

FCA AND PRA CONSULTATION ON DIVERSITY AND INCLUSION IN THE FINANCIAL SERVICES SECTOR: NON-FINANCIAL MISCONDUCT

The FCA and PRA (the 'regulators') have published their much anticipated consultation papers ([PRA CP 18/23](#) and [FCA CP23/20](#)) on a package of measures to promote diversity and inclusion (D&I) in the financial services sector with a view to achieving healthier firm cultures, reducing groupthink, unlocking new talent and addressing consumer needs. The regulators clearly regard some of the proposed steps as significant interventions.

The regulators' July 2021 discussion paper ([DP21/2](#)) made it clear that they wanted firms to think about how they can advance D&I through improvements to their policies, governance arrangements, accountability, remuneration arrangements and disclosure. To help inform their proposals a one-off voluntary pilot data survey was carried out in late 2021 culminating in the December 2022 FCA review paper: [Understanding approaches to D&I in financial services](#).

These consultations mark the regulators' next step towards the achievement of greater D&I in financial services and importantly also provide greater clarity on the regulators' expectations around non-financial misconduct (the regulators are seeking to clamp down in particular on bullying and sexual harassment as part of their D&I strategy).

The final regulatory requirements will be set out in a Policy Statement (PS) in 2024. In-scope firms will be subject to the new rules 12 months after the publication of the PS subject to some limited transitional provisions.

The regulators have worked closely together to produce consistent and coordinated proposals for consultation albeit that their respective proposals are necessarily driven by the regulators' underlying statutory objectives resulting in some subtle differences. In broad terms, the following policy areas are addressed by the regulators: non-financial misconduct, D&I Strategies, Data Reporting, D&I Disclosure obligations and setting D&I Targets. This Briefing explores the proposals on non-financial misconduct. We have prepared separate Briefings providing an overview of the proposals and a focus on D&I proposals.

Contents

[What Firms are in Scope?](#)
[Territorial and Group Application](#)
[Non-Financial Misconduct Conduct Rules](#)
[Non-Financial Misconduct: Fitness and Propriety \(F&P\)](#)
[Historical Conduct](#)
[Timetable/Next Steps](#)

What Firms are in Scope?

All FSMA Firms with a Part4A permission and where relevant Threshold Conditions and existing chapters of the Handbook apply (including COCON and FIT)

All CRR and Solvency II firms with respect to their establishment in the UK, including third country branches

Territorial and Group Application

The territorial scope for the fitness and propriety requirements and COCON remain unchanged by the regulators' proposals.

NON-FINANCIAL MISCONDUCT: CONDUCT RULES

There has been much uncertainty around the extent to which non-financial misconduct can and/or should be taken into account for the purposes of assessing individual fitness and propriety (F&P), whether FCA Conduct Rules/the PRA Rulebook have been breached and what (if anything) should be included in regulatory references. This has resulted in inconsistencies in approach between firms and differences in opinion of the FCA and the Upper Tribunal on whether individuals should be subject to a prohibition notice. In particular (as evidenced in the cases of Frensham and Zahedian) there has been tension between the extent to which behaviour in an individual's private life and their personal integrity, character and reputation should fall within this regulatory parameter.

The FCA is proposing to explicitly include non-financial misconduct within: 1) the Conduct Rules; 2) Fit and Proper assessments; 3) Suitability guidance on the Threshold Conditions and the PRA proposes to update [SS35/15](#) (Strengthening individual accountability in insurance) and [SS28/15](#) (Strengthening individual accountability in banking) to clarify that the PRA may take into consideration established patterns of behaviour of an individual that would, or would be likely to, affect the firm's safety and soundness, when considering whether the individual meets the PRA's standards of fitness and propriety.

The draft Handbook rules and guidance are extensive. Whilst this aligns with the regulators' increasing focus on this area, the shift from being largely silent in the Handbook is marked and is in contrast to the level of detail provided in relation to other aspects of conduct and F&P.

Conduct rules: the FCA proposes to expand the scope of COCON to clarify that it covers **serious** instances of bullying, harassment and similar behaviour towards fellow employees and employees of group companies and contractors.

Additional guidance is to be added to COCON on the types of behaviour that would fall within the expanded scope of COCON that may breach the FCA Conduct Rules, general factors for assessing compliance, and what conduct is out of scope because it relates to an employee's personal or private life (which is outside the scope of COCON). COCON will include a list of examples of conduct by conduct rules staff towards colleagues that may breach COCON.

Non-financial misconduct in a person's private or personal life may however be relevant to the assessment of their fitness and propriety under the revised rules in FIT (see below).

The new COCON rules set out guidance on the factors that are relevant when deciding whether conduct is within COCON (was the conduct on the firm's premises, using firm equipment etc) with a table of examples (see below) of when conduct will be regarded as personal or private and whether it comes within COCON. The examples are useful but invariably not exhaustive and there will always be grey areas; in the immediate aftermath of the rules coming into effect firms may well err on the side of caution reporting matters to the regulators as COCON breaches until further clarity is achieved. For example, if a manager is sending abusive texts to a colleague after their relationship has failed, does it make a difference if the texts are sent only after hours from a personal phone, on a personal phone late at night from the office, or from an employer issued phone after work?

Description of conduct	Whether generally within the scope of COCON
Misconduct by A in relation to a fellow member of the workforce while both are on their <i>firm's</i> premises	Yes
Misconduct by A in relation to a fellow member of the workforce while A is working remotely for their <i>firm</i>	Yes
Misconduct by A in relation to a family member while A is working remotely for their <i>firm</i>	No
Misconduct by A in relation to a member of the public while A is commuting to their <i>firm's</i> place of business for work	No
Misconduct by A in relation to a fellow member of the workforce when both are travelling to a meeting in which they will represent their <i>firm</i>	Yes
Misconduct by A in relation to a client at a business meeting in which A is representing their <i>firm</i>	Yes
Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by their <i>firm</i>	Yes
Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by them in their personal capacity	No
Misconduct by A in relation to a fellow member of the workforce at a social occasion organised by a client of their <i>firm</i> in which they will represent their firm or where the main reason for the invitation is their working for their <i>firm</i>	Yes
Notes 1. 'A' refers to a member of a <i>firm's</i> conduct rules staff. 2. 'Yes' means that generally the conduct is within COCON 1.1.6R to COCON 1.1.7R and thus within the scope of COCON unless excluded by COCON 1.1.7AR to COCON 1.1.7FR. 3. 'No' means that generally the conduct is outside the scope of COCON.	

Some of the conduct to which the new COCON rule applies is in part based on the approach of the Equality Act 2010 (EQA); it applies (amongst other things) to conduct that has the purpose or effect of violating the recipient's dignity or that creates an intimidating, hostile, degrading, humiliating or offensive environment. There is however no requirement that the conduct must be related to an EQA protected characteristic (sex, race etc). Other conduct that is captured under the new rule is conduct that is offensive, intimidating, or violent, or unreasonable and oppressive or humiliates, degrades or injures the recipient (who must be an individual listed in the new rules).

Although the proposed rule emphasises that conduct will only come within the rule if it is serious, it is unclear whether an objective or subjective approach should be applied to assessing whether the conduct is unreasonable, oppressive, bullying etc. Under the EQA in deciding whether conduct has a particular effect a number of things must be taken into account: the particular circumstances, whether it is reasonable for the conduct to have that effect and the perception of the individual. The PRA expects firms to ensure that allegations of non-financial misconduct are assessed objectively and independently by an appropriately qualified person.

The group of individuals in relation to whom serious misconduct can give rise to a breach of COCON is broad as it covers 'employees' (adopting the wider definition of the regulators), service providers and consultants. However, it does not capture conduct towards former employees, so for example a repeated failure to provide a reference that might amount to an act of victimisation under the EQA would not be captured (albeit such conduct might be relevant to the assessment of their fitness and propriety under the FIT Handbook).

Firms will need to notify the FCA if they take disciplinary action for non-financial misconduct that is a breach of the Conduct Rules in accordance with their notification obligations for SMFs, certified persons and conduct rules staff.

Territorial implications: COCON applies to SMF managers and Material Risk Takers (MRTs) wherever the conduct occurs. In practice where the misconduct in question has occurred overseas domestic regulatory and employment requirements may lead to tensions in relation to the application of the new FCA rules to SMFs and MRTs.

For all other conduct rules staff, COCON applies to conduct of staff at a UK office or (in the case of a UK firm) when dealing with a client of the firm in the UK from an establishment overseas.

NON-FINANCIAL MISCONDUCT: FITNESS AND PROPRIETY (F&P)

The FCA proposes to amend the Fit and Proper test for Employees and Senior Personnel (FIT) section of its Handbook setting out in more detail how non-financial misconduct forms part of the F&P test, providing examples and clarifying that bullying and similar misconduct within the workplace is relevant to fitness and propriety and that similarly serious behaviour in a person's personal or private life is also relevant. This raises a number of questions: to what extent will firms be required to actively explore an individual's conduct outside the workplace in respect of F&P assessments? Assuming firms are not expected to proactively investigate private lives unless on notice of an issue, what amounts to being on notice?

The FCA's amendments to FIT seek to address some of the perceived inconsistencies and problems that have arisen in relation to some of its enforcement decisions and criticism of some of its decisions by the Upper Tribunal (UT). Under the proposed Handbook guidance 'misconduct in a person's private or personal life or in their working life outside the regulatory system may be relevant to their fitness and propriety even though it does not involve a breach of standards that are equivalent to those required under the regulatory system. In particular, it may show that the person lacks moral soundness, rectitude and steady adherence to an ethical code. That in turn raises doubts as to whether they will follow the requirements of the regulatory system'. The guidance goes on to provide that misconduct that is 'disgraceful or morally reprehensible or otherwise sufficiently serious' may be relevant to fitness and propriety even if it does not damage public confidence in the financial system and/or there is little or no risk of it being repeated in the individual's work for their firm. The proposed rules and guidance in relation to F&P and conduct still leave room for interpretation in specific cases. However, for firms who have been used to having the latitude to form a 'house view' this may be reduced.

HISTORICAL CONDUCT

The regulators have indicated that the new rules will come into force 12 months after the publication of their Policy Statements. What is potentially unclear is whether firms are expected to address and apply the new rules retrospectively to historical misconduct that comes to light after the rules come into effect. The PRA's proposed updated SS35/15 and SS 28/15 state that it may take into consideration established patterns of behaviour of an individual that would, or would be likely to, affect the firm's safety and soundness, when considering whether the individual meets the PRA's standards of fitness and propriety. This suggests that historical conduct is relevant. However, it is far from clear and one reading is that it may be harder for a firm or the FCA to take action in respect of historical conduct?

PREPARATORY STEPS

Firms would be advised to consider:

- how they currently approach non-financial misconduct;
- what the practical and legal implications of the proposals outlined might mean for, amongst other things, their annual review and certification, and regulatory references and related HR systems;
- employee engagement surveys and training;
- operational and senior manager oversight (of for example workplace culture);
- what areas of the firm currently 'own' matters relating to non-financial misconduct (such as designated Senior Managers, HR or People & Culture/ D&I leads) and whether that may need to be expanded to include, for example risk and audit;
- what consultation may be needed with key internal stakeholders when the changes are finalised (and making senior managers and relevant operational areas aware changes are in the pipeline);
- developing early communications campaigns around non-financial misconduct, culture and accepted behaviours and the consequences of infringement.

Once the final Policy Statement is published firms will want to carry out a deep dive to ensure that they have the frameworks, culture, training and processes in place across the firm to ensure that they can comply with this regulatory 'intervention'.

[Diversity and inclusion in the financial sector DP21/2](#)

[FCA Understanding approaches to D&I in financial services](#)

[FCA CP 23/20 Diversity and inclusion in the financial sector – working together to drive change](#)

[PRA CP 18/23 Diversity and inclusion in PRA-regulated firms](#)

[Briefing: FCA and PRA Consultation on Diversity and Inclusion in the financial services sector: an Overview](#)

[Briefing: FCA and PRA Consultation on Diversity and Inclusion in the financial services sector: D&I Strategies, Reporting, Disclosure Obligations and Targets](#)

TIMETABLE/NEXT STEPS

- Responses to the consultation paper can be submitted until **18 December 2023**
- The FCA/PRA Policy Statement will be published in 2024 and the implementation date for changes will be 12 months after publication of the Policy Statement to give firms time to prepare.

CONTACTS



ALISTAIR WOODLAND
Partner

T +44 (0)20 7006 8936
E alistair.woodland
@cliffordchance.com



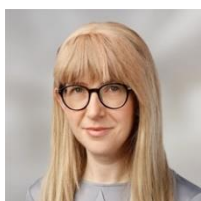
**CHINWE ODIMBA-
CHAPMAN**
Partner

T + 44 (0)20 7006 2406
E chinwe.odimba-
chapman
@cliffordchance.com



ALASTAIR WINDASS
Partner

T + 44 (0)20 7006 2458
E alastair.windass
@cliffordchance.com



AMY BIRD
Senior Associate

T +44 (0)20 7006 3830
E amy.bird
@cliffordchance.com



TANIA STEVENSON
Knowledge Director

T + 44 (0)20 7006 8938
E tania.stevenson
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street,
London, E14 5JJ

© Clifford Chance 2023

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street,
London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi • Amsterdam • Barcelona • Beijing •
Brussels • Bucharest • Casablanca • Delhi •
Dubai • Düsseldorf • Frankfurt • Hong Kong •
Houston • Istanbul • London • Luxembourg •
Madrid • Milan • Munich • Newcastle • New
York • Paris • Perth • Prague • Riyadh • Rome
• São Paulo • Shanghai • Singapore • Sydney
• Tokyo • Warsaw • Washington, D.C.

AS&H Clifford Chance, a joint venture entered
into by Clifford Chance LLP.

Clifford Chance has a best friends relationship
with Redcliffe Partners in Ukraine.