STANDARDS BOARD FOR ALTERNATIVE INVESTMENTS

FCA Discussion Paper Response

Diversity and inclusion in the financial sector – working together to drive change

1. Introduction

The Standards Board for Alternative Investments ("SBAI") welcomes the opportunity to respond to the Financial Conduct Authority's ("FCA") Discussion Paper DP21/2 on Diversity and inclusion in the financial sector – working together to drive change[1] ("DP").

At the SBAI we are an active alliance of managers and investors dedicated to advancing responsible practices, partnership, and knowledge in the alternatives industry. At our core is a community that is committed to knowledge sharing, informed dialogue, and innovation. We set clear standards and actively promote responsible practice to normalise quality and fairness. Together, our community of allocators and managers create real world solutions – in short, we solve for better.

Our SBAI Alternative Investment Standards are supported by more than 140 alternative investment managers with over $1 trillion in alternative assets under management and by more than 90 major institutional investors, overseeing $4 trillion in assets.

As part of our mission to increase collaboration between asset managers and institutional investors to improve industry outcomes, we have a working group focused on culture and diversity. This working group is initially looking at three areas:

1. The principles of culture and diversity strategies within organisations,
2. Beyond the Metrics – A focus on smaller firms' diversity strategies and how institutional investors can assess these firms, and
3. How institutional investors can increase the diversity of their portfolios.

We are supportive of the FCA's intentions in this discussion paper. We would welcome the chance to share the feedback and potential solutions that have been discussed within our community with the FCA on this important topic. For further information please feel to reach out to us at info@sbai.org.

This consultation response contains:

1. Important high-level observations on Culture and Diversity (Section 2)
2. The responses to the consultation questions (Section 3)

2. High Level Observations on Culture and Diversity

[1] https://www.fca.org.uk/publications/discussion-papers/dp-21-2-diversity-and-inclusion-financial-sector-working-together-drive-change

Prior to responding to the specific questions in the DP, we would like to provide some context to the responses with observations on the below topics:

- Principles framework for culture and diversity strategies,
- Considerations for effective culture and diversity regulation,

2.1 Principles Framework for Culture and Diversity Strategies

We have recently published the first of our reports providing practical guidance for asset managers and allocators within our culture and diversity initiative.

Throughout the years, we have held several roundtable discussions with our community and positively have observed that many in the alternative investment industry understand the diversity challenges within our industry and want to actively be part of the solution. One of the impediments to this appears to be that people do not necessarily know where to start.

The principles we have put together collaboratively with our community of asset managers and allocators, provide a framework for firms to work through to set out their own strategies. The full memo can be found in our culture and diversity toolbox here and a summary of the principles is provided below:

1 **LEADERSHIP: Senior Leadership Must be Accountable for Culture and Diversity**
Leaders should take responsibility for culture and diversity, drive the agenda, and be both an advocate and a role model.

2 **STRATEGY: Set a Diversity Strategy that is Aligned with Business Goals and Supported by Measurable and Tailored Action Plans**
Take stock of where you are today, identify your objectives, develop measurable and achievable actions plans for these objectives, and ensure they are regularly reviewed, measured, and adjusted where necessary.

3 **COMMUNICATION: Align Internal and External Communication with Diversity Strategies**
Make a public commitment to your diversity strategy. Engage with your employees regularly and honestly communicate progress towards your diversity objectives. Ensure the public profile of your firm is in line with your diversity strategy.

4 **POLICIES: Review Existing Policies for Alignment with Diversity Objectives**
Examine policies and procedures for recruitment. Ensure performance reviews and career development discussions are structured and promotion decisions based on objective criteria. Make sure employees feel free to raise any grievances.

5 **INCLUSION: Evaluate People on Skills Required for Inclusion**
In interviews and performance reviews assess managers on skills required for an inclusive culture such as ensuring everyone is heard and managing disagreements.

2.2 Considerations for Effective Culture and Diversity Regulation

We are fully supportive of several of the statements made within the foreword to this discussion paper in particular "The key consideration is about the linkage between insufficient diversity and inclusion and groupthink, which can present a serious risk to safety and soundness" and "Shared assumptions and cultural biases can undermine the quality of discussions, and the robustness of decisions made, because views and practices go unchallenged. Increased diversity, in particular at senior levels, helps reduce the risk of groupthink." Whilst we agree that effective regulation, particularly around disclosure, can be a useful tool to achieve the goal of increasing the diversity of the financial sector, there are several factors that should be considered.

Making use of Existing Frameworks

Large allocators are already making use of diversity questionnaires examples include the AIMA and Albourne DDQ[2] and the Asset Owner Charter[3]. In the ESG space there has been a proliferation of different frameworks and taxonomies which can not only cause confusion for the end investor but also increases the resources required by firms to meet all of these requires. We would recommend the regulators reach out to allocators and asset managers in the UK do understand the data requests that already exist and look to use these frameworks rather than create new ones.

Quantitative vs Qualitative Reporting

Diversity data reporting has historically predominantly focused on metrics including amongst other things the number of employees of differing seniority that identify as protected groups. This trend has been observed through legislation such as the Gender Pay Gap reporting in the UK and through questionnaires sent by investors to asset managers. Whilst these metrics can be useful for establishing baselines for firms and monitoring progress, there are some challenges with these. Care needs to be given as to what level this data is collected on – focus only on board or senior leadership may not be enough to provide a true picture but detailed data collection on all employees may be too much.

Larger firms will typically benefit more from metrics-based reporting. Naturally higher turnover means that there is more scope for improvement in these metrics year on year. By contrast changing the composition of smaller firms is a longer-term goal and the hiring or loss of a single individual can have a much larger impact on these metrics. There is also a risk that detailed metrics for smaller firms may make certain individuals identifiable in any reporting – this would not be the case in larger firms.

The DP does discuss limiting reporting requirements for smaller firms and keeping these requirements high level. Whilst this recognises the challenges faced by smaller firms, there may be an unintended consequence where smaller firms are disadvantaged where investors use this diversity data as an input for manager selection.

We would recommend a qualitative disclosure-based approach as opposed to a metrics or targets-based approach. Firms should be required to explain how they have achieved diversity of experience and thought in the current composition of the board and senior management. If reporting requirements were updated to include qualitative as well as quantitative measures, smaller firms could report based on the qualitative only measures therefore providing allocators with some comparable diversity information for managers of all sizes.

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[2] https://www.aima.org/resource/aima-albourne-diversity-and-inclusion-questionnaire.html
[3] https://diversityproject.com/resource/asset-owner-diversity-inclusion-questionnaire

Principle 2 of our Principles Report (Strategy) recommends that firms should do the following:

Take Stock: Spend some time assessing where you are now, for example, how diverse is your organisation, how do your employees perceive the culture of the firm, where do you stand against peers? Use this data to understand the cap between where you are now and where you want to be.

Identify your Objectives: Determine a small number of objectives that you would like to achieve in a specified time frame. Ensure that the number of objectives are appropriate and that they are clearly defined and measurable.

Develop Action Plans: For each objective develop a clear action plan. This should include the steps that will be taken to achieve each objective, the person responsible for the objective, and the time frame it is expected to be achieved in. Completion of the action plans should be considered in the performance reviews of the responsible person and the senior leaders responsible for diversity.

Review, Measure, and Adjust: Ensure there are regular review points for these action plans. Measure progress towards success at these points and identify if any steps on the action plan need to be changed or if new steps need to be added.

A requirement for a firm to complete the above and disclose on an annual basis may be a more effective driver to change that relying solely on metrics-based reporting.

Size of Organisations

As with any disclosure-based regulation thought needs to be given to proportionality depending on the size of the organisation. This is very important when it comes to diversity metrics as discussed in the Quantitative vs Qualitive part of this section. Smaller firms will have less resources to complete detailed sets of metrics and a concept of standard versus enhanced reporting may be appropriate here. We note that the DP references this need in many places.

Regional Differences

We acknowledge that the FCA proposes any future regulation to be for firms that are within its regulatory arena and therefore at least partly UK based; however, there are certain regional differences that may still impact both the scope of reporting and the resources required.

Regional Diversity Focuses:
Globally the focus of diversity initiatives varies, gender has been important worldwide and particularly in the APAC region. More recently focus has shifted in certain jurisdictions to issues such as race in the US and socio-economic status in the UK. Asset managers will be required to respond to diversity questionnaires from investors from multiple jurisdictions who may have different focus areas. In addition, any strategies put in place for firms that have global offices may be required to be tailored by region.

Employment Laws and Cultural Differences:
Particularly relevant for quantitative reporting, there will be jurisdictions where collation or retention of certain metrics is not permitted. In some jurisdictions there will also be some questions that it would be culturally inappropriate to ask, for example on sexual orientation. There will be some UK based firms that will have global offices and therefore may not be able to supply metrics-based data for their entire organisations.

Board vs Senior Management

Whilst we believe the board should be involved in setting high-level goals for a firm and monitoring the progress of objectives within a diversity strategy, it may be more appropriate for the senior management or executive team to set the specific strategy details. Diversity strategies are successful when they have the buy-in from senior leaders who are visible to staff both advocating for this strategy and acting as role models. These strategies need to be aligned with the business objectives of the company. Allowing the senior management team to devise these strategies means they can be more tailored to the daily operations of the business and the employees and are more likely to have full buy in from senior management. Board oversight is important, and board sign off and monitoring of any strategy should be encouraged.

Privacy of the Individual

Collecting any sort of diversity data brings with it privacy issues. The more granular the data the more intrusive it may be to collect this data. **We would be supportive of a clear statement from the regulatory bodies on exactly how, where, and when this data will be used so employees of firms can make an informed choice on whether they wish to provide this data or not.** Coupled with this point the provision of data to your employer should not be made mandatory for any individual.

3. Responses to CP Questions:

Please find below our responses to the specific questions raised in the DP. We would be happy to discuss any of these further with the FCA.

Question 1: What are your views on the terms we have used, how we have defined them, and whether they are sufficiently broad and useful, now and in the future.

At the SBAI our initiative has deliberately focused on Culture and Diversity rather than solely diversity, as we support the view referenced in 1.17 that an inclusive culture is required to support diversity. We also support the definition of the focus of diversity as being "diversity of thought" rather than singling out specific characteristics such as gender or ethnicity.

With regards to inclusion, whilst we agree with your definition, we would also add that it is important for firms to create an inclusive culture, and this should be led by senior management. This can be supported by things such as employee engagement, robust grievance processes, and the tone being set from the top that everyone's views are important. It should also be acknowledged that this may require training for managers in inclusive skills such as those referenced in Principle 5 of our Principles Report:

Principle 5: Inclusion – Evaluate people on the skills and structures required for inclusion.

An inclusive culture is important for any firm to achieve its diversity objectives, but it can be hard to measure and assess. Interviews and performance appraisals can be adapted to cover inclusive skills and firms can regularly engage with their employees on their perception of culture.

What are Inclusive Skills?
There are many skills that can be assessed that would contribute to the inclusive culture of a firm such as:

- *Moderation of discussions. Soliciting views from quieter team members, giving the floor back to someone who has been interrupted, or encouraging dissenting views.*

- *Soliciting opinions from people impacted by the decisions or someone who may not agree but who could give helpful feedback.*
- *How disagreements are managed. Are decisions made by majority rules or are creative solutions involving compromise sought.*

In interviews or performance appraisals people could be asked to give examples of where they have applied these skills or how they would respond to hypothetical situations.

Question 2: Are there any terms in the FCA Handbook, PRA Rulebook or Supervisory Statements or other regulatory policies (for any type of firm) that could be made more inclusive.

As a not-for-profit industry organisation, we are not regulated by these entities and are therefore not best placed to answer this question. We do however support the self-reflection shown by the agencies in asking this question.

Question 3: Do you agree that collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector? What particular benefits or drawbacks do you see.

At a high level we agree that collecting and monitoring diversity and inclusion data will help drive improvements – in essence it is hard to improve what you can't measure.

In terms of benefits, this will not only cause more firms to review their levels of diversity but can also help investors to make more informed investment decisions based on their priorities. Having a baseline that can then be measured year on year provides a good way to measure progress of firms and to monitor alignment with any stated diversity objectives.

Collecting any sort of diversity data brings with it privacy issues. The more granular the data the more intrusive it may be to collect this data. **We would be supportive of a clear statement from the regulatory bodies on exactly how, where, and when this data will be used so employees of firms can make an informed choice on whether they wish to provide this data or not.** Coupled with this point the provision of data to your employer should not be made mandatory for any individual.

There will also need to be flexibility when including data from any non-UK offices due to differing regulatory environments and cultural sensitivities in different regions as discussed in Section 2 above.

Question 4: Do you have a view on whether we should collect data across the protected characteristics and socio-economic background, or a sub-set?

The proposed pilot survey noted in 4.10 may be a useful tool in determining the level of data required as it asks firms what data they are currently collecting.

To collect data based on a focus of diversity of thought, it would appear to be necessary to collect a wide range of data from protected characteristics. We note however that some data is more sensitive than others for example sexual orientation and socio-economic background which can require detailed and personal information to categorise someone. We would repeat an earlier point that if collecting data at this level employees of all firms should have the option to not disclose this data.

Following on from the discussion in section 2 on quantitative versus qualitative disclosure – this proposed data is all metrics based. We believe it is appropriate to also focus on what a firm is doing or planning to do via qualitative questions to get a fuller view of diversity. This may include simple yes/no/plan to implement answers to questions on policies and practices within the firm.

Question 5: What data could the regulators monitor to understand whether increased diversity and inclusion is supporting better decision making within the firms and the development of products and services that better need customers' needs?

It is likely that there is a significant amount of data already being collected by regulatory bodies that could be used in conjunction with diversity data to collect this. This has been discussed in the Bank of England's Staff Working Paper No. 912 on "Organisation Culture and Bank Risk"[4]. This looks at taking indicators such as:

- Data quality metrics such as late or inaccurate submissions as a proxy for detail orientation
- Approved persons data as a measure of inclusivity
- Complaints reports as a proxy for customer satisfaction
- Whistleblowing and Internal fraud data as a proxy for integrity
- Balance sheet and Capital Requirements data as a proxy for risk orientation

Whilst these indicators are more banking orientated, similar data collected by other regulators on different firms could be used in the same way and compared against diversity data to measure any improvements in decision making and meeting customer needs.

Question 6: What are your views on our suggestion to approach scope and proportionality?
Question 7: What factors should regulators take into account when assessing how to develop a proportionate approach?
Question 8: Are there any specific considerations that regulators should take into account for specific categories of firms?

The below is a combined response to questions 6 to 8:

We agree for any efforts to increase diversity in the industry a broad scope is in general a positive, but also agree that a proportional approach needs to be taken as discussed in the challenges for smaller managers in section 2 above.

In 5.5 it discusses a proportionality test based on "volume of business". We would recommend that some consideration is also given to the number of people in a firm. This is both from a resource perspective (depending on how detailed any disclosure reporting would be) but also due to the considerations on how metrics-based reporting might not be appropriate or comparable for smaller firms as discussed in Section 2. 5.6 does suggest this as an alternative.

5.8 discusses limiting the reporting requirements for smaller firms and keeping any requirements high level. Whilst this recognises the challenges for these smaller firms there may be an unintended consequence where firms may face challenges when investors are trying to compare diversity data across all firms. If reporting requirements were updated to include qualitative as well as quantitative measures it may be possible for these smaller firms to report based on the qualitative only measures therefore providing investors with some comparable diversity information for these managers also.

[4] https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2021/organisational-culture-and-bank-risk.pdf?la=en&hash=81DD3E865BC0159475FD10A78AA2293F0379FB8E

Question 9: What are your views on the best approach to achieve diversity at Board level?

In answering this question, it is important to refer back to the diversity focus of this discussion paper which has focused on diversity of thought rather than identifying any specific characteristics. It is this cognitive diversity that is important to reduce the risks that can appear through groupthink.

The setting of targets based on gender or race may not achieve this – a board comprised of a mixture of males and females that all come from the same background, have the same experience and that have been educated in the same way will not necessarily result in cognitive diversity.

We would recommend a disclosure-based approach to this as opposed to a targets-based approach. Firms should be required to explain (with reference to the people on the board) how they have achieved diversity of experience and thought in the current composition of the board. There could also be a requirement for board recruitment policies to include a documented review of how any new additions to the board would increase its cognitive diversity. These statements and policies should be made available to investors.

Succession planning as mentioned in 5.17 to 5.19 is crucial to increasing diversity at board level. Targets can often have the unintended consequence of companies chasing the same small pool of diverse applicants to achieve these targets rather than actively training and planning for new entrants to the pool.

Question 10: What are your views on mandating areas of responsibility for diversity and inclusion at board level?

5.13 states that the "board is the appropriate body for setting the diversity and inclusion strategy and policy for overseeing its progress. As per the first principle in our Principles Report, we believe that the tone from the top is vital for the success of any culture and diversity initiatives:

Principle 1: Leadership – Senior Leadership must be accountable for culture and diversity

Successful culture and diversity initiatives are fully supported by senior management – the tone is set from the top. Leaders with a personal commitment to diversity indicate that it is a key priority aligned with the success of the business.

Leaders must:
- *Take responsibility for culture and diversity*
- *Drive the agenda (supported by but no relying on employee resource groups or networks)*
- *Advocate and be a role model*
- *Have their performance assessments linked to culture and diversity objectives.*

This could also be combined with the second principle of Strategy where we recommend setting clear, measurable, and achievable objectives supported by action plans. We believe that the boards of firms should be both aware of and monitor the progress of these objectives.

Whilst we believe the board should be involved in setting high-level goals for a firm and monitoring the progress of objectives within a diversity strategy, it may be more appropriate for senior management or the executive team to set the specific strategy details. As mentioned above diversity strategies are successful when they have the buy-in from senior leaders who are visible to staff both advocating for this strategy and acting as role models.

These strategies also need to be aligned with the business objectives of the company. Allowing the senior management team to devise these strategies means they can be more tailored to the daily operations of the business and the employees and are more likely to have full buy in from senior management. Board oversight is important, and board sign off and monitoring of any strategy should be encouraged.

It is important to note that many financial firms, particularly in the alternative investment space, are formed as limited partnerships and as such may not have a board of directors. In these instances, an alternative governance process may be required.

Question 11: What are your views on the options explored regarding Senior Manager accountability for diversity and inclusion?

We agree that diversity and inclusion should be a specific Senior Manager accountability. For Dual regulated firms, we agree that this fits well within the responsibility for culture of a firm and that this prescribed responsibility should be updated with explicit guidance that culture includes the oversight and responsibility for the firm's diversity and inclusion strategy.

5.24 states "Good data and ongoing monitoring, including through internal audit would be necessary to be able to show that these responsibilities are being met". It is likely that some flexibility would need to be built into this as smaller firms will not have an internal audit function. Alternatives such as external audits would also not be appropriate for smaller firms as this increases the costs (and therefore barriers to entry) for smaller firms which could ultimately be detrimental to diversity in the industry. Any requirements for internal audits should feature in the proportionality decisions made on any potential regulation.

For solo managers, we are supportive of expressly allocating responsibility for elements of the diversity and inclusion policies to Senior Managers, rather than including them in the general wider responsibilities.

Question 12: What are your views on linking remuneration to diversity and inclusion metrics as part of non-financial performance assessment? Do you think this could be an effective way of driving progress?

In principle one of our report "Leadership" we recommend the following:

Assessment of the performance of senior leaders should factor in progress on diversity and how inclusive the culture of the firm is. Objectives that could be assessed include levels of engagement with employee groups, delivery of new initiatives, and any improvements made in the diversity of the organisation.

We have explicitly not recommended that performance assessments be solely linked to metrics. There are two primary reasons for this:

- Firstly, as discussed in the quantitative vs qualitative part of section 2 above, metrics may not be the best measure for smaller firms. The larger the firm, the more natural turnover, meaning there are more opportunities for metrics-based progress. Driving smaller firms to either expand too fast or "force" turnover of their staff to improve metrics and therefore performance assessments may have the unintended consequence of reducing stability and sound investment decisions.

- Secondly, improvement in metrics should be a result of other work that has been completed and not necessarily the end goal. Metrics can be improved by mass hiring for larger firms, but this does not necessarily mean that effective strategies are in place to genuinely improve diversity in the industry. Metrics also cannot necessarily reflect cognitive diversity – as mentioned earlier a collection of people that all fit into different boxes in a metrics report but that have similar backgrounds, employment, and educational experiences does not result in cognitive diversity.

We would recommend that firms are required to put in place specific and measurable objectives to support the firm's diversity strategy. Senior manager performance appraisals can then take account of achievement (or not) of these objectives.

In this section there is a focus on remuneration committees and boards of directors. Some flexibility will be required here for smaller firms that do not have remuneration committees and other firms that are structured, for example, as limited partnerships and therefore may not have a board of directors.

Question 13: What are your views about whether all firms should have and publish a diversity and inclusion policy?

In our principles report we recommend the following:

> *Make a public commitment: Public statements on diversity increase both the transparency and the accountability of diversity principles and objectives. Ensure your employees, investors, and peers are aware of your commitments.*

We would therefore be supportive of firms publishing a diversity and inclusion policy.

Question 14: Which elements of these types of policy, if any, should be mandatory?

In our principles report we have deliberately not been prescriptive about what a published policy should include. This is because we believe that diversity strategies are individual to firms accounting for current diversity of employees, business objectives, and jurisdictions.

Mandatory sections could include:
- Senior Manager responsible for the strategy,
- Firm's diversity and inclusion objectives, and
- How these objectives will be measured.

Question 15: What are your views on the effectiveness and practicability of targets for employees who are not members of the board?

Where the objective is to increase the cognitive diversity of a firm the setting of specific targets may not be practical. Targets by necessity are likely to be based on protected characteristics such gender and ethnicity. As discussed in responses to previous questions, teams that are diverse in these terms may not necessarily be cognitively diverse if they share similar educational and employment backgrounds.

Targets, particularly where there is a relatively short time frame to achieve them, can sometimes have the unintended consequence of causing firms to chase the same pool of talent, especially for senior management roles. It may also create issues for these hires where they may be viewed as a "diversity hire" rather than just the right hire.

Smaller firms may have further challenges with targets with lower natural turnover in the firms. Stability of investment teams needs to be considered to avoid adding additional risks into the process.

Disclosure of policies and strategies such as inclusive recruitment practices, clearly defined objectives for promotion, and the like may be more appropriate than a reliance on targets.

Question 16: What are your views on regulatory requirements or expectations on targets for the senior management population and other employees? Should these targets focus on a minimum set of diversity characteristics?

Noting our views on targets set out in the response to question 15, should regulators decide to enforce targets, as per 5.46 our view is that targets should be set by the firms and not the regulators. Each firm will have its own diversity gaps and therefore diversity targets.

Question 17: What kinds of training do you think would be effective in promoting diverse workplaces and inclusive cultures?

We support the statement in 5.48 that training should be focused on real business outcomes. This means that the exact training required may vary from firm to firm. There is also some evidence that a one size fits all training programme for an individual firm may not be as effective as more targeted training[5].

Training is important and can provide time and space for firms to reflect on the culture of their organisation. Training could include things like training management teams for inclusive skills such as effectively moderating meetings and decisions to ensure no individuals are disenfranchised during the process. The use of formal/informal mentoring schemes in larger firms may also help to provide individuals with differing viewpoints within their firms. Smaller firms may be able to make use of role models within the industry to achieve the same perspective.

Structured training courses can be expensive and could create an additional cost or barrier to entry for smaller firms. We would recommend that the regulators do not specify the exact type of training required as this would potentially create a tick-box compliance culture rather than detailed thought into the type of training that would be more appropriate for the firm. Like other responses a disclosure-based approach to this may be more beneficial than stringent requirements for specific training needs.

Question 18: What kinds of training do you think would be effective for helping understanding of the diverse needs of customers?

In the alternative investment industry, most "customers" will be institutional investors although some larger firms may also cater to the retail environment.

We would not be best placed to answer this question in terms of retail customers. For institutional investors conversations on diversity within the manager selection process are becoming more standard and this may be the most effective way to gain perspective on the diversity requirements of these investors.

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[5] https://www.pnas.org/content/116/16/7778

Question 19: What are your views about developing expectations on product governance that specifically take into account customers' protected characteristics, or other diversity characteristics?

As per question 18, given our community consists of institutional investors we are not best positioned to answer this question.

Question 20: What are your views on whether information disclosures are likely to deliver impact without imposing unnecessary burdens? Which information disclosures would have the biggest impact?

At the SBAI, we are generally supportive of disclosure to investors to allow for informed investor decisions. We also support the view that disclosure of practices in general can lead to improvements and as such our Alternative Investment Standards (which our asset manager signatories sign up to) specifically cover disclosure to investors in many areas.

As noted in many responses to previous questions, there are typically two forms of investor disclosure – quantitative and qualitative. For diversity disclosure historically, focus has been on quantitative disclosure – i.e., metrics-based reporting. Metrics-based reporting is often preferred as it can appear to offer direct comparisons between firms and may be an easier method of establishing a baseline to measure any improvement from. As noted in Section 2 above there are some challenges with reliance on metrics-based reporting including the difficultly of comparing large and small firms and the potential incentive for short term fixes to improve metrics rather than thoughtful strategies designed to have a long-term impact.

Qualitative disclosures may have more impact on changing behaviours. The requirement to disclose strategies, objectives, and how firms are trying to solve this issue can provide a better insight into how seriously the firm treats culture and diversity. These policy and strategy disclosures could be supported by additional questions that can be responded to with "yes", "no", or "planning to implement in the next 12 months" which will assist to provide a comparable baseline for firms.

Question 21: How should our approach for information disclosure be adapted so that we can place a proportionate burden on firms?

As discussed in Section 2, we agree that proportionality is important. Any regulation should take care not to significantly increase costs and resource requirements for smaller firms which can create potential barriers to entry. Increased barriers to entry may be detrimental to diversity in the industry.

Should the regulators decide to introduce metrics-based reporting it may be more appropriate to include a threshold, where this approach becomes mandatory only when a firm has a certain number of employees – similar to the Gender Pay Gap Reporting legislation in the UK. Any qualitative based disclosures could be mandatory for all firms.

Question 22: What should we expect firms to disclose and what should we disclose ourselves from the data we collect?

We would support the public disclosure of a diversity policy for firms. Regulators could provide guidance for sections that should be disclosed in this policy which could include:

- Details of current policies and practices in areas such as recruitment, retention, and promotion. Larger firms could also include details of any mentoring or sponsorship programmes along with any employee networks that have been set up.

- Details of objectives and plans for the next 12 months to make improvements in any of these areas. This may include targets should the firm choose to but could also include details of any planned changes to policies and practices. Disclosure of this kind would allow investors to monitor whether progress continues to be achieved.
- Firms may choose to disclose metrics as part of this; however, as noted we would be supportive of this not being mandatory for all firms. Qualitive questions measured on a yes/no/plan to implement in the next 12 months basis could be included here.

Where metrics are required, it may be appropriate for the regulators to disclose the data received; however, the following point should be considered:

- Disclosure of metrics without regards to the size of the organisation may produce misrepresentative comparisons. Larger firms will naturally have more opportunities to change these metrics than smaller firms will. Metrics for smaller firms may also risk making individuals identifiable.

It may be more appropriate for regulators to use the data they have collected to create industry statistics based on firm size, location, and type of business. This would allow investors to compare the firm's disclosed data against these statistics to benchmark against peers.

Question 23: What are your views on how we should achieve effective auditing of diversity and inclusion?

This section talks about internal audits of diversity strategies. We agree with the view that a lack of diversity can be a risk where groupthink becomes prevalent and as such can limit decision making abilities.

Where practical, an audit of policies and strategies vs results may be useful for firms to understand whether the actions they are taking are achieving the intended results.

The requirement for an audit, however, may not be appropriate for smaller firms who do not have an internal audit function. There may need to be a threshold requirement for this.

Principle 2 of our Principles Report (Strategy) recommends that firms should do the following:

Take Stock: Spend some time assessing where you are now, for example, how diverse is your organisation, how do your employees perceive the culture of the firm, where do you stand against peers? Use this data to understand the cap between where you are now and where you want to be.

Identify your Objectives: Determine a small number of objectives that you would like to achieve in a specified time frame. Ensure that the number of objectives are appropriate and that they are clearly defined and measurable.

Develop Action Plans: For each objective develop a clear action plan. This should include the steps that will be taken to achieve each objective, the person responsible for the objective, and the time frame it is expected to be achieved in. Completion of the action plans should be considered in the performance reviews of the responsible person and the senior leaders responsible for diversity.

Review, Measure, and Adjust: Ensure there are regular review points for these action plans. Measure progress towards success at these points and identify if any steps on the action plan need to be changed or if new steps need to be added.

A requirement for a firm to complete the above and disclose on an annual basis may be a more effective driver for change that the mandating of audits on diversity policies and practices.

Question 24: How can internal audit best assist firms to measure and monitor diversity and inclusion?

Following on from our response to question 23, in larger firms, internal audit should review the described objectives and action plans to measure their success.

Question 25: Do you agree that non-financial misconduct should be embedded into fitness and proprietary assessments to support an inclusive culture across the sector?

We are supportive of the inclusion of non-financial misconduct in fitness and proprietary assessments. As part of our mission to improve industry outcomes we believe that the integrity of market participants is vital.

We would agree with 5.69 and 5.70 that there would need to be clear guidance on what should be considered. As with any sensitive topic, it is important that any disclosures of this sort are evidence based rather than anecdotal. This would also mean a consistent approach is applied across the industry.

Question 26: What are your views on the regulators further considering how a firm's proposed appointment would contribute to diversity in a way that supports the collective suitability of the Board and senior management?

We are supportive of considering how a proposed board or senior management appointment would contribute to the cognitive diversity of the firm and reduce the risks associated with groupthink. We would recommend that this is done via a statement from the firm as opposed to providing diversity data on the individual seeking authorisation.

As noted in responses to prior questions, specific protected characteristics are not necessarily indicative of cognitive diversity – educational and other backgrounds may be similar, for example, between a male and female appointee and as such will not necessarily increase cognitive diversity. Therefore, providing regulators with specific diversity characteristics will not necessarily provide the required information to determine whether the proposed individual would add to the cognitive diversity of the firm. This may also have the unintended consequence of hiring based on these specific characteristics as opposed to considering true cognitive diversity at the firm.

A statement on why this hire would add to the cognitive diversity of the firm may be more appropriate. Statements could then refer to any number of different experiences, including education and employment as well as more common diversity characteristics such as gender and ethnicity.

We believe the requirement of an explanation of this type would be more likely to encourage thorough review of new hires than simply providing diversity metrics.

Question 27: What are your views on providing guidance on how diversity and inclusion relates to Threshold Conditions?

We agree that any changes such as the above should come with guidance. Whilst in general we agree that attitudes to diversity and inclusion should be considered as part of a fit and proper test – particularly non-financial misconduct records of individuals in the firm - there are some challenges to this.

5.74 talks about taking the diversity of boards into account when assessing whether the firm meets the Threshold Conditions – this would face the same challenges that we have previously discussed on metrics-based data.

Question 28: Do you have any suggestions on which aspects of our supervisory engagement with firms that you think could be improved to help deliver and support greater diversity and inclusion?

The detailed changes regarding questions for firms on how they consider diversity and inclusion within their organisation would be a good step. We believe that this combined with disclosures on firm's objectives in this area (as discussed in the response to Question 23) would be a good basis for supervision.

Question 29: What impact do you think the options outlined in this chapter, alongside the FCA's proposals for a new Consumer Duty, would have on consumer outcomes?

We believe that increased cognitive diversity in decision making within financial sector firms would improve consumer outcomes by making the decision-making process more robust.