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**Insights**

# THE FCA'S RECENT FOCUS ON DIVERSITY, INCLUSION AND PSYCHOLOGICAL SAFETY

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Two senior members of the FCA have recently delivered significant speeches on the importance of diversity and inclusion ("**D&I"**) in regulated firms and why this should be considered a regulatory issue. Whilst the importance of D&I has long been discussed and highlighted by the regulators, these two speeches mark a step change in the level of FCA focus on this area.

The speeches also demonstrate the FCA's renewed commitment to promoting "psychological safety" - creating an environment where people feel empowered to speak up - and the impact D&I has on improving this.

## Why diversity and inclusion are regulatory issues – Nikhil Rathi (FCA CEO)

On 17 March 2021, the FCA's CEO, Nikhil Rathi, delivered a speech at the launch of the HM Treasury Women in Finance Charter Annual Review in which he asserted the importance of D&I in regulated firms.

Mr Rathi noted that D&I is important to the FCA, as it seems to improve risk management and decrease the frequency of misconduct fines. He cited a McKinsey report titled 'Diversity Wins', which showed that the most diverse companies tend to outperform the least diverse. D&I, therefore, directly contributes to the stability and overall health of the financial markets. He also highlighted the fact that the more diverse an organisation is, the more it is able to cater to vulnerable customers who are often from minority backgrounds, which is something the FCA considers crucial. Lastly, Mr Rathi questioned whether any firm can adequately prevent bias and overcome blind spots if they do not have a diversity of background and experience within their own ranks.

The speech concluded by Mr Rathi noting that whilst the FCA does not yet have the formal powers to enforce D&I (although it is currently working with the PRA to formalise their future joint regulatory approach), it is not afraid to draw on its wider supervisory tools. This is a thinly veiled threat to firms to expect supervisory interventions by the FCA if they do not get on board with the FCA's agenda in this increasingly important area. We also expect to see the FCA increasingly taking D&I considerations into account when assessing Senior Management Function approval applications.

Find Nikhil Rathi's full speech here.

## From regulator to firm to consumer: a virtuous chain of events - Georgina Philippou (FCA Senior Advisor)

On 16 March 2021, Georgina Philippou, Senior Adviser to the FCA on the Public Sector Equality Duty, delivered a speech at the Building Ethnic Diversity and Inclusion in Investment Management – Report Launch.

Ms Philippou opened by noting that whilst D&I policies have improved in recent years, there is plenty of work yet to be done to secure D&I in investment management. The FCA recognises that organisations will inevitably have their own cultural differences and it is not appropriate for the FCA to mandate a particular culture. However, it expects all regulated firms to be able to articulate their D&I purpose, to set an appropriate tone from the top, and to be able to show that their people policies are effective in driving D&I.

Regardless of the cultural differences between the regulated firms, the speech noted that the FCA puts a particular emphasis on the notion of "psychological safety". This entails, in Ms Philippou's own words: "*creating an environment where employees feel safe to share ideas and speak up".* She further explained that an important element of psychological safety is an effective and attentive response of an organisation to any employee concern, which can in turn encourage other employees to speak up.

The speech further emphasised that the FCA is subject to the Public Sector Equality Duty and as such, it must encourage D&I in carrying out all their functions. Ms Philippou explicitly acknowledged that whilst there is no rule in the FCA Handbook that states that regulated firms must be diverse or even have a diversity policy, the FCA is not silent or powerless and it possesses formal and informal tools to compel firms to embrace D&I. A look at the impressive range of supervisory powers in the FCA's toolkit shows that Ms Philippou is absolutely right about that.

Find Georgina Philippou's full speech here.

## Key takeaways

As highlighted by the two speeches, it has become apparent that the FCA is putting an increasing emphasis on the D&I activities and policies of the regulated firms. Whilst this should not come as a shock, the FCA has additionally toughened its language around enforcement of D&I by noting that D&I is indeed a regulatory issue. Furthermore, it has indicated its willingness to work with the PRA to enforce D&I in regulated firms.

In light of the above, firms should look into enhancing their D&I policies and practices and furthering their knowledge of D&I topics in order to avoid the unduly attention of the regulators. Here at BCLP, we have developed a briefing session especially designed for financial services firms on

how to implement psychological safety in practice. The session gets great feedback – please get in touch with us if you would like to know more.

*Katerina Hemalova, Trainee Solicitor, assisted with the publication of this Blog.*

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