AFM Response to PRA CP18/23, Diversity and Inclusion in PRA-regulated firms

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:

- Comment on the proposals, and
- Highlight concerns about the costs and benefits of the proposals.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 32 million people in the UK and Ireland, collect annual premium income of over £22 billion, and employ nearly 30,000 staff¹.

3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

³ http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted
Introductory comments

4. We welcome the opportunity to respond to this consultation paper. We recognise the imperative that financial services organisations reflect the diversity of the population they serve. As member-owned organisations, this has been key to the evolution of the mutual sector. Indeed prior to greater regulatory controls on the composition of management boards, it was common for members of AFM to recruit some or all of their members from the trade or community the organisation represents. In relation to business form, mutuals themselves offer a different approach and focus, which, as mentioned in the paragraph above, encouraged parliament to include a corporate diversity clause into FiSMA in 2016.

5. And diversity make good business sense. As early as 2015, research from McKinsey indicated that companies with a high level of gender and racial diversity were likely to outperform other businesses in their sector by 25%4. Since that time of course there has been a proliferation of initiatives and reviews relating to workplace diversity, and there has been a significant commitment from the financial services industry to invest in improving diversity.

6. It is true however that the rate of progress is not consistent across firms, and has not moved forward effectively across all forms of diversity and inclusion. We therefore recognise the opportunity for regulatory intervention from PRA and FCA. However, we are concerned that the projected costs of the two regulators’ proposals are excessive, amounting to over £1.7 billion over three years. The draft rules thereby place a heavy burden on firms, with little account given for the investment they are already making in raising standards.

7. We responded in support of the approach being taken by PRA and FCA to D&I in the 2021 Discussion Paper. Since then though the climate for regulatory intervention may be changing: for one thing, firms have continued to invest significantly in initiatives designed to address shortfalls in D&I. More recently, government has signalled concern at the level of red tape for businesses: in withdrawing legislation on reporting requirements it has signalled a need for regulators to carefully consider any proposals that create an extra burden on business, to demonstrate that they generate measurable benefits5. As a result, the Financial Reporting Council announced recently that it was reining back

on some of the onerous proposals for change in the UK Corporate Governance Code. The Ministerial letter to FRC on 22 November set out the government’s expectations of all regulators:

“Proportionality of any new requirements is essential and it is also important to look actively at where rules and guidance are no longer proportionate and can be removed or streamlined.”

8. We support work on diversity and inclusion, but not at any cost: the net impact of the proposed requirements is not likely to be positive, at least not for all industry audiences. For that reason we suggest the new rules are simplified significantly with many elements replaced with guidance, or are only applied to large firms for at least three years and only extended once the incremental benefits of new rules are proven.

9. In addition to the comments in our letter, we have attached a copy of our responses to the questions raised in the FCA consultation, and have cross-referenced these where appropriate to our comments on the PRA paper. This is because the two regulators have opted for similar but separate consultations, and it means the majority of our comments in this letter are restricted to PRA-specific proposals.

10. The news release issued by PRA when the consultation was published provided an incorrect statement that the PRA rules would not apply to friendly societies. Whilst PRA provided an update on its website a week later, it was disappointing that this error was made and that no publicity was given to the correction other than within the consultation webpage. We think PRA should have made this information more widely available.

**Firm-wide strategies**

11. We agree with the decision not to be prescriptive, and this will help firms build on existing policies, and enable them to recognise the progress they have already made. We also agree that firms are likely to need to undertake training of the workforce to effectively disseminate a D&I strategy; however we note that this has not been factored into the PRA or FCA cost-benefit case. This appears to be because the costs were significant and that FCA concluded this would negatively affect the cost-benefit case. We consider training is both desirable and unavoidable in

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implementing a firm-wide strategy, so the costs should be factored back into the CBA.

12. We agree that PRA should not be prescriptive in its approach to risk and control of the D&I strategy. We note though that in paragraph 5.6 of Appendix 6 (the draft Supervisory Statement), PRA expects firms to employ both second and third lines in ‘providing appropriate challenge and oversight’, and query whether this is appropriate for all small firms.

13. In our response to FCA, comments in relation to Q7 are also relevant here.

**Targets**

14. The section on targets in chapter 3 describes the expectation that large firms set targets for ‘the board, senior leadership, and throughout the employee pipeline’. It would be helpful for PRA to describe what it means by ‘employee pipeline’ in this context (paragraph 3.5), as it is not covered in the draft supervisory statement. We note also the intention to add a new definition of senior leadership to the glossary; however, we have concerns over how this applies to smaller firms in the scope of the CP.

15. Equally, in this section the reference to large firms specifies the threshold of 251 employees; as the CP is addressed to Solvency 2 (and CRR) firms only, it would be helpful to have confirmation that this does not therefore include non-Directive firms with more than 250 employees. FCA’s approach would appear to include non-directive firms with 251-plus employees in the requirements for large firms.

16. There is an abundance of factors that firms need to take into account in setting targets. Paragraph 3.8 highlights differences in strategy, size location, complexity, and business models, whilst at paragraph 3.6 the consultation states firms should set targets (for women and ethnicity as a minimum), if ‘the firm identified underrepresentation in these areas’. We would imagine this would be a judgment for a board, and the lens through which it judges underrepresentation might include with regard to the level of representation elsewhere in its sector/industry, generally accepted targets e.g. in the Hampton-Alexander review, the market a firm serves, or natural representation in the economy as a whole.

17. PRA helpfully identifies that geography might be a factor for mutuals, since most are located outside the main conurbations. Based on the 2021 census\(^8\), just 36.8% of people in London identify as ‘white British’;
in other regions the rate tends to be between 80 and 90%. That has a fundamental impact on firms based outside London to recruit 'representative' numbers of people from ethnic minorities, unless that is compared to the region in which they operate.

18. A further factor for some AFM members will be the affinity group that they serve (especially if directors are recruited from within a membership base of, for example, farmers or train drivers). The socioeconomic, educational and experiential diversity will therefore be limited, and it is likely that this is also reflected in the gender, age and ethnic composition of the board and the workforce.

19. We agree that targets for representation on the board need not necessarily increase the size of the board; however, from the data we collect across AFM members, the average size of Board has increased from 9 at the end of 2020, to 9.3 at the end of 2022, reversing a trend previously for board sizes to reduce (in light of the extra costs and complexity of the SMCR and its impact on board recruitment). This has coincided with an increase in female representation on the board in the sector, to 31% at the end of 2022.

20. Our responses to FCA questions 4 and 8 are also relevant here.

Board governance

21. The PRA suggests that the 'available talent pool for boards' should not be a challenge in increasing diversity (in paragraph 4.2). However, for some mutual organisations that is not a helpful statement: for example, one Solvency 2 firm has a workforce of just five people, and others recruit some or all of their directors from within their members. As we explained in our response to DP2/21:

‘Some AFM members retain a delegate system, whereby branches within the organisation appoint their own delegate to the annual general meeting, and delegates directly appoint the board, based on nominations partly or wholly from within the membership. This makes it much more difficult for the chair or executive to exercise control over who is appointed to the Board. Membership in such organisations may be drawn from a relatively narrow set of demographics, and targeting in these circumstances is not likely to be helpful.’

22. We agree that the board should ‘hold management to account for promoting diversity and an inclusive culture’. The indication from PRA that management might be remunerated for their work in embedding culture across the firm (in paragraph 4.8) would surprise mutual organisations, for whom the need to maintain the right culture is part of their raison d’être, and not a factor in the incentive structure.
23. We note the proposed addition to SS5/16 of paragraph 2.4 in Appendix 2. This refers to the D&I strategy, but does not make it explicit that this requirement does not extend to non-directive firms (which the rest of SS5/16 does). Indeed the text of the paragraph indicates that ‘for all-PRA regulated firms, the PRA expects firms to be able to provide evidence of... the effectiveness of the firm-wide strategy’. Please amend to ensure this does not include non-directive firms.

24. On the other hand, we are very supportive of the proposals to add a sentence to paragraph 4.1 on SS5/16 on inclusion, and on ensuring that the culture of the board enables individuals to offer their views. Similarly we agree with the clarity on addressing groupthink (revised paragraph 5.1), though we do not accept that this is largely a D&I problem. Indeed, as Baron Andrew Tyrie (ex-Chair of the CMA and of the Treasury Select Committee) recently stated, the 2008 crisis rested much more on the comfort zone of the London-centric authorities and banks:

“There is too much “groupthink” at the highest levels, he says. The Bank of England and Financial Services Authority were so “deep in their comfort zone” that they failed to see the financial crisis coming.”

Individual accountability

25. Our experience of operating the Mutual Diversity Alliance (covered further in response to FCA Q.2 below) is that there is significant value in a firm appointing a senior leader in the business to lead work on D&I issues. We have received positive feedback from firms about how this has garnered action across the business, and how it has helped the individual appointed to better account for the benefits of the approach taken. Hence, we recognise the value of the proposal for at least one SMF to have responsibility for implementing the firm’s D&I strategy.

Monitoring diversity and inclusion

26. We agree that it is important for firms to monitor delivery of their D&I strategy, to help identify what further activity is necessary, even where the firm is outside the scope of target-setting. However, for firms below the 251 threshold, it is important that PRA helps foster a proportionate approach, and does not unreasonably set expectations on small firms that should be the preserve of much larger ones. We would be concerned if supervisors sought to mandate that firms adopt the voluntary aspects of the proposed rules, such as in setting targets and disclosing results, or in surveying staff, or undertaken firm-wide training.

Regulatory reporting

27. We agree that firms with fewer than 250 employees should only provide data on the number of employees. PRA has invited smaller firms to complete more of the regulatory return voluntarily, where this supports broader benchmarking work. It would be helpful for PRA to set out in more detail what it intends to do with this data, as a sensitive approach might encourage more firms to provide data voluntarily. As PRA intends to publish the results it obtains, it is important that there is no risk of a data protection breach in anything published, and that the publications are constructive and not used to take a critical view, and can be used to set out examples of good practice.

28. As this chapter covers similar ground to FCA, we have not repeated here responses given to FCA questions 2, 6, and 8 to 13. Please treat these as part of our response to this consultation.

Disclosure

29. Within the Mutual Diversity Alliance, signatories agreed to publishing on their website an account each year covering how they have met the expectations of the Alliance. We have been pleased to see the imagination and effort that has gone into this, and whilst there were no mandatory data requirements for Alliance members, firms have used the report to draw expansively on the extensive work they undertake to maintain an effective and proportionate approach to D&I in their firm.\(^{10}\)

30. Our responses to Qs 14 to 16 in the FCA consultation are included below and should be considered to reflect our response to PRA as well.

Cost Benefit Analysis

31. We appreciate the range of desk-based analysis conducted by PRA in preparation of this consultation paper. The section on ‘PRA objectives analysis’ in Chapter 9 provides a very helpful overview of research into the benefits of effective D&I in firms. Whilst this provides compelling evidence, it was a missed opportunity for PRA and FCA not to conduct more recent research: since early 2020 the way people work has changed significantly, and research into how firms are taking forward good D&I practices in a hybrid working environment would have been very illuminating, and would take account of the significant activity undertaken over the last few years.

\(^{10}\) Examples of reports provided by some signatories are provided via the AFM website: https://financialmutuals.org/events-training/mutual-diversity-alliance/
32. We recognise that the costs set out by PRA are imprecise and that the low responses to firm survey requests contributed to this. That said, the estimated combined costs of the new rules proposed by FCA and PRA are very high. For example, a smaller Solvency 2 firm can expect on average to spend over £100,000 over three years, and a large Solvency 2 firm has estimated costs of over £650,000. We recognise these costs are likely to vary across firms. The costs exclude training of staff, but we consider it would be unavoidable to achieve the scale of change sought by the regulators without a commitment to staff communication and training: as PRA stated, despite 10 years of progress on D&I, ‘the rate of change has been slow’ in ‘changing organisational cultures and structures’.

33. One of the benefits of the approach cited by PRA was to address the nature of groupthink which contributed to the 2008 financial crisis. We agree that lack of diversity (and inclusion) contributed to this: as mutual organisations we consider that corporate diversity is just as relevant a solution. That being the case, we consider there is scope for a regulatory dividend for mutual organisations, and this might include exemptions from requirements such as those copied over from the Listing Regime, and to producing a more simplified approach more generally. A clause in FiSMA 2016, inserted an expectation into PRA’s (and FCA’s) regulatory principles, to take account of corporate diversity (see footnote 3 above), and we consider this to be a relevant opportunity of that in action. After all, no mutual insurer or friendly society received any of the £23 billion government support provided to banks during the 2008 crisis (as stated by PRA at paragraph 9.48).

34. We agree on the likelihood of benefits to firms and the financial services industry of greater inclusion. As part of our Mutual Diversity Alliance, we have invited various speakers from outside the sector to explore the benefits of a more diversified approach, and to broaden the workforce to welcome people from different situations and backgrounds. Amongst AFM members, we see the benefits of that diversity and inclusion as member-owned organisations, where for many organisations, board members are recruited from the membership of the business and/or the local community.

35. Our critique of FCA’s CBA analysis, via Q.18 of their consultation, is also relevant here.
36. We would welcome the opportunity to discuss further the issues raised by our response. We are happy to be included in the published list of respondents, though some of the data we have provided was collected on the express understanding that it would not be published to an external audience.

Yours sincerely,

[Signature]

Martin Shaw
Head of Policy
Association of Financial Mutuals
AFM responses to questions raised in the FCA consultation

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

We agree that this approach would not prevent a firm reporting on a group basis, and that reporting on a solo entity basis would aid comparability and encourage progress at a firm level (for each entity within a group). We do not consider that the proposed rules are punitive to the extent that groups would consider re-structuring their businesses in order to avoid some of the reporting and disclosure requirements, though we would expect FCA to consider this.

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

The decision by the Government, after the FCA consultation was released, to withdraw legislation on new reporting requirements was made to ensure that industry was not burdened by ‘additional reporting requirements’\(^{11}\). The resulting decision by the Financial Reporting Council to remove most of the proposed changes to the UK Corporate Governance Code is an important example of how regulators may consider anew the potential to avoid imposing significant new burdens on firms, even in areas where there is a general commitment to reform.

Judged against this, we query whether it would be more proportionate to exempt more firms from costly new requirements, especially where those rules create unintended hurdles to a firm delivering good outcomes. In our view, requiring firms with fewer than 251 employees to develop a diversity and inclusion strategy (along with other governance and accountability requirements from PRA) would add material costs and complexity to those businesses.

In addition, it would add to greater scrutiny from external auditors for any information published in the report and accounts. We have already seen a reaction against the more intrusive approach by auditors to disclosure on ESG more generally, including on managing the financial risks of climate change. This has led smaller firms being more cautious about what they disclose, and in some cases firms have concluded that it is preferable to reduce auditable/ non-financial disclosures to no more than the minimum required, and to be more circumspect in their approach to ESG work in general. Applied to D&I, this would be a bad outcome, and undermine much of the good and extensive work already in place to help firms achieve better D&I outcomes. (We will include various of our sector’s initiatives in this respect in our response.)

Looking at the specifics of the proposals, the regulators have adopted the number of employees as the main basis for comparison and proportionality. We consider other options might have been considered, as the employee base may not always provide a good indicator of size: for example, if many of a firm’s functions are outsourced. More reliable measures of scale include the turnover of the business

or the number of consumers served, though we recognise all measures will have a degree of compromise within them. It is surprising though that both here and more generally in the consultation, there is little regard to the competition effects on consumers of firms’ approaches to D&I.

To illustrate, in 2020 members of AFM established the Mutual Diversity Alliance, in order to foster good practice in the sector around D&I issues, and to enable training and collaboration. In establishing the high-level principles, as below, we recognised that as businesses it was equally vital to demonstrate a strong commitment to treating all customers well, in addition to employees.

**Mutual Diversity Alliance**

As a member of the Mutual Diversity Alliance, we are committed to maintaining a culture in our organisation that allows all our employees to thrive, and which avoids barriers to our customers, partners and suppliers effectively engaging with us.

Our business should be accessible to everyone, and we are committed to demonstrating inclusive behaviours, and to embracing diversity in all its forms. We recognise the business benefits of having a truly diverse workforce, that is representative of the wide diversity of our membership.

In order to do this, members of the Mutual Diversity Alliance adopt the following good practices:

- Appointing a senior leader in the organisation to lead our work on mutual diversity across the business;
- Treating all customers and employees with respect, dignity and courtesy;
- Making reasonable adjustments to, and maintain, an appropriate working environment, where employees from diverse backgrounds enjoy an equality of opportunity, and to demonstrate this through equality of pay, the capacity for agile working, fair recruitment and other HR policies;
- Maintaining an effective culture via our Board, that promotes diversity and sets the right example;
- Working with other members of the Alliance to support problem solving, to sponsor training of our people on inclusivity and diversity, as well as on conscious inclusion, and to share good practice, as necessary;
- Reporting each year in September on how we have met the expectations of the alliance.

Furthermore, an employee-centred approach to deciding whether and how firms are involved in the proposed rules, may be an imprecise basis for applying proportionality, particularly for small businesses. As a trade association we collect a range of information from members each year, including the number of employees, as depicted in the chart below, which is drawn on a logarithmic scale to aid presentation.

The chart illustrates the relative complexity of the audience within AFM’s 46 member organisations, and the problems of using a simple measure like the number of employees as the basis for applying proportionality, particularly for smaller businesses.
To explain the various colours:

- those in green are Solvency 2 insurers, of which there are four above the 251 employee threshold;
- there are a further two Solvency 2 insurers, in blue, with around 251 employees in total, but where some of their activities may not be in scope;
- firms in purple are Solvency 2 firms below the 251-employee threshold, and have a range of between 2 and 180 employees;
- the yellow column represents small non-Directive firms, who make up over a quarter of our membership;
- the red column depicts three discretionary mutual organisations, who are outside the scope of Solvency 2, and include two organisations with over 251 employees.

Whilst the text of the consultation does not state it clearly, we understand that the two large non-Directive firms with more than 251 employees will be treated as large firms for the purposes of this consultation, and in scope for all requirements. The third of these firms, with fewer than 251 employees would be treated as a small non-Directive and therefore is only in scope of the requirements for ‘non-CRR and non-Solvency 2’ firms. We ask that FCA makes this more explicit in its final rules.

PRA has recently consulted on proposals to raise the threshold for inclusion in Solvency 2: this will enable firms that fall outside the new threshold to consider whether they should drop out of the regime (and become non-Directive firms). The chart above illustrates how small some of these organisations are and who, without the changes proposed to Solvency 2 thresholds, would see a significant hardship.
from the extra costs imposed via FCA’s proposals. It would be helpful therefore if the rules might spell out that a firm in the process of dropping out of Solvency 2 can also consider not applying the D&I requirements for Solvency 2 firms.

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

It has not been set out in the consultation why there are divergences in the approach of FCA and PRA. We would have preferred a unified approach, as the differences between the two regulators will inevitably lead to extra cost and complexity for firms and the risks of confusion.

In terms of scope, PRA’s proposals are targeted in insurance only at Solvency 2 firms. Hence non-Directive firms, including those with more than 250 employees are out of scope, and this is a different approach to FCA, as covered by our response to Q.2.

For firms with fewer than 250 employees but who are in the scope of Solvency 2, PRA has added a range of additional requirements. This includes a responsibility to ‘provide evidence of how the board has taken an active role in understanding and progressing the effectiveness of the firm-wide strategy’\(^\text{12}\). This monitoring of strategy is a natural step in maintaining a strategy and it is not clear why FCA has avoided this.

We also note PRA proposes to include an individual accountability for D&I. We are wary of the addition of ever-more responsibilities attached to senior manager roles, but should this prove necessary, firms would benefit from a greater consistency between the approaches of FCA and PRA.

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

We consider that the definition of ‘senior leadership’ is very broad and may not apply meaningfully in smaller organisations, as the third tier of ‘senior leadership’ will include junior staff. We suggest this third tier only applies to firms with 251 or more employees.

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

We agree with the general approach to dealing with non-financial misconduct in the rulebook. This is an important and potentially underexplored aspect of conduct and of firm culture. The guidance though is also lengthy and potentially repetitive. We would expect HR Departments to need to review these on a regular basis, to understand regulatory requirements and to weigh up the most appropriate action in any cases of non-financial misconduct: there is a risk of being overzealous and of a firm facing litigation.

Firms will also need to factor in new tests as part of their regular fit and proper tests for SMCR staff, and will need to consider what new sources of conduct outside the workplace they should be taking into account. It is also likely that the changes will

\(^{12}\) PRA consultation CP18/23, Appendix 2 paragraph 2.4, relating to SS on board responsibilities
add significant extra work to FCA, given reports that it only opened six investigations into allegations of sexual misconduct between 2018 and 2020\textsuperscript{13}, and that the potential new rules could change this dramatically.

The table, at 1.3.6G in COCON, and the subsequent examples, as well as the content in COCON 4.1 provides a useful summary of situations a firm might be faced with, in deciding whether an individual’s conduct is in scope of the rules.

The wording proposed in FIT 1.3.9G(2) appears somewhat colloquial (e.g. ‘A firm can only act through its staff’), and FCA may wish to consider how developments in artificial intelligence might change this.

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

We agree this is a necessary requirement of an approach focused on the number of employees. We note that draft rule SYSC 29.1.4R requires firms to determine the average for the date the final rules are published, of the three years leading up to and including that date.

For example, if the final rules are published on 15 March 2024, a firm would need to know the number of employees on that date, plus employees’ numbers of the same day in 2022 and 2023. We think this will be difficult and onerous for firms if it doesn’t coincide with their usual reporting cycles, and in any event, may not be very useful where the number of employees has varied over the three years. We suggest the first data exercise at least is for a single data point for the month-end following publication of the final rules: in this case that would be 31 March 2024.

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

We agree that FCA should set minimum standards for a firm’s D&I strategy, and that beyond this the firm should determine for itself the right approach. We also agree that firms should publish their strategy, through their website, and that this will encourage them to be ambitious in its form and in taking the strategy forward.

The FCA review published in December 2022 indicated that amongst the sample of large firms (all had a published gender pay gap, indicating they had at least 250 employees), few had effective strategies in place\textsuperscript{14}. Despite this, those large organisations were making efforts to monitor their approach to D&I, and in assessing their culture: for example, in PRA’s consultation, they have used the same survey results in paragraph 2.2 to state that 76% of respondents already have a D&I policy. Regardless, it does highlight the scale of work needed across the industry, and the benefits of FCA working with the industry to understand what good practice looks like, and to take a patient approach to monitoring compliance.

\textit{Q8: To what extent do you agree with our proposals on targets?}

We agree that regulatory targets can only be meaningfully set for larger organisations. We consider that smaller firms will take account of data from


\textsuperscript{14} Understanding approaches to D&I in financial services | FCA, paragraph 2.6
elsewhere and that this will influence their strategies and their own internal goals, but it would not be helpful to set targets for the board, senior leadership or customer-facing roles.

It is vital that firms retain control of the metrics they focus on and the targets they set. This is particularly the case because firms start in different places: FCA research from 2019 indicated that female employees made up only 17% of FCA-approved staff\(^\text{15}\) (‘senior managers and customer-facing staff’). Analysis of AFM members indicates that 28% of Executive directors and 31% of NEDs in AFM members were female at the end of 2022, and 58% of all employees were female\(^\text{16}\).

We note that FCA cites research from PWC that shows that the gender pay gap is higher in financial services than in many industries\(^\text{17}\). PWC highlights that insurance has a lower pay gap than banking, and that building societies have the highest gap.

As most AFM members are outside the scope of mandatory pay gap reporting, for a number of years AFM has collected data on a voluntary basis, and provided anonymised collective data, as illustrated in the exhibit below. The primary use of this data is for benchmarking, though we might expect AFM members to draw on the analysis further when monitoring their D&I strategy. However, as with the PWC comparison between banks and building societies, it is likely that smaller mutual organisations are more affected by external market forces and their operating environment, and will continue to suffer from competition for talent.

Gender pay gap reporting

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<tr>
<th>Year</th>
<th>Male</th>
<th>Female</th>
<th>Difference</th>
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<tbody>
<tr>
<td>2019</td>
<td>8,104</td>
<td>6,769</td>
<td>1,335</td>
</tr>
<tr>
<td>2020</td>
<td>8,396</td>
<td>6,508</td>
<td>1,888</td>
</tr>
<tr>
<td>2021</td>
<td>6,568</td>
<td>4,351</td>
<td>2,217</td>
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<td>2022</td>
<td>6,684</td>
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The hourly pay gap between men and women is at its highest in four years. This represents more than £10k a year.

The gap in average bonus paid has fallen from 2021, however, it is still higher than 2019 and 2020.

The pay gap may be driven by the greater proportion of men holding more senior positions.


\(^{17}\) Gender pay gap and diversity in financial services (pwc.co.uk)
In paragraph 5.25, FCA indicates firms would be required to take account of the diversity profile of the geographical areas in which they operate. PRA take this further: in the ‘impacts on mutuals’ section of their consultation, PRA note that the geographical spread of mutuals ‘may make it more difficult to increase diversity among certain demographic characteristics’. We agree with this as, for example, the majority of staff employed in AFM members are based outside major cities.

Based on the 2021 census\textsuperscript{18}, just 36.8\% of people in London identify as ‘white British’; in other regions the rate tends to be between 80 and 90\%. That has a fundamental impact on firms based outside London to recruit ‘representative’ numbers of people from ethnic minorities, unless that is compared to the region in which they operate. It also has the greater risk that firms seeking to achieve higher targets will be forced to recruit employees and directors from the major conurbations, with the attendant higher costs, and a perversely increased risk in groupthink (via the export of London-based values to the rest of the country).

In addition, mutual insurers and friendly societies that support a particular affinity group (such as farmers or railway engine drivers), will often expect a majority of board directors to be from that same cohort, and this is likely to impact the gender, ethnic, age and social mobility diversity of their board.

Our annual data collection exercise on board composition also highlights the difficulty of relying on self-reporting. In 2021, 5\% of executives and 2\% of NEDs were reported as being disabled or having a longstanding impairment; in 2022 the respective figures were 3\% and 1\% and those changes are not the result of any significant changes in personnel.

This reaffirms the need for firms to set targets themselves; it also means FCA should be wary of statements such as ‘firms would be required to set targets to address underrepresentation’, where the nature of that underrepresentation is not defined and the inference is that all firms are working to a common goal.

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

We agree with the date for first submission of data. The option to ‘comply or explain’ for this first submission only is helpful in cases where the data is not available.

We are concerned that FCA requires firms to undertake this exercise annually, whilst good practice elsewhere (including as listed in paragraph 5.69) is for data reporting every two or three years. We consider this results in extra costs for firms which, given the acknowledgement that change takes time, will not be outweighed by the benefits.

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

\textsuperscript{18} https://www.ethnicity-facts-figures.service.gov.uk/uk-population-by-ethnicity/national-and-regional-populations/regional-ethnic-diversity/latest/
We recognise the list of characteristics adopted, and those which FCA consider will not be useful. We consider that providing firms the option of reporting on either sex or gender will hinder comparison, and would have preferred a single measure.

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

We agree that as it will be difficult for firms to collect all the data in the proposed spreadsheet, that it is helpful to leave some of it as voluntary initially. We note FCA will review this over time.

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

Not at this stage.

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

We are supportive of reporting to help address culture and inclusion. The measures set out in paragraph 5.64, as well as in the draft reporting form, set out the approach helpfully. We consider extra attention may be needed to some of the questions though: for example, the proposed wording of the following questions may be difficult for individuals to interpret consistently and assumes a working knowledge of inclusion and personal characteristics:

- ‘My manager cultivates an inclusive environment at work’, and
- ‘I have been subject to treatment (for example actions or remarks) that have made me feel insulted or badly treated because of my personal characteristics’

In 2023, we revised our regular survey of staff within the sector to include a range of D&I questions. This was intended to help our members to benchmark their culture against other mutuals, and to support reporting in relation to the Mutual Diversity Alliance. A slide showing some of the results is included below; it was noticeable that there was a good correlation between the results here and some of the other culture and leadership questions we asked (for example, ‘Our leaders clearly communicate the organisation’s vision, culture and objectives’, and ‘My organisation achieves positive outcomes because it invests in people’).
Q14: To what extent do you agree with our proposals on disclosure?

We agree that firm disclosures should be set to the same frequency as regulatory reporting- though as we indicate earlier, we do not consider this should be an annual exercise.

In paragraph 5.86 FCA indicates firms would be required to publish disclosure material at the same time as they publish their report and accounts (unless they do not publish an annual report). We do not agree with this timing: the disclosure would provide an unwelcome distraction from work on the report and accounts, and incur extra work at a time when resources are constrained. Publishing the data at the same time as the report and accounts may add pressure to include the results in the external audit, and this would lead to very significant costs and the risks that financial publications are jeopardised.

In addition, the data would relate to different timescales: for example if the regulatory deadline for disclosure is 31 March and the firm’s financial year end is 31 December, they would either be making the disclosure nine months after the reporting period, or three months after their financial year end. Either way, the data would not be compatible and it would be misleading to publish both simultaneously. We suggest FCA sets a deadline of three months after the regulatory reporting deadline.

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

We agree, as this is consistent with the requirements for regulatory reporting.

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

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We do not.

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

We agree that large firms should assess to what extent they are delivering on D&I commitments/targets, and to what extent any failure in this area represents a wider risk to the business. There is a risk that where a firm sets inappropriate D&I targets and has a low commitment to assurance, that problems may not be adequately addressed, particularly in cases where the financial metrics of the business are strongly positive. The more formal requirements on risk and control by PRA for dual-regulated firms will assist.

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

The CBA opens with the contention that ‘a lack of D&I may result in poor outcomes for consumers…’ (paragraph 3). Given the extent of research into the topic by FCA and a host of other parties, it is surprising that FCA is not prepared to be more definitive. We consider this uncertainty weakens the case presented. In our experience as mutual organisations, many of whom were established to serve the underserved, many consumers risk being excluded from high street financial providers, and this is often as a result of the personal characteristics covered in this consultation.

It is discouraging that less than 15% of firms invited to participate in surveys to help quantify the costs of this work responded. This makes the sample relatively small and the data less reliable than might be hoped. We recognise that FCA sought to address this with a second data request.

The total costs over three years for the new D&I regime is estimated at £1.5 billion (£561m one-off costs plus £317m ongoing), and therefore represent a significant extra burden on firms. Indeed, with the extra costs for PRA, the total bill is above the mid-range estimate for implementing the Consumer Duty, which brought forward new principles and an evidential and substantial improvements in the level of consumer protection19.

The costs for dual regulated firms such as AFM members are estimated as:

- Small non-Directive firms: one-off costs of £5,800 and £3,200 annually
- Smaller Solvency 2 firms: one-off costs of £29,300 and £11,500 annually (£39,200 and £25,225 respectively once extra PRA costs are added).
- Large non-Directives and large Solvency 2 firms: £173,600 one-off costs and £102,000 annually (£195,00 and £160,00 in total including PRA costs).

These are very significant costs, especially given the investment that firms are already making to deliver better D&I outcomes. We expect some firms will be forced to cease some of the voluntary approaches they are currently adopting, in order to re-direct costs to regulatory requirements.

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19 https://www.fca.org.uk/publication/consultation/cp21-36.pdf provided estimated implementation costs of £688 m to £2.4 bn.
For small Solvency 2 firms the highest individual costs relate to the production and maintenance of the D&I strategy. PRA’s CBA case indicates that the data for this was derived from the analysis of large firms only, and both FCA and PRA have therefore made the assumption that the production costs will not vary according to size of firm. We suspect smaller firms will seek cost savings, though there is also a risk that, for firms with limited internal resources, some of the work will need to be outsourced, and that this will increase costs. This is the primary reason why we suggest smaller Solvency 2 firms are excluded from this work. Alternatively, delaying implementation for three years would allow them to continue with voluntary initiatives and assess what good practice looks like and therefore develop a D&I strategy at a more realistic cost.

With regards to the benefit case, it is vital that FCA undertakes post-implementation review, should it go ahead with the proposals as planned. This is partly because of the unquantified nature of the benefits described\(^{20}\). And it is also vital that FCA measures the incremental benefits of the new regulations, as opposed to the general trends in improvement over time that will continue to accrue.

The FCA concludes in paragraph 37 that ‘we expect proposals to be net beneficial’. We think this is a bold statement and one that will not readily be achieved; the following equation provides our view on the challenge to FCA in evidencing this.

\[
\text{net incremental benefit of FCA rules} = \text{position at time of post-implementation review} - \text{position at time of made rules} - \text{change that would have happened without new rules} - \text{implementation cost to industry (£1.5 billion)}
\]

In our view, the net impact of the proposed requirements is not likely to be positive, at least for all audiences. For that reason we suggest the new rules are either abandoned and replaced with guidance, or are only applied to large firms for at least three years and only extended once the incremental benefits of new rules are proven.

An additional challenge for FCA in its original DP proposals was an expectation of training of staff. FCA has withdrawn this proposal due to the very high estimated costs (based on the assumption that training costs would have amounted to 85% of the combined costs of implementing ‘D&I strategies and training’, the cost would have been around £350 million). However, in order to deliver the assumed benefit of ‘reduced groupthink’ (as per the chart at paragraph 51), it seems unlikely that firms will achieve improved staff inclusion scores without training, combined with a range of new procedures and work practices.

\(^{20}\) In paragraph 36 of the CBA these are stated as: ‘higher standards of conduct; improved decision-making and risk management including through more effective challenge; helping to make the UK market a more attractive place to work and do business; and products that can cater for a diverse consumer base through more innovation and competition’. 

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