Diversity and inclusion – embracing the true colours in financial supervision[1]

Executive summary

In the financial sector, "diversity" often refers to having staff or customers with different dimensions such as gender, ethnicity, sexual orientation, age, social background and physical or mental ability, while "inclusion" means valuing and accepting people for who they are and providing them with equal and fair opportunities. Diversity and inclusion (D&I) can be considered internally in a financial institution in terms of the composition of its board of directors, management and staff members, or externally in terms of its dealings with customers and the public. One of the main focus of diversity has been on gender, but the scope is expanding to cover other diversity dimensions, including age, disability, race and ethnicity.

Sound D&I practices by financial institutions can support the core prudential objective of promoting the safety and soundness of the financial sector. D&I can support prudential objectives by improving the quality of corporate governance of regulated financial institutions. It is observed that a commonly desired regulatory outcome of D&I is to avoid groupthink by including people with different lived experiences at all levels within a financial institution. Diverse teams that are inclusive also perform better because they are more likely to re-examine facts, encourage greater scrutiny, become more aware of bias and minimise the risk of blindness to information. In addition, in promoting the fair and equitable treatment of customers, D&I requirements contribute to the mitigation of reputational and legal risks. Therefore, even without a specific mandate to advance the D&I agenda, prudential supervisors may introduce D&I requirements to achieve their fundamental safety and soundness objectives.

Overarching legislation on social justice typically underpins specific regulatory instruments that elaborate how laws related to D&I are to be implemented in the financial sector. This is unlike other areas of prudential supervision in which regulatory requirements or guidance are issued on the basis of legal powers accorded to a prudential supervisor under relevant financial sector supervisory legislation. The underlying legislation provides the force of law from different angles, ranging from the public accountability of financial sector regulators to D&I objectives to financial sector-specific requirements. Nonetheless, there are conduct and prudential justifications for regulatory interest in D&I, as set out above.

D&I regulatory approaches vary significantly across jurisdictions. In certain jurisdictions, the emphasis is very much on the diversity of decision-makers within firms in order to promote sound business strategies. In other jurisdictions, the focus is on advancing broader social justice policies aimed at the inclusion of underrepresented groups of the population in the workforce. In addition, some jurisdictions focus mainly on customer-related issues from the perspective of the accessibility of financial services. It might be worthwhile for financial regulators to consider consolidating these disparate regulatory issuances, to have a coherent regulatory framework covering all D&I aspects that matter for financial institutions. Firms themselves would benefit from such a holistic approach to D&I.

International regulatory standards call for banks to establish a sound corporate governance framework that is underpinned by well qualified board members not only individually but also collectively. Some regulators implement these standards from a broader diversity perspective, for example, by requiring diversity of board members in terms of an underrepresented gender. One of the

[1] By Nompumelelo Simelane, Central Bank of Eswatini (nompumelelos@centralbank.org.sz); and Jeffery Yong, Bank for International Settlements (jeffery.yong@bis.org). The authors are grateful to Varshaa Kutik and Ruth Walters for their valuable input on this paper and to Esther Künzi for administrative support.

main regulatory objectives relevant to D&I is for boards of directors as a whole to possess "collective suitability", which can be measured from various diversity perspectives, including gender and ethnicity. In practice, D&I regulations aiming to achieve this objective establish minimum requirements on suitability assessments, board composition, succession planning, and remuneration and recruitment practices. To make further progress in this area, supervisory review processes need to embed such requirements in order to facilitate proper implementation.

From a conduct of business perspective, unfair business practices typically impact the "inclusion" more than the "diversity" of customers. Financial consumers have the right, as in any consumer relationship, to equitable and dignified treatment conditions. Discriminatory and exclusionary business practices can have prudential implications for firms, for example through reputational risk, lawsuits or regulatory fines. As such, sound D&I conduct by firms is not only relevant for authorities with a conduct of business mandate, but also for prudential authorities more generally.

Market discipline is another key component that fosters sound D&I practices. Accordingly, D&I regulation often requires banks to disclose their D&I policies or strategies, the objectives of those policies and the measurement of progress. Indeed, major financial institutions, especially listed firms, typically publicly disclose their internal D&I policies, initiatives and in some cases, targets. Disclosure of the appointment of members of the board of directors is particularly important to support the overarching D&I objective of diversity of thought (or cognitive diversity) for better decision-making. However, it is uncommon to find disclosure of customer-related D&I policies.

While there has been noticeable progress in improving firms' D&I, especially in the area of gender, the pace needs to accelerate and the scope to be broadened to other dimensions. Specifically, a gender-balanced target for boards of directors, senior management and firms as a whole remains elusive. The gender pay gap has not narrowed, partly due to men holding more higher-paid senior level positions in firms. Other areas of diversity should also be considered – including age, ethnicity, sexual orientation and socio-economic background, amongst others – to promote diversity of thought and, ultimately, the financial safety and soundness of firms. Nevertheless, it should be recognised that some cultural and societal issues, which go beyond the regulatory remit, need to be addressed first before any meaningful change can be introduced in the financial sector.

International standards and guidance on D&I might be helpful to prompt progress in improving the quality of corporate governance of regulated financial institutions, thus enhancing the safety and soundness of firms, and of the financial sector. While existing international standards and guidance do cover corporate governance from a diversity angle, they could be more explicit in articulating expectations on D&I more specifically. Financial sector supervisors would benefit from clear guidance on the extent of their regulatory remits in promoting D&I in support of their core prudential objectives. Nevertheless, it should also be acknowledged that D&I is not a silver bullet to address corporate governance deficiencies in firms. In other words, D&I is a necessary but not a sufficient condition to promote sound corporate governance practices.