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Consultation Paper on Diversity & Inclusion CP23/20

Dear Nikhil,

ShareAction is a UK registered charity that works to build a financial system that serves our planet and its people. We have spent the last 18 years building a movement for responsible investment, and coordinated investor-led efforts to address the pressing environmental and social challenges the world faces.

One of the key goals at [ShareAction](https://shareaction.org) is for the investment system to support good workforce practices such as living wages, dependable contracts, and diversity, equity and inclusion. We co-ordinate an investor coalition, currently representing £4.2tn assets under management and advisory, who support our campaign to improve workforce standards.

ShareAction also founded the Workforce Disclosure Initiative (WDI), an investor-backed corporate reporting initiative, in response to investor demand for more consistent, comparable and higher quality reporting on sustainability issues. This is to enable investors to better allocate capital and fulfil their stewardship obligations. 145 of the world's biggest companies now respond to the WDI's annual survey, which covers the breadth of companies' direct operations and supply chains, including topics such as pay and working conditions, diversity and inclusion, human rights and sourcing practices.

We were delighted to see the FCA release a consultation paper on diversity and inclusion in the financial sector. We strongly endorse the framing and the overall effort being made by the FCA on the diversity agenda and welcome the opportunity to respond to its proposals. Last month we met with Peter Ewing, Technical Specialist, The Culture Team (Environmental, Social and Governance) at the FCA and his colleague Rachel Johnson, Senior Associate, Culture & Remuneration Team, to discuss the consultation paper. Below is our full response.

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

We strongly support proposals requiring firms to 'develop an evidence-based D&I strategy that takes account of their current progress on diversity and inclusion'.

We also agree that the board would be responsible for the maintenance and oversight of the firm's D&I strategy. However, we would urge the proposals to go further and require a specific Group Executive Sponsor for D&I. Our research shows that FTSE100 financial companies have found D&I responsibility at senior level was critical to progress. Senior leaders taking action, and being seen to take action, greatly helped advance DE&I initiatives, such as increasing employee ethnicity self-disclosure rates to enable

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ethnicity pay gap reporting (the difference in the average pay between ethnic minority colleagues and White colleagues across an organisation). ([Ethnicity Pay Gap Reporting: An investor briefing and toolkit, ShareAction, 2023](#)). Often, the sponsor was on the Executive Committee and the Board, with the top down oversight greatly increasing self-disclosure rates for companies that report their ethnicity pay gap, and for those that have not yet done so.

We welcome the proposal to make the firm's D&I strategy easily accessible and free to obtain. Yet this should go further than simply posting on the company website. To strengthen stakeholder engagement, there must be active engagement with employee representatives. This is particularly necessary to increase ethnicity representation and support ethnicity pay gap reporting, as demonstrated in our research above. The majority of companies emphasised a combined grassroots and top down approach, or a cascade approach. Actions starting from an executive committee through to employee led networks are key in achieving D&I goals.

Q8: To what extent do you agree with our proposals on targets?

We agree with companies reporting data on progress against their own targets.

Specifically, we support the suggested disclosures of:

- the demographic characteristics they have set targets for (as proposed by the new target setting rules set out in paragraphs 5.20-5.27), as well as their inclusion targets, if any (with the caveat to 5.26, see below).
- the percentage at which each target has been set
- the year each target was originally set
- the year the firm is aiming to meet the target
- the firm's current level of representation against each target (%)
- the rationale for the targets set
- any further information the firm would like us to consider about targets they have set

We would recommend the setting of mandatory ethnicity targets

If the FCA wishes to achieve '*20% minority ethnic representation*' (p.4 of CP), then ethnicity targets are essential. Our research found that setting ethnicity targets was invaluable to companies in committing to actions which increase employee ethnicity self-disclosure rates, and ethnicity representation.

Therefore, we would amend 5.26, which does not propose to mandate which demographic characteristics the targets must cover, and instead propose to mandate ethnicity targets. The Paper mentions that 87% of large firms and 45% of small firms already have a D&I strategy in place and see D&I as core to a firm's culture and practices. However, our research shows this drops to low figures on target setting, and performance data drops even further to low single digits.

We agree that it does not need to specifically cover what those ethnicity targets should be, and allow the company to decide depending on the context in which they operate and their company profile.

Finally, the paper mentions that the company '*must take into account current diversity profile*' (5.24), and to '*consider context*' (5.25). We would amend 5.24 and add '*and context*', and not to simply '*consider*' it, given context is key. We found this to be the case, particularly in ethnicity pay gap reporting (see further information under question 14).

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

We strongly support proposals to introduce demographic data reporting, but believe the list of characteristics should be amended.

At a minimum, mandatory disclosures should cover the protected characteristics as set out in the Equality Act 2010 (the Act) (i.e., the disclosures should include gender as well as sex and parental responsibilities). This is because, given the regulatory consideration given to these characteristics, there are material financial risks related to companies' treatment of workers that are parts of these groups. While the specific categories of 'gender' and 'parental responsibilities' proposed by the FCA do not identically align with the protected characteristics of 'gender reassignment' and 'pregnancy and maternity' as set out in the Act, we believed they are sufficient umbrellas to help identify issues with discrimination (and potential legal risks under the Act). This would particularly be the case if the FCA provided a framework and guidance for companies to voluntarily provide disaggregated data to align with the specific characteristics protected under the Act within the broader categories of 'gender' and 'parental responsibilities'.

To also align with the Act, 'marriage and civil partnership' should also be included but as a voluntary indicator. We agree with the rationale set out by the FCA regarding the treatment of this data. However, we still feel it is of value to provide companies with the framework to consistently and comparably report this information, where relevant.

Lastly, we agree with the framing of 'gender' rather than 'gender reassignment' as a more inclusive term that would more accurately allow for companies to gather information on workers whose gender identity doesn't align with the sex they were assigned at birth. As mentioned previously, the FCA could provide voluntary, additional disclosures on 'gender reassignment' specifically, to ensure any specific, Equality Act related issues can be identified.

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

Ideally, demographic characteristic data would be mandatory. If this can't be done immediately, it should happen over time.

We understand the rationale for having both mandatory and voluntary disclosures, but think the limited proportion of mandatory disclosures is both disappointing and unhelpful. The purpose of mandatory disclosures is to compel companies to report information that may not have been disclosed otherwise. If voluntary reporting was sufficient, mandatory measures wouldn't be necessary, and so the rationale that there is insufficient voluntary disclosure to warrant mandatory disclosure doesn't reflect this.

Where there are voluntary disclosures, there should be clear, concrete and time-bound plans to move towards mandatory disclosures against all demographic characteristics. This is helpful for companies, as it gives them predictability and time to plan and introduce necessary systems. It also enables investors to know when they will be able to access important social data. All the voluntary indicators are critical for addressing inequality, which has been recognised as a systemic risk to investors and a threat to the effectiveness of markets as a whole, making the data key for those looking to understand and act upon these issues.

Additionally, providing more expansive, mandatory disclosures is important for ensuring alignment with other reporting frameworks and initiatives, such as ESRS in Europe and the ISSB, ensuring consistency and comparability in disclosures, and ensuring efficiency for companies in their disclosures.

It is also important, however, that FCA makes clear to both companies and workers that mandatory reporting means it is mandatory for the company to implement mechanisms to collect this data, not mandatory for workers themselves to provide information. We completely agree on the need for workers to be able to opt out of data collection, either through not taking part in data collection at all, or through choosing 'prefer not to say' for particular data points.

Nevertheless, it is incumbent upon the company to drive up employee self-disclosure rates, raise awareness on the rationale for disclosure (to better address the needs of their employees), and build trust by providing reassurance on confidentiality issues. However, this should not interfere with an employee's

right to refuse to disclose their ethnicity data. Rather, it is to make workers feel safe enough to want to disclose it. For guidance on how to increase self-disclosure rates, please see our investor toolkit. ([Ethnicity Pay Gap Reporting: An investor briefing and toolkit, ShareAction, 2023](#)).

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

Ideally, demographic characteristic data would be mandatory. If this can't be done immediately, it should happen over time.

More information is provided on this under question 11.

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

We agree with introducing inclusion metrics, but think these should be supplemented with additional datapoints that will highlight their validity

Additionally, it would be helpful if inclusion data from employees could be mapped against other key workforce datapoints. This is to validate and reinforce any messages coming from the data, and to provide investors with a clearer picture of exactly how diversity and inclusion is playing out in practice within organisations.

For example:

Suggested additional datapoint	How it relates to inclusion questions
Number of grievances reported and resolved (disaggregated by demographics)	Shows whether workers do feel safe to speak up, whether concerns are taken seriously
Examples of decisions of substance employees have influenced	Shows whether workers contributions are valued and meaningfully considered
Pay quartiles by demographic data, pay gaps by demographics, specifically including the ethnicity pay gap	Shows whether workers contributions are valued and meaningfully considered; ^[L] _{SEP} Shows whether workers are subject to treatment that has made them feel insulted or badly treated because of their personal characteristics; ^[L] _{SEP} Shows whether workers are safe to make honest mistakes; ^[L] _{SEP} Shows whether managers are creating an inclusive environment at work
Turnover rates by demographic group	Shows all the potential aspects of inclusion

Q14: To what extent do you agree with our proposals on disclosure?

The proposals should be asking for the disclosure of a firm's ethnicity pay gap

The Consultation Paper mentions that the financial sector has '*further to go to achieve 20% minority ethnic representation for the same group*' and '*Good work has been done, but the results are not yet being seen universally across financial services.*' To address this issue, ethnicity pay gap reporting should be a mandatory disclosure for larger employers for results to be seen universally. The ethnicity pay gap shows the difference in the average pay and bonus pay between ethnic minority colleagues and White colleagues across an organisation. It is different to equal pay, the legal requirement to pay the same to people doing the same job of equal value.

There are already some firms in the investment industry voluntarily producing ethnicity pay gap reporting, some of which are making these public, including the FCA themselves. Other firms include State Street, M&G, Bridgewater, Pension Protection Fund and PWC. The process a company undertakes to report its ethnicity pay gap is a catalyst for further action. ShareAction's research, which involved interviews with 17

FTSE100 financial sector companies, revealed reporting of ethnicity pay gaps was the first step to bringing transparency and action. (See [Ethnicity Pay Gap Reporting: An investor briefing and toolkit, ShareAction, 2023](#)). Although companies who voluntarily report their ethnicity pay gap found that often the gap was due to underrepresentation, simply reporting their ethnicity representation is not enough – there could be stark pay differences between ethnicities at each seniority level of the company.

As companies continue the journey in tackling racial inequality, we recommend that firms report on employee ethnicity, broken down into the most appropriate categories and quartile pay bands, in addition to the overall pay gap. A quartile pay band should provide the proportion of different ethnicities within each of the quartile pay bands, the average pay levels and any gaps within each quartile. This would address under representation in senior management and overrepresentation in low paid jobs. ([CIPD's Guide to Ethnicity Pay Reporting, 2021](#)).

Where possible, we would ask for companies to disaggregate data by ONS ethnicity categories. This is important, as a broad ethnicity categories can mask vast discrepancies within them. For instance, in 2019, Chinese and Indian groups earned a higher hourly pay than White workers, whereas Pakistani and Bangladeshi workers earned 16% and 15% less than White workers respectively ([Office for National Statistics, Ethnicity Pay Gaps: 2019](#)). An employer's ability to provide such granulated data will be dependent on the makeup of their workforce, and the demographics of the geographical area. Following government guidelines published this year ([Department for Business and Trade, Ethnicity Pay Reporting: guidance for employers, April 2023](#)), we would expect employers to only publish this information where there is a minimum threshold of 50 staff members of that ethnicity. However, this could be phased in time – it's better to begin this journey and start reporting. The process itself encourages accountability, the creation of an action plan and monitoring of progress.

We would argue that ethnicity pay gap reporting is merely a disclosure; it's not prescribing how companies act on DEI issues. Companies can come up with their own solutions, as we ask them to publish a narrative and action plan to complement the disclosure of their ethnicity pay gap.

On a final note, we are pleased that the proposals require more granular disclosures on ethnicity (5.83). For more information on ethnicity pay gap reporting, see information under question 13.

The proposals should be asking for greater disaggregation than board/senior leadership/all employees.

Ideally, the FCA would also be asking for data on contingent workforce as well, even if this starts off as voluntary to give companies time to implement systems. Specifically, this should be broken down into the following two sets of groups:

For employees:

- Indefinite/permanent employees
- Fixed-term/temporary employees
- Full-time employees
- Part-time employees
- Non-guaranteed hours employees (casual workers, on-call employees, zero-hours contracts)

For contingent workers:

- Contractors (independent, self-employed)
- Agency workers (e.g. labour agency, recruitment agency workers)
- Franchisee workers
- Third party on site workers (e.g. subcontracted service workers, third-party workers)

This is because contingent workers are much more likely to be from marginalised groups and the conditions in contingent work often exacerbate or perpetuate that marginalisation. Also, contingent workers can make

up a significant proportion of company's workforces and so this data is necessary to get an accurate picture of diversity throughout an organisation.

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

Ideally, demographic characteristic data would be mandatory. If this can't be done immediately, it should happen over time.

More information is provided on this under question 11.

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

Ideally, demographic characteristic data would be mandatory. If this can't be done immediately, it should happen over time.

More information is provided on this under question 11.

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 a lack of D&I should be treated as a non-financial risk but we also believe it is a financial risk and should be treated accordingly

Our Investor Toolkit and Briefing on Ethnicity Pay Gap reporting shows several risks to a lack of diversity.

McKinsey's 2020 study, "Diversity Wins", found that companies with the most ethnically and culturally diverse executive teams were the most financially successful. McKinsey's study not only illustrated performance gains from diversity, but also a performance penalty for companies lagging behind on diversity and inclusion. Firms with the least ethnic and gender diversity were '27% more likely to underperform on profitability than all other companies'

A 2022 study by As You Sow and Whistle Stop Capital analysed 277 publicly traded companies that have their EEO-1 reports (ethnicity data) and found that "*higher representation of Black, Indigenous, and people of color (BIPOC) employees in management has a positive relationship to higher cash flow, net profit, three- and five-year revenue, and five-year return on equity (ROE), and stock performance. It is also associated with lower volatility*". The study also found that '*negative financial performance is associated with larger gaps between BIPOC representation in the broader employee base and BIPOC representation in the management team*'. In fact, it found the five-year ROE has a slight negative association across all sectors "*when representation of White employees in management increases*".

However, those gains are only apparent if diversity is linked with equity and inclusion; that is, the participation of marginalised team members is boosted. '*Increasing diversity does not, by itself, increase effectiveness; what matters is how an organization harnesses diversity, and whether it's willing to reshape its power structure*'. Harvard Business Review, "A Seat at the Table Is Not Enough", August 2022. Deloitte supported this finding, as it found if employees feel included, they report better business performance in terms of ability to innovate (by 83%) and team collaboration (by 42%).

There are also reports demonstrating risks to attracting and retaining talent. Monster's global "Future of Work" report found 86 per cent of employees consider inclusion and diversity critically important.

Another risk is the risk of losing capital, given the increased investor appetite to see social returns. Morgan Stanley found that 50% of all investors and 75% of millennial investors "*have made or plan to make investment changes within 12 months in response to racial justice movements*." Many pension holders have preferences related to their investments' diversity and inclusion performance. Royal London, the insurance company, found that the majority of consumers now want to see their pensions invested responsibly. More

specifically, PensionBee, the pension provider, found that 57% of its savers expect companies in their pension to publish ethnicity pay gaps.

Should regulations change, there is a risk to sustainability and even license to operate. The UK government stated, in its “Inclusive Britain” policy paper published in March, 2022, that ethnicity pay gap reporting will not be mandatory for employers “at this stage.” It explained one of the reasons for this is that it wants to ‘avoid imposing new reporting burdens on businesses as they recover from the pandemic’. However, with 35 FTSE100 companies now leading the way by voluntarily reporting their ethnicity pay gap, it demonstrates the benefits of reporting and challenges narratives around ‘burdens’; weakening the argument against legislation.

Finally, inequality itself is a systemic risk and demands urgent action. It undermines social cohesion, erodes trust in institutions and fuels unrest (The Business Commission to Tackle Inequality, 2022). According to the PRI, income inequality can negatively:

- impact long-term investment performance;
 - change the risks and opportunities that affect the universe of investment opportunities; and
 - destabilise the financial system within which investors operate, threatening portfolios and bottom lines
- (Principles for Responsible Investment, ‘Why and how investors can respond to income inequality’, 2018).

Once again, we want to commend the FCA consultation on diversity and inclusion, and are grateful for the opportunity to respond. We welcome continued engagement with the FCA on its work in this area.

Yours faithfully,

The image shows two handwritten signatures in black ink. The signature on the left is more complex and stylized, while the one on the right is more fluid and cursive. Both appear to be professional signatures.

Kohinoor Choudhury, Senior Campaigns Officer (Good Work), and Charlotte Lush, WDI Senior Research Manager

Cc: Peter Ewing, Technical Specialist, The Culture Team (Environmental, Social and Governance), FCA; Rachel Johnson, Senior Associate, Culture & Remuneration Team, FCA