a clear allocation of responsibilities supports greater accountability," and "all senior managers should take responsibility for developing and embedding a healthy culture." We suggested in response to the DP that making senior managers directly accountable for D&I "would create a more tangible and meaningful link between the SMCR and the Regulators' agenda on promoting diversity and inclusion." We remain of the view that including D&I as an aspect of SMCR would mean firms are more likely to engage with it as a regulatory priority.

9.6 We note that the PRA has adopted a different stance on individual accountability by proposing

[28] Paragraph 2.2, the PRA Consultation Paper

that relevant SMFs would have responsibility for the development and implementation of D&I strategies. For example, the SMF holding PR H would be responsible for ensuring that the strategy is implemented across the firm. Further, 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."

9.7 We believe that this approach, which ensures better individual accountability for D&I matters, should be replicated by the FCA for example by requiring the inclusion of such matters in senior managers' statements of responsibilities. To the extent that this were to include accountability for meeting targets, please also see our comments in the response to question 8.

9.8 The PRA will require firms to publish their D&I strategy on their website. Similarly, the FCA proposes that a firm's D&I strategy should be easily accessible to third parties and free to obtain with publication on a firm website meeting that requirement (SYSC 29.2.2). This is a generally positive proposition as it will mean there is some accountability due to internal and third party scrutiny and challenge if the strategy is not progressed (or seen to be progressed) or where firms do not strike the right balance of setting goals that are stretching but realistic, so that the strategy is perceived to be unambitious.

9.9 However, there is no requirement, or even suggestion, within the Consultation Papers that firms might consult their employees on their D&I strategy. This seems like an obvious step in garnering support for and engagement with a firm's D&I strategy and indeed raising awareness of it and related D&I initiatives within a firm. Moreover, trade unions and employee representatives are likely to have a significant amount of relevant experience in dealing with these issues. ELA would remind the FCA of a guiding principle expressed in "DP20/1 Transforming Culture in financial services – driving purposeful cultures:" "our task isn't to convince people of the meaning in their work, but to create conditions for them to discover it for themselves."[29] Applying this to allow employees to understand the need for a D&I strategy and feel they have discovered or created it can ensure it is owned by the workforce, increase effectiveness, and prevent a backlash. Employee consultation can often also help to facilitate meaningful change and effective development of employer policies and procedures, particularly on inclusion matters which can be harder to measure and address in practice especially without meaningful input from the workforce. It can also increase transparency and a sense by employees that they are being listened to – which Emily Shepperd highlighted in her November 2023 address to City & Financial's Culture and Conduct Forum as a key way of building a healthy culture. The Regulators may wish to provide further guidance for firms on how to disseminate information about their strategy and its progress including any barriers to progression through internal communications channels, in order to generate support and buy in.

[29] Page 38, per James Elfer, MoreThanNow

9.10 The proposed rules set out in the FCA Consultation Paper state that firms "must establish, implement and maintain **an effective**" D&I strategy (our emphasis added) which must include, amongst other things, a plan for meeting its D&I objectives and goals (SYSC 29.2.3). This could be particularly challenging for larger firms with a multi-jurisdictional presence and global HR policies that apply across their business but do not necessarily account for variations in local laws such as positive action in the UK which is something the FCA might expect to see in an effective D&I strategy. Adopting positive action initiatives could be particularly challenging for those businesses with a US footprint where there has been a retreat from affirmative action initiatives following the US Supreme Court's decision in the university admissions case. It is unclear whether, in assessing the effectiveness of a firm's D&I strategy, the FCA would take account of the fact that it applies on a global rather than a local level and may provide for a minimum, as opposed to the highest, standard.

9.11 On a separate but related note, the FCA does not explain how the adequacy of a firm's D&I strategy will be measured. We note, in particular, the reference in the FCA Consultation Paper to "shortcomings with many existing D&I strategies,"[30] which are not exhaustively outlined. Clearer guidance for firms about how adequacy will be assessed would be welcome. In our experience, some firms still struggle to understand how to measure and/or assess D&I (and, more broadly, culture) beyond raw statistical demographic data and so clear, tangible guidance may be of assistance.

9.12 Regarding the proposed components of a firm's D&I strategy, we would suggest that the FCA should also consider including confirmation of the firm's commitment to D&I (which is an important aspect of an effective D&I strategy and something we would generally expect to see in a D&I strategy) as well as a requirement to engage with the workforce on (as opposed to just informing them of) the strategy. We note that this is included in the proposals in the PRA's Consultation Paper.

QUESTION 8 OF FCA CONSULTATION PAPER / CHAPTER 3 OF PRA CONSULTATION PAPER

10. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSALS ON TARGETS?**

10.1 As set out in our response to the DP, we consider that comparable statistical data may achieve the Regulators' objectives without the need for targets. Some members of the current working group continue to hold the view that the reporting of data, whether as a number or proportion of employees holding a particular characteristic within a defined group, provides sufficient clarity without the need for targets. Other members of the Working Party consider that targets are an appropriate tool to drive change, if adopted thoughtfully and pursued appropriately (so that they are owned and met, in line with legal safeguards to prevent positive discrimination). Our comments in relation to the Regulators' proposed disclosure requirements are detailed in response to question 14 below.

10.2 To the extent that the Regulators proceed with their proposals to require firms to set and publish targets for improving diversity, firms will need to have a strong understanding of the demographics and diversity of their workforce before doing so. This will rely in large part on the

[30] Paragraph 5.10, the FCA Consultation Paper

diversity data that firms currently hold in respect of their employees being of sufficient quality and quantity. Where a firm has limited existing demographic data in respect of its workforce, it may first need to take steps to build trust with employees to ensure that they feel comfortable providing this data. We consider that firms may struggle to set meaningful D&I targets unless and until they have collected this data. As a result, we support the PRA's proposal that the annual disclosure of targets should not be mandatory until the second year after the rules come into force and the similar transitional provisions proposed by the FCA.[31]

10.3 We note that the Regulators' proposals in relation to D&I targets apply to all large firms. We agree that imposing this obligation on large firms only is a proportionate approach in the circumstances, although we refer to our comments detailed in response to question above.

10.4 Whilst there is some divergence between the PRA's and FCA's proposals as to which demographic characteristics should be covered by a firm's D&I targets, we note that the Regulators have generally afforded firms' flexibility by enabling them to decide their own targets. In our response to the DP, we expressed concern that setting a defined target for a particular characteristic, measured at a particular time, potentially risked ignoring the specific circumstances of a firm (including circumstances that may be reflective of the local community and societal factors and trends that influence the population demographics of the firm's workforce). We are therefore supportive of the flexibility afforded by the Regulators' proposals, including in particular the FCA's suggestion that firms should consider the context in which they operate, including "available data on the diversity profile of the UK population **and available data on the diversity profile of the geographical area in which the firm carries out… regulated activities…**" (our emphasis added) (SYSC 29.3.3). We consider that empowering firms to set their own targets will help to ensure that those targets directly address the "…specific challenges of underrepresentation within either their firm or the sector."[32]

10.5 However, some members remain concerned that requiring firms to set and publish diversity targets may result in legal and practical challenges for both firms and the Regulators. In taking steps to meet targets, firms will need to be mindful of employment law and data privacy constraints (for example, not departing from lawful positive action into unlawful positive discrimination).

10.6 The EQA prohibits unlawful discrimination relating to nine protected characteristics (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation). This includes "positive discrimination," i.e., the practice of giving preferential treatment to individuals based on one or more protected characteristics. However, there are two provisions in the EQA which permit "positive action:"

10.6.1 Section 158 of the EQA contains a general rule in relation to positive action. This can apply where an employer reasonably considers that persons with a particular protected characteristic are disadvantaged, have different needs or are disproportionately under-represented. In those circumstances, an employer can take proportionate measures to enable or encourage persons with the relevant characteristic to overcome that

[31] Paragraph 5.71, the FCA Consultation Paper

[32] Paragraph 5.17, the FCA Consultation Paper

disadvantage, meet their needs, or enable or encourage their increased participation. The potential scope of lawful activities which fall under this provision are wide. For example, it covers such things as providing prayer facilities at work exclusively to meet the needs of a religious minority or providing free English language lessons to non-English speaking employees. Further detail can be found in Chapter 12 of the Equality and Human Rights Commission's Employment Code of Practice.[33]

10.6.2 Section 159 of the EQA contains a more specific provision. This can apply where an employer reasonably considers that persons with a particular protected characteristic are disadvantaged or disproportionately under-represented. In those circumstances, the employer can treat a person with the relevant characteristic more favourably than others in recruitment or promotion processes, as long as the person with the relevant characteristic is "as qualified as" those other individuals. In other words, the provision makes certain types of positive discrimination lawful. It should be noted that this provision only allows a "tie break" in favour of an individual from an under-represented group where the relevant candidates are as qualified as each other. It does not allow the recruitment or promotion of a less qualified person just because they are from an under-represented group. Further detail can be found in the Government Equalities Office Guide to positive action in the workplace.[34]

10.7 Setting aspirational targets will generally be a lawful means of promoting diversity and inclusion. However, in the event that targets become de facto mandatory quotas in practice, there is an increased risk that these could amount to unlawful discrimination. Firms will need to avoid having a policy of promoting or hiring individuals because they have a particular characteristic in an attempt to meet their targets. Favouring an under-represented group in a disproportionate way in an attempt to meet targets could amount to unlawful discrimination unless the narrow exception detailed in paragraph 10.6.2 above applies. In the event that an individual is not promoted or hired for reasons relating to their protected characteristics or the diversity of the firm's board or senior management body (for example, on account of being white, or a man, or both), and appropriate legal tests are not met, the firm in question could be liable for discrimination. Firms must consider equity towards all their employees, not just those who may currently be underrepresented, and the laws on positive action provide some safeguards for this if followed.

10.8 As detailed in our response to the DP, we consider that there is a lack of awareness and understanding around the existing legal framework under the EQA permitting firms to take positive action to improve workplace equality. As a result, we consider the reminder to firms that there is a distinction between positive action and positive discrimination and the link to the Equality and Human Rights Commission's website at SYSC 29.7.2 may be helpful.

10.9 We note the FCA shared feedback from the DP that some respondents expressed concern that mandating a link between variable compensation and D&I metrics could drive negative practices such as tokenism. This could also be the case where firms choose to allocate individual

[33] https://www.equalityhumanrights.com/sites/default/files/employercode.pdf

[34] https://www.gov.uk/government/publications/positive-action-in-the-workplace-guidance-for-employers/positive-action-in-the-workplace

accountability to specific SMFs and this could be a driver for increasing the risk of positive discrimination (e.g. senior managers making hiring, promotion or redundancy selections based on pursuit of diversity targets – and therefore potentially their own KPIs and remuneration – because an individual is a "minority" rather than also considering merit). On the other hand, individual accountability and personal performance impact (including an impact on variable compensation) could be a beneficial driver for legitimate behaviour to meet targets. Where firms do choose to formalise individual accountability for meeting D&I targets, they should consider appropriate steps to balance the legal risk of positive discrimination (e.g. training for managers and appropriate oversight of decisions).

10.10 The Regulators propose that firms should publicly disclose their D&I targets on an annual basis, alongside the firm's rationale for setting those particular targets and the progress made towards them over time. The FCA has provided details in relation to the specific information that should be disclosed by firms, which we consider to be helpful (SYSC 29.5.20). Requiring firms to disclose this information may help to improve transparency and allow the Regulators and other third parties to benchmark a firm's progress against that of their peers, and allow a measure of effectiveness. However, this may also encourage employees to consider the extent to which their employers have met – or are making efforts to meet – their targets, which may generate litigation risk for firms if employees consider that insufficient progress is being made (notwithstanding the FCA's acknowledgement that "… meaningful progress may take several years" to achieve).[35] Ultimately, it is a point of policy for the Regulators to consider whether that is a risk that firms should have to accept taking, to drive D&I in the Financial Services sector. However, the Regulators do need to be cognisant in measuring the effectiveness of firms in pursuing D&I strategies and targets (and in finalising the relevant provisions) that there are constraints imposed by employment law and appetite for risk in this area.

QUESTION 9 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

11. **TO WHAT EXTENT DO YOU AGREE WITH THE DATE OF FIRST SUBMISSION AND REPORTING FREQUENCY?**

11.1 Whilst, again, the date of first submission and the reporting frequency is more of a logistical issue than an employment law issue, we are broadly supportive of the proposed approach to implementation and consider it appropriate to give firms the benefit of a transitional period so that they have sufficient time to determine how they intend to collect, collate and report their data.

11.2 It may be considered by some firms that an annual D&I reporting requirement is onerous, particularly as it relies upon engagement by employees to keep their personal information up to date. As described in response to question 6, the SRA D&I reporting requirement is a 2-yearly requirement.

11.3 Employers often undertake a specific communications drive when requesting that their employees update their diversity information for record-keeping purposes. As the FCA intends to set a reference date as at which D&I data must be reported, employers will have a relatively

[35] Paragraph 5.28, the FCA Consultation Paper

limited ability to choose the ideal timing for any such communications drive. We note that the gender pay gap reporting regime sets a snapshot date for reporting purposes (5 April for private employers) but employers then have until the following 4 April to report their data. Against that backdrop, the proposed 3-month reporting window following the reference date looks tight and may create some practical challenges.

QUESTION 10 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

12. **TO WHAT EXTENT DO YOU AGREE WITH THE LIST OF DEMOGRAPHIC CHARACTERISTICS WE PROPOSE TO INCLUDE IN OUR REGULATORY RETURN?**

12.1 As set out in our response to the DP, we broadly agree with the list of demographic characteristics. However, we note that socio-economic background can be difficult to define and so firms are likely to welcome guidance on how to measure this characteristic and how to drive social mobility change within the financial services sector (for example, by reference to information from the Social Mobility Commission and the SRA's diversity data questionnaire).

12.2 We note that race (i.e., colour, nationality and ethnic or national origins), which is a specific protected characteristic in the EQA, does not appear to be included. Is this intentional?

12.3 We also note that long-term health condition is referred to, but we query whether it is preferable for the term "disability" which already has a definition in the EQA to be used instead.

12.4 We agree that there is no need for firms to collect data on maternity, but we believe that collection of data on marital/civil partnership status is important to build a profile of the relevant firm (for example, whether or not it is supporting an inclusive culture).

12.5 Our general view is that the more relevant data firms collect, the easier it should be for firms to drive D&I change. However, firms may be concerned if they are asked to collect data that they do not already collect (for example, for internal purposes) or if they are asked to collect data using a different (or unclear) definition.

12.6 We expect that firms will welcome clarification of what is expected in terms of encouraging staff to provide D&I data to ensure a good uptake (in particular if staff can't be compelled to provide certain data) and in terms of reassurance that can and should be given to staff about how the data will be used (for example, to ensure that they will not be identified as having a particular characteristic). It may be that a request for some types of data (for example, ethnicity), may require additional reassurance in some firms, or more complex positioning from a group perspective in firms that operate outside the UK (in some jurisdictions it may not be culturally or legally appropriate to request some data sets).

QUESTION 11 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

13. **TO WHAT EXTENT DO YOU AGREE THAT REPORTING SHOULD BE MANDATORY FOR SOME DEMOGRAPHIC CHARACTERISTICS AND VOLUNTARY FOR OTHERS?**

13.1 Mandatory reporting is proposed for: age, sex or gender (must report on one, may report on the other voluntarily), ethnicity, disability or long-term health condition(s), religion and sexual orientation.

13.2 Voluntary reporting is proposed for: sex or gender, gender identity, socio-economic background, parental responsibilities and carer responsibilities.

13.3 We agree that mandatory reporting for a limited group of characteristics is a helpful approach – at least initially to allow the reporting regime to become fully embedded within organisations. Wider mandatory reporting could be introduced at a later stage.

13.4 This will allow organisations time to develop appropriate systems to capture and store this information (in a way that is compliant with data protection legislation).

13.5 It will also allow employees time to get used to the reporting rules, understand why their data is being collected and what will happen to it. It allows trust to be built and wider mandatory reporting is more likely to be accepted at that point.

13.6 The characteristics selected for mandatory reporting broadly map onto six of the nine characteristics protected under the EQA (although gender and long-term health condition(s) are not protected characteristics). We agree that this is a sensible starting point as many of the large organisations that will be subject to the proposed reporting requirements will already be collecting some or all of this data. Where this is the case, the mandatory reporting requirements should not be unduly onerous.

13.7 We agree that the characteristics included in the voluntary reporting list are the right ones on the basis that the majority of firms are not already collecting this data, meaning further time and money will need to be invested in putting in place appropriate systems.

13.8 It is not entirely clear what is meant by the seemingly distinct categories of sex, gender and gender identity. While we note the Regulators' comments that they have avoided the use of the term "gender reassignment" and aligned with SRA and census wording, we consider that firms would benefit from some further guidance. This is particularly so as the EQA refers to sex and gender identity. Further clarification would be helpful.

QUESTION 12 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

14. **DO YOU THINK REPORTING SHOULD INSTEAD BE MANDATORY FOR ALL DEMOGRAPHIC CHARACTERISTICS?**

14.1 It could be argued that the distinction between mandatory and voluntary reporting risks creating a hierarchy of characteristics. To the extent that this is true, however, it reflects the hierarchy that is already established in law under the EQA. Of the voluntary characteristics, only sex is a protected characteristic.

14.2 We consider that the FCA should remain mindful that if organisations do not tend to report on the voluntary characteristics this could lead to areas of underrepresentation being overlooked. Therefore, we would urge the distinction between mandatory and voluntary reporting to be maintained for an initial period only, with the voluntary reporting moved to mandatory in due course, ideally setting out a timetable.

14.3 In the meantime, we believe that the FCA should encourage voluntary reporting and showcase organisations that have chosen to do this.

QUESTION 13 OF FCA CONSULTATION PAPER / CHAPTER 7 OF PRA CONSULTATION PAPER

15. **TO WHAT EXTENT DO YOU AGREE WITH THE LIST OF INCLUSION QUESTIONS WE PROPOSE TO INCLUDE IN OUR REGULATORY RETURN?**

15.1 ELA is supportive of the focus on inclusion (as well as diversity) and in particular, that the importance of "psychological safety" and "speak up / listen up" cultures is recognised. We consider that this will encourage firms to take this matter seriously and will tie-in with the Regulators' desire for matters relating to diversity and inclusion to be considered as a non-financial risk and treated accordingly by a firm's relevant functions; to the extent that employee questionnaires are currently siloed in HR or employee engagement functions, they will now need to be dealt with more broadly (including at board and company secretarial level). We also note the Regulators' consideration of the FSSC's Inclusion measurement guide[36] in formulating its proposed measures of inclusion. Additional questions could be added that draw a distinction between feeling included by direct line managers and organisational leaders acting as role models for inclusive behaviour in order to identify more precisely where a lack of inclusion stems from. We suggest sliding scales of agreement should be suggested, from "strongly agree" to "strongly disagree". Opportunities for comment / elaboration should also be provided. We do not however believe that high levels of "prefer not to say" responses should necessarily be interpreted by the Regulators as a matter for concern. Whilst the Regulators should encourage firms to communicate to their workforces the importance of completing D&I questionnaires, in the absence of negative responses or specific complaints, we feel it places too onerous a burden on employers to have "neutral" responses potentially interpreted against them.

[36] https://wp.financialservicesskills.org/wp-content/uploads/2021/07/FSSC-Inclusion-Measurement-Guide.pdf

QUESTION 14 OF FCA CONSULTATION PAPER / CHAPTER 8 OF PRA CONSULTATION PAPER

16. **TO WHAT EXTENT DO YOU AGREE WITH OUR PROPOSALS ON DISCLOSURE?**

16.1 We consider that the Regulators' proposals on disclosure are sensible.

QUESTION 15 OF FCA CONSULTATION PAPER / CHAPTER 8 OF PRA CONSULTATION PAPER

17. **TO WHAT EXTENT DO YOU AGREE THAT DISCLOSURE SHOULD BE MANDATORY FOR SOME DEMOGRAPHIC CHARACTERISTICS AND VOLUNTARY FOR OTHERS?**

17.1 By the response to question 11 above and specifically paragraphs 13.3 to 13.7, those factors and features that influence and inform a split reporting regime (which regime distinguishes demographic characteristics on a mandatory and voluntary reporting basis) are more fully described.

17.2 A concern often raised by firms, as data controllers, is the specific challenge of UK GDPR compliance when processing sensitive employee data relating to D&I reporting (and any associated statistical analysis). The structure of the reporting regime, including, importantly, by the adoption of prescribed obligatory reporting obligations requiring the processing of specific employee data, will support and better resolve GDPR compliance by permitting necessary processing pursuant to a regulatory obligation.

17.3 Further, the regulatory obligation to report, which can be explained to employees, will support and justify a firm's request for information on demographic characteristics. Such explanation is anticipated to assist in advancing employee engagement and participation in critical D&I surveys and data gathering exercises. This consequence will naturally ensure the collation of data that is both qualitatively and quantitatively better, enabling firms and the Regulators to design and implement interventions that achieve enhanced participation, opportunities and progression for and in work across all described demographics.

17.4 Consistency in terminology between reportable demographic characteristics and the protected characteristics set out in the EQA will be helpful or, as is the case with gender identity, where there is a divergence in description, if there is an explanation. Such consistency (or, in the case of divergence, explanation) will support firms to realise consistency between existing D&I and reporting and future regulatory obligations, reducing the administrative burden on firms, and easing compliance.

QUESTION 16 OF FCA CONSULTATION PAPER / CHAPTER 8 OF PRA CONSULTATION PAPER

18. **DO YOU THINK DISCLOSURE SHOULD INSTEAD BE MANDATORY FOR ALL DEMOGRAPHIC CHARACTERISTICS?**

18.1 Please see responses to questions 11 and 15 above.

QUESTION 17 OF FCA CONSULTATION PAPER / CHAPTER 4 OF PRA CONSULTATION PAPER

19. **TO WHAT EXTENT DO YOU AGREE THAT A LACK OF D&I SHOULD BE TREATED AS A NON-FINANCIAL RISK AND ADDRESSED ACCORDINGLY THROUGH A FIRM'S GOVERNANCE STRUCTURES?**

19.1 We welcome the Regulators proposals, and consider that it is necessary, to make clear that matters relating to D&I are to be considered as a non-financial risk and treated appropriately within a firm's governance structures. This will allow firms to drive the changes expected by the Regulators by allocating cross-function resources to D&I, and ultimately board-level oversight (rather than one function alone e.g., HR being responsible). There would have been a risk that by making D&I the purview of one function, it could become siloed or deprioritised. Therefore, it is welcomed that the FCA are no longer proposing that the audit function alone assesses non-financial risk with regard to D&I. Additionally, the audit function of firms would not have had the appropriate expertise to take a holistic approach to analysing D&I progress, as the appropriate role for the audit function is likely to be limited to assessing whether there has been compliance with regulatory reporting requirements.

19.2 The Regulators should note, however, that the greater the number of people internally who have access to D&I information (in connection to governance/monitoring), the greater the risk that employees are less willing to provide D&I information due to concern with regard to who sees / has access to the information within their firm and beyond. Conversely, where employees are reluctant to provide D&I information for internal use only, then a regulatory expectation to provide data may assist firms with gathering such data.

19.3 The FCA is not now proposing that a single individual senior manager will have a prescribed responsibility in respect of D&I or non-financial misconduct. ELA would observe that, in reality, this may mean that solo-regulated firms become less focused on D&I than the FCA would have wished in making its "interventions," and that there is insufficient ownership within solo-regulated firms to develop D&I. ELA considers that this creates a further risk of industry dual standards as between dual and solo regulated firms (coupled with the dropped FCA intervention on board recruitment/ succession planning/ talent pipelines).

19.4 ELA welcomes the further enshrining by the Regulators, in their handbooks, of D&I.

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