FAIR BY DESIGN
Ending the extra costs of being poor

FINANCIAL CONDUCT AUTHORITY (FCA)

DP21/2: DIVERSITY AND INCLUSION IN THE FINANCIAL SECTOR

SEPTEMBER 2021

Fair By Design welcomes the invitation to respond to the FCA's consultation on diversity and inclusion in the financial sector.

Please note that we consent to public disclosure of this response.

For more information about this response, please contact Martin Coppack: m.coppack@barrowcadbury.org.uk

ABOUT FAIR BY DESIGN

Fair By Design is dedicated to reshaping essential services, such as energy, credit and insurance, so they don't cost more if you're poor.

People in poverty pay more for a range of products including energy, through standard variable tariffs; loans and credit cards with higher interest rates; and expensive insurance premiums, for example, by living in postcodes considered higher risk. This is known as the poverty premium.

We collaborate with industry, government, and regulators to design out the poverty premium.

Our Venture Fund provides capital to help grow new and scalable ventures that are innovating to make markets fairer.

The Barrow Cadbury Trust runs our advocacy work, and Ascension Ventures manage the Venture Fund.

We have responded to questions 1, 3 – 5, 9 – 13, 15, 16, 18, 19 and 29.

Q1: What are your views on the terms we have used, how we have defined them, and whether they are sufficiently broad and useful, now and in the future?

The FCA's use of the terms "diversity of thought" and "cognitive diversity" demonstrate that 'diversity' is not an end in itself, but an interim outcome towards positive change. Positive change here, for example, being firms able to successfully recognise and respond to the diverse needs of customers, or designing products and services that improve customer outcomes.

We agree with the FCA that diversity of thought supports "[improved] decision-making within firms" and enables them to meet expected standards of care, such as the FCA's guidance on the fair treatment of vulnerable customers.

We disagree that inclusion can be defined as "providing equal access to opportunities and resources for people who might otherwise be excluded or marginalised, for example due to demographic characteristics." For true inclusion to occur some people will need increased access/help/assistance than others to reach their full potential in terms of career progression, and in terms of consumer outcomes, it will mean that not everyone will get exactly the same product or service. This is because inclusion requires we all get an *equitable* outcome.

Diversity can be thought of in terms of *numbers* whilst inclusion is more of a change in *behaviour* – in order to obtain an *equitable outcome*.

Put another way, diversity is *who* we are and inclusion is what we *do*. Therefore, as well as considering inclusion as it relates to the workforce, the FCA should also continue to guide firms towards achieving inclusion in their product governance through the inclusive design of products and services (we discuss this point further in our response to Question 19).

It is paramount that the FCA should also lead by example and apply inclusive design principles to its own work. These should inform the way it sets regulatory policies, to ensure all consumers can access products and services that meet their needs, at a price they can afford. This would add credibility to discussions with the regulated community. At present the FCA requires firms to commit to inclusive design principles as part of its consumer vulnerability guidance, however, it does not commit to the same principles for itself. For markets to be fully inclusive, the regulatory environment must also be inclusive as firms and competition alone will not lead to equitable outcomes for consumers. This leads to many consumers paying more because they are poor – a poverty premium – as well as many people being locked out of products altogether[1].

[1] https://fairbydesign.com/wp-content/uploads/2021/06/Fair-By-Design-A4-Summary-Doc_May21.pdf

Q2: Are there any terms in the FCA Handbook, PRA Rulebook or Supervisory Statements or other regulatory policies (for any type of firm) that could be made more inclusive?

We have not responded to Question 2.

Q3: Do you agree that collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector? What particular benefits or drawbacks do you see?

We agree that, *as a first step*, collecting and monitoring of diversity and inclusion data will help drive improvements in diversity and inclusion in the sector. However, more must be done than simply increasing numbers of people with a variety of different protected characteristics and backgrounds. **Inclusion requires a change in behaviour.**

Q4: Do you have a view on whether we should collect data across the protected characteristics and socio-economic background, or a sub-set?

We firmly believe that the FCA should collect data across the protected characteristics and socio-economic background.

Q5: What data could the regulators monitor to understand whether increased diversity and inclusion is supporting better decision making within firms and the development of products and services that better meet customers' needs?

Firms currently collect a range of data on customers, and have the capabilities for monitoring trends and assessing how different customers use products. We know these tools are currently deployed to upsell other products to customers.

These tools could be better used by firms to assess whether products and services better meet customers' needs – and this data should be reported to, or monitored by regulators.

Data could be used to identify potential harms, and to ensure remedies can be delivered to customers in a timely fashion.

For instance, we know that people from lower socio-economic backgrounds experience worse outcomes in many areas of financial services, including paying more for being poor or being excluded altogether[2] [3]. Fair By Design's own commissioned research[4] demonstrates

[2] Financial Conduct Authority, Occasional Paper No. 17: Access to financial services in the UK (2016)
[3] Financial Inclusion Commission, Improving the financial health of the nation (2015)
[4] University of Bristol, The Inequality of Poverty (2021)

how the more of certain protected characteristics a person has, the more likely they are to be in poverty – and paying a poverty premium. Intersectionality plays a large role here.

Firms should therefore collect *consumer* data across the protected characteristics and socio-economic background to better understand which groups of consumers are experiencing worse outcomes.

As discussed below, our recommended Inclusive Design approach would also require firms to regularly collect information on how consumers' experiences are changing.

We also believe that the FCA itself should collect this consumer data.

We have not responded to questions 6 – 8.

Q9: What are your views on the best approach to achieve diversity at Board level?

We believe that senior level buy-in is essential for progress. We are supportive of the FCA's suggestions around Board succession planning needing to happen within the context of diverse representation. This can include greater positive engagement with recruitment firms to ensure diversity is at the heart of future recruitment, as well as greater engagement and consideration when it comes to supporting the 'executive pipeline.'

Boards can also take steps now if they are not yet diverse in their membership. Different perspectives can be provided through 'shadow' boards made up of non-executive staff with certain demographic characteristics, for example, younger employees. This approach has been used to some success in industries ranging from hospitality to fashion but also in financial services, as trialled by insurance firm Beazley.[5]

Speakers can also be invited to meetings for relevant agenda items, but Boards should also directly engage with their consumers, and be exposed to people 'not like them.'

Q10: What are your views on mandating areas of responsibility for diversity and inclusion at Board level?

We are supportive of mandating responsibility for diversity and inclusion at a Board level, and that good outcomes for consumers should form an integral part of the Board's strategy.

Boards set the culture of organisations and approaching this work with a lens of consumer outcomes would demonstrate that simply increasing diversity in people and creating an inclusive culture are not an outcome in themselves.

This would also support the FCA's shift to an outcomes-focused approach to regulation, as firms' activities, including operational activities outside their regulated activities – such as

[5] https://www.standard.co.uk/business/shadow-boards-how-young-executives-are-running-corporates-a4318861.html

recruitment and progression processes – are prepared around the needs of customers.

Q11: What are your views on the options explored regarding Senior Manager accountability for diversity and inclusion?

We support making senior leaders directly accountable for diversity and inclusion, and this role should include product governance.

A UK Finance report[6] that evaluated the Senior Managers and Certification Regime (SMCR) found that rules introduced to improve governance and culture at banks following the financial crisis had led to a "meaningful and tangible change in culture, behaviour and attitudes." 93% of respondents agreed that the SMCR had induced change for the better.

As such we are convinced of the potential for the SMCR to influence meaningful change, both as it relates to diversity and inclusion within a firm, and as it relates to products and services that better meet customers' needs.

Q12: What are your views on linking remuneration to diversity and inclusion metrics as part of non-financial performance assessment? Do you think this could be an effective way of driving progress?

As noted in Virgin Money's 'Empowering Productivity' report[7], a significant proportion of remuneration packages comprise of bonuses. As such, we believe that linking diversity and inclusion metrics to remuneration is an under-utilised lever and could be an effective way of driving progress.

Q13: What are your views about whether all firms should have and publish a diversity and inclusion policy?

We believe all firms should have, and publish, a diversity and inclusion policy. Increased transparency is beneficial for helping to ensure that firms are serious about increasing diversity and inclusion.

Q14: Which elements of these types of policy, if any, should be mandatory?

We have not responded to Question 14.

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[6] UK Finance, SMCR: Evolution and reform (2019)
[7] Virgin Money, Empowering Productivity (2016)

Q15: What are your views about the effectiveness and practicability of targets for employees who are not members of the Board?

We agree with the FCA's view that there are merits in targets for employees who are not members of the Board, including senior managers as well as, for example, those employed in product development and those in customer-facing roles. As above, greater diversity in thought will help in understanding and serving a diverse range of customers, including those on low incomes, for example.

However, as the FCA has acknowledged, progress-to-date, especially in senior roles, has been slow or even reversed. Therefore, as discussed in our response to Question 19, firms should also consider inclusion as it relates to the design of their products and services. We welcome the innovative inclusion of targets being applied to areas with customer-facing roles.

Q16: What are your views on regulatory requirements or expectations on targets for the senior management population and other employees? Should these targets focus on a minimum set of diversity characteristics?

Data collection should be linked to the outcomes you're trying to see. The logical extension of this is that the consumer population is diverse so collecting data on a broad range of characteristics make sense. Firms do not have to do it all at once but should have a plan to build more comprehensive data sets as their strategies evolve

Q17: What kinds of training do you think would be effective in promoting diverse workforces and inclusive cultures?

We have not responded to Question 17.

Q18: What kinds of training do you think would be effective for helping understanding of the diverse needs of customers?

Money Advice Trust provide training and consultancy[8] that helps organisations and their staff identify and support customers in vulnerable situations. This includes inclusive design for essential services. Please also see the toolkits on inclusive design explained below.

[8] https://moneyadvicetrust.org/training-and-consultancy/

Q19: What are your views about developing expectations on product governance that specifically take into account consumers' protected characteristics, or other diversity characteristics?

While we support increasing diversity of firms, so that they reflect the customers they serve, we also welcome the FCA's intention to set clear standards for firms to meet in their products and services.

We support the FCA's ambition in CP21-13: A new Consumer Duty[9] that "all products and services that are sold to consumers [are] fit for purpose. We want them to be designed to meet consumers' needs, and targeted at the consumers whose needs they are designed to meet. This is an essential requirement for products and services to be able to represent fair value for consumers."

Right now, despite essential services (e.g. payments services, credit and insurance) being needed by everyone, the UK market has evolved in a way that penalises or excludes many people on low incomes and/or in vulnerable circumstances. Driven by competition, markets do not work effectively in these consumers' interests, with firms competing for the 'healthy and wealthy' or the digitally savvy. Products and services often do not meet the needs of people who do not fit into these boxes, and the poverty premium is an egregious example of harm experienced by low income consumers, where being poor leads to paying more.

Research by the Personal Finance Research Centre (PFRC) at the University of Bristol, commissioned by Fair By Design, found that some low income households were paying an extra £237 for using high cost short term credit, such as payday loans. Car insurance was the biggest contributor to the poverty premium, with some of these households paying nearly £300 a year more for living in a deprived area considered riskier by insurers[10].

Further research by the PFRC, also commissioned by Fair By Design, found that people with certain protected characteristics had an increased likelihood of paying a poverty premium for financial services – even when compared to low income households as a whole[11]. Lone parents and those under 35 were most likely to have used some form of high-cost credit. There is also wider evidence that Black households are more likely to be excluded from the credit card market. This means that those households either go without credit altogether, or are pushed into the high cost credit market.

As recommended in our response to CP21-13[12], we believe that, rather than simply asking themselves questions about customers' needs, firms should bring in the customer voice and start product design 'from the customer' – to take into account their protected characteristics, or other diversity characteristics such as lower socio-economic background.

Bringing in the customer voice into product design is particularly pertinent because of slower-than-expected progress on diversity within the sector.

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[9] Financial Conduct Authority CP21/13: A new Consumer Duty
[10] University of Bristol, The poverty premium: a customer perspective (2020)
[11] University of Bristol, The inequality of poverty (2021)
[12] https://fairbydesign.com/policy/fca-consumer-duty/

For example, as cited in the discussion paper, people from higher socio-economic backgrounds held 89 percent of senior roles in financial firms. In addition, fewer than 1 in 10 management roles in financial services are held by people from Black, Asian or other racially minoritised communities.

This lack of diversity in thought can lead to decision-making based on assumed consumer lives and biases. This excludes those consumers who decision makers do not typically think about: those whose lives are very different from their own.

This disconnect, between firms and people's lived experiences (financial or driven by other factors such as protected characteristics) is a driver of the poverty premium and indeed exclusion.

In order for firms to really act in a consumers' best interests they have to speak to those consumers, rather than asking themselves questions – and trying to place themselves in the shoes of people 'not like them'. People in firms (especially senior people) are not necessarily representative of consumers – especially low income and/or certain types of vulnerable consumers – in terms of (1) knowledge of financial services and (2) their needs and expectations of the market. As the FCA recognised in CP21-13, "different customers will have diverse needs, and their needs may change."

The most effective way for firms to recognise and respond to customers' needs – including those with protected characteristics and other diversity characteristics – is through the application of Inclusive Design principles. Fair By Design, in partnership with the Money Advice Trust, has created two guides:

One for firms.

One for regulators. This is discussed further below.

By understanding and applying the principles of Inclusive Design, firms can design services and products around real people's lives rather than assumed consumer lives. This will help lead to the FCA's desired outcome of an "environment where consumer harms [such as the poverty premium] do not occur in the first place."[13]

Inclusive Design would also enable firms to meet the FCA's expectations in CP21-13 that firms should be able to "identify when particular groups of customers receive systematically poorer outcomes, and should investigate the root cause and what they can do to improve outcomes for those customers least well served. This is particularly important where those receiving poorer outcomes share protected characteristics under the Equality Act 2010."

There are also commercial considerations for firms to adopt an inclusive approach to product design – even if the FCA does not expect firms to design products and services that meet the needs of all consumers, as stated in the discussion paper.

[13] Financial Conduct Authority CP21/13: A new Consumer Duty

It can improve their competitiveness, as customers are more likely to choose firms that can offer services that meet their various needs.

Regulators and inclusive design

We welcome the acknowledgment by the FCA/Bank of England/PRA that they too have more work to do improve the diversity and inclusion of their own institutions.

However, markets as a whole need to be designed inclusively, too. In essential services markets, all consumers need to be served, even those that are less profitable. Otherwise, groups of consumers – including those with certain protected characteristics – fall through the cracks and receive negative outcomes or miss out altogether.

An inclusive design approach to policymaking would help the FCA meet its strategic objective of ensuring that markets work well. The existence of the poverty premium is evidence that markets do not work well for many consumers – including people with certain protected characteristics or other diversity characteristics such as being on a low income. As the Financial Lives survey shows, anyone can be vulnerable and Covid-19 has shown that anyone can suffer an income shock such as redundancy or ill health. Furthermore, low income/low financial resilience is often the overlapping form of vulnerability experienced by consumers in vulnerable circumstances[14].

The FCA, in the discussion paper, states that it has "engaged and active network groups that provide subject matter expertise [and] insights around lived experiences" on diversity and inclusion.

However, to be truly inclusive, regulators and policymakers should also be directly exposing their policy-designers and decision makers to people 'not like them' – alongside engaging with consumer representatives such as Fair By Design. This is especially important, as the civil society sector does not always have the resource to adequately represent consumers, and is not always reflective itself of the most vulnerable.

In addition it is essential for regulators to share their power with others and invite different perspectives and voices to help design – co-design – the best policies and interventions to create a market that works for all. The FCA, and other regulators, need to lead by example.

The FCA actively states the need for inclusive design by firms in its consumer vulnerability guidance, yet does not to do this itself. This is both a reputational risks as well as a failing to follow best practice in meeting the needs of all people on behalf it regulates.

An inclusive design approach will also enable the FCA to demonstrate its Public Sector Equality Duty 'due regard' to advancing equality of opportunity for people with protected characteristics. This is because the best solutions are those created in partnership and informed by the actual lives of consumers, rather than just the experiences of economists, competition specialists or just the remits of institutions.

[14] Financial Conduct Authority, Occasional Paper No. 8: Consumer Vulnerability (2015)

It would also complement existing approaches that build in expertise by experience to policymaking. For example, the Government's approach in its recently launched National Disability Strategy[15], which has a focus on lived experience and "putting disabled people at the heart of government policy making."

We have not responded to questions 20-28.

Q29: What impact do you think the options outlined in this chapter, alongside the FCA's proposals for a new Consumer Duty, would have on consumer outcomes?

We welcome the fact that the FCA is considering how to join up thinking between this work and its work on a Consumer Duty (and vulnerable consumers).

As above, increasing diversity and inclusion should be approached with the aim of achieving good outcomes for consumers.

Our recommended Inclusive Design approach complements the anticipatory nature of the Consumer Duty as the first step is for regulators and firms to know what consumers really experience and what the best solutions to problems look like to them. By doing this, they minimise the risk of detriment and maximises consumer welfare.

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[15] Department for Work and Pensions, National Disability Strategy (2021)