Ed Sibley: The importance of diversity in financial services

Remarks by Mr Ed Sibley, Deputy Governor (Prudential Regulation) of the Central Bank of Ireland, at the "Importance of Diversity in Financial Services" event of the FuSIoN Network (the Financial Services Inclusion Network), Dublin, 13 February 2018.

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I am delighted to be here this evening and to have the opportunity to speak about diversity and inclusion in financial services at the first FuSIoN event of 2018. I would like to thank Francesca McDonagh for the invitation.[1] [2]

I strongly believe that diversity in all its forms is important, and that there remains a serious deficit in diversity of background, experience, and, critically, thinking at senior levels in financial services in Ireland. This needs to change. In my remarks this evening, I will cover: some background on the roots of my interest in diversity; the business case for improving diversity and inclusion, the Central Bank's approach to diversity and inclusion (from both an internal and external perspective); and outline how we are seeking to drive improvements in diversity across regulated firms. It is important to note that the opportunities and benefits that can accrue from increasing diversity in the workplace are dependent on creating an inclusive workplace, where different views, background, experiences, cultures, etc., are valued and nurtured.

I will conclude that meaningful and sustained improvements in diversity and inclusion can help to improve the safety and soundness of financial services firms and contribute to the restoration of trust in the financial system in Ireland.

My background

I have been working in financial regulation and supervision since the onset of the financial crisis, firstly, in the UK, and now in Ireland. As Deputy Governor, Prudential Regulation at the Central Bank, my role spans the entire Irish financial services system. It is also a very international role. I am a member of the Supervisory Board of the Single Supervisory Mechanism (SSM), the pan European banking supervisor. I am on the Board of Supervisors for both the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) and the General Board of the European Systemic Risk Board (ESRB).

In other words, I occupy an extremely privileged position of being able to see across the financial services system both here in Ireland, and across Europe. I also have the privilege of engaging with, debating with and disagreeing with international colleagues with diverse opinions, backgrounds, incentives and views.

I am also privileged in many other ways. In fact, you might wonder why a middle-aged, white, able-bodied, English, male, member of the establishment (by role at least) cares about diversity and inclusion. Well, I would argue that my good fortune by birth and upbringing does not preclude my desire for change – and, indeed, my strong belief that change is necessary.

But I would accept that it is, perhaps, the diversity of my family background, my career, my experiences and my interests beyond work that increase the resonance with me of the evidence that I see. It is for this reason that, within the Central Bank, I am Chair of the Diversity & Inclusion Steering Group and why, with the support and drive of many others, I am seeking to improve our approach to diversity and inclusion within the Bank and drive meaningful change across the financial services system.

Diversity and inclusion in the Central Bank

I will start with an example. In July last year, the second event of the Central Bank's Rainbow

Network was held. BeLonG To, an organisation, which no doubt is familiar to many of you, and which does fantastic work with young people who identify as LGBTQ, came to talk about their work. I hosted a panel discussion with incredibly inspiring young people who spoke about their journey in coming out. I was really proud to have had a role in making this event happen in the Central Bank, and in sending a very clear message to my colleagues, that our organisation was supportive of diversity, and wanted to be an inclusive employer.

This is important. Research[3] shows that many LGBTQ people to not feel fully comfortable about disclosing their sexuality at work. There is no obligation for anyone to do so. But employers should provide supportive environments to show that all employees are treated equally and fairly and can bring their whole selves to work. In the Central Bank we are ensuring that we have such a supportive environment that helps all of our people to grow and develop and reach their potential.

This was one event of many, and through these events, the creation of other D&I networks, and senior sponsorship to harness and support the energy of employee led initiatives, we have demonstrated our commitment to meaningful change and improvement. I strongly credit our Women's Network, which has been in existence for a few years, in being a real driver of awareness and the case for change, recognising that diversity goes far beyond gender, important as that is.

And I am proud of where we are. From a gender perspective, we strongly outperform both the financial services sector, the public sector and European peers, in terms of seniority and pay, from the Board (our Commission) down through our executive and senior leadership levels, there is a very healthy balance. More than one third of our board are women, as are 40% of our executive committee, and 43% of our leadership team (Head of Function and above).[4]

Our ambition is to go further, and there is much more work to be done in the Central Bank. We have dedicated resources to improve our approach to D&I across the Bank, and have established Parents and Carers, Bankability and the Rainbow Networks running alongside the Women's Network.

Why?

There is a plethora of research that a more diverse and inclusive workplace can better enable the Central Bank to fulfil its mission and vision of '*safeguarding stability, protecting consumers*' and of being '*trusted by the public, respected by our peers, and a fulfilling workplace for our people*'.

As stated by Governor Philip Lane during a speech at the European Financial Forum two weeks ago, "*We see diversity and inclusion as vital to ensuring we have the right mix of people to deliver our complex and diverse mandate and that all our people have the chance to reach their potential.*"[5]

The research has shown that having diverse teams can improve the quality of decision-making[6] at all organisational levels, reduce groupthink[7] and allow assumptions to be challenged more effectively[8]. Heterogeneous teams are, on average, better than homogeneous teams on creative and complex problems[9]. They increase the number of perspectives, provide better understanding of customer needs and flex management approaches. In a diverse and inclusive workplace, there is greater potential for internal crowd sourcing of ideas, innovation, challenging of ideas, and refining ideas in real time[10].

Research based on mathematical models and social experiments, demonstrates how diversity can trump ability in group decision-making processes[11].Diversity has been found to reduce the average error in decisions[12]. It has been found, that the more variation in the pool, the better the selective process[13], which is key to reducing groupthink. The more diverse a team, the more likely its predictive capability in the face of uncertainty[14].

The 2016 Empowering Productivity Report, which was sponsored by the UK Treasury and the Bank of England concludes that, "*Diverse groups tend to have a well-rounded view on business issues and risks. It is widely believed that greater diversity of thought results in better decision making and improved corporate governance and risk management, thus avoiding the perils of 'groupthink'*."

All of this research is very relevant to us in our role as regulator, both from an internal and external perspective.

We also recognise that if the Central Bank is not seen to be a diverse workplace, it will lose out on the pool of talent. McKinsey's 'War for Talent' Report[15] and other more recent research[16] positions increasing competition among organisations for talent as a key driver of organisational success or failure. The reality is that many graduates will actively seek 'diverse' organisations because they associate them with creativity, innovation and stimulation[17].

Once we attract the right people, we recognise that it is equally important to ensure that they feel included so that they stay in the Bank for the long term. Research indicates that the lack of focus on diversity and inclusion is likely to be a contributing factor to higher attrition levels[18]. In order to operate optimally, we recognise that as well as attracting and retain the best talent, the Central Bank needs everyone working to his or her individual optimum. Research shows that if organisations become both more diverse and more inclusive, employees will perform better, as they can be themselves and the resultant discretionary effort can be harnessed[19].

I am also aware that, particularly as a public sector organisation, the Central Bank has a moral imperative to reach out and include diverse talent that is reflective of Irish society and not to discriminate or create barriers, either real or perceived, against minority groups.

Diversity in financial services

When Governor Lane spoke at the European Financial Services Forum, he emphasised the focus on diversity in financial services by the Central Bank and said that "*The inclusion of this issue as part of this year's European Financial Forum is indicative of the welcome and necessary recognition of the importance of improving diversity across the financial services industry*".[20]

I have given a number of speeches over the past year, as have other colleagues from the Central Bank, in which we have spoken about the importance of diversity in financial services.

For many of the same reasons that the Central Bank has prioritised diversity and inclusion within our own organisation, we are also focused on diversity in the financial services we regulate. As I have touched on, there is strong evidence to show that diversity at senior levels of regulated entities can help to reduce the likelihood of groupthink, increase the level of challenge and improve decision making and risk management. There is also a clear connection between the diversity in an organisation and its culture.

These are all attributes that as a regulator we should and do care about. Groupthink, in particular, was identified in the Nyberg Report as a contributing factor to the financial crisis in Ireland. In my own experience, a lack of diversity at senior management and board level in organisations is a leading indicator of elevated behaviour and culture risks, and consequently prudential and conduct risks.

If we look at the causes of the financial crisis, we can see clear linkages to behaviour, culture and diversity. It is clear that there were multiple failures and multiple individual and collective decisions leading up to the financial crisis. For example, collective groupthink, business model and strategy failures, governance and control issues, financial misconduct, excessive optimism, regulatory failures, political interference and so on. There are behavioural and cultural linkages across all of these failures.

The behaviours and underlying cultures within financial services firms were wholly inappropriate. Short termism was incentivised, particularly with respect to shareholder returns. Effective internal challenge of the prevailing views was not. While many improvements have been made, not enough progress has been made with respect to underlying behaviours, cultures and incentives.

The culture in the retail banks has led to catastrophic failings in the treatment of customers affected by the tracker mortgage scandal, which has done further lasting damage to the reputation of the Irish banking sector. Globally, there is evidence of cultural failings across the financial services sector, be it Wells Fargo, the LIBOR scandal, RBS, PPI and so on. Moreover, at an individual firm level, I have seen too many examples where regulated firms are having to be pushed too hard by the regulator to address failings and remediate issues, where the focus is on the letter of the law and not the desirable outcome. In some cases this has led, ultimately, to the failure of the firm when earlier acceptance and change would have, perhaps, preserved it.

I spoke at an event last year[21], during which I highlighted that the consequential breakdown in public trust and confidence in financial services, and the need for meaningful cultural change to repair and restore trust. As the reputation of financial services firms has been damaged there is a tendency for a greater degree of commoditisation of services, products and product providers. If consumers do not trust providers or their products, they are understandably going to be more driven by price, when other factors may also be important in terms of suitability. Concerns are so deep rooted that there is a lack of trust regarding pricing (e.g. car insurance, mortgage pricing), and customer treatment (e.g. re mortgage and SME borrowers in distress). Ultimately, I do not think this is positive from either a financial stability or a consumer protection perspective.

Diversity and inclusion have roles to play in mitigating some of these risks. McKinsey[22] research in this area suggests that companies in the top quartile for gender or racial and ethnic diversity are more likely to have financial returns above their national industry medians. Companies in the bottom quartile in these dimensions are statistically less likely to achieve above-average returns.

In other words, diversity is directly relevant to the key outcomes that we are seeking to achieve for regulated firms and the system as a whole – specifically, that regulated firms are well governed, with appropriate cultures (including relating to challenge) and risk management arrangements in place; and that they have business models that generate profits over the long term in a sustainable way.

Current levels of diversity in financial firms

Given the positive impact that diversity can have on behaviour and culture in financial firms, it is concerning that a significant imbalance in gender and other diversity aspects remains at senior levels of most regulated firms in Ireland.

In September 2008, before the bank guarantee, the main retail banks operating in Ireland had no female executives at Board level; the 18% of female Board members were non-executives.

Worryingly, the situation is not improving. Approximately 80% of the most senior and influential appointments in regulated firms in Ireland between 2012 and 2016 were male[23]. Comparisons are almost certainly worse for any other measure of diversity.

Strikingly, underneath the headline numbers, there is an even greater gender imbalance for roles that are revenue generating. At the board level, women comprised 12% of nominations for Chief Executive roles, 12% of nominations for Chairman of the Board roles, 15% of nominations for executive director roles and 18% of nominations for non-executive director roles.

It is also interesting to look at the split across roles – women are more prominent in risk, compliance and audit functions, men even more so in front line / revenue generating roles.

This is not to suggest that diversity is all about gender. There are no studies that I have seen for the EU or Ireland on racial and ethnic or sexual orientation diversity in business, but I have no reason to believe that it is any better than the UK – where 78% of UK companies have senior-leadership teams that fail to reflect the demographic composition of the country's labour force and population – or indeed the US, where the figure is 91%.

So the current situation, in Ireland at least, is concerning. Last year, we reviewed a sample of diversity policies in regulated firms, which many financial services firms are now required to have (under the CRD, Solvency II and the Central Bank's Corporate Governance Codes). These are not going to turn the dial.

In the main, they were striking for their lack of ambition. In many cases internal targets that are already being met have been set, many lack accountability, and there is little evidence that progress against them is being monitored. Remarkably, for two large financial services firms, their diversity policies were exactly the same, word for word, with the exception of the names of the firms and some of the targets they had.

Notwithstanding these issues, there are financial services firms that have a healthy gender balance, with nominations among certain banks and insurance companies at 44% and 45% female applicants over the past five years. There are financial services firms that have diversity policies and programmes that demonstrate that diversity is a priority. There are also sector wide initiatives, such as the 30% Club, and the work of FuSIoN itself, which are focusing on addressing these issues, which the Central Bank is actively participating in.

But more needs to be done.

What actions are we taking

As stated by Governor Lane during his address to the European Financial Forum, "*The financial services industry can certainly expect to see a continued increase in the intensity and intrusiveness of our engagement on diversity*."[24]

Diversity is supervisable. We can legitimately expect regulated firms to meaningfully address diversity and inclusion in the boardroom, at the executive level and the pipeline of talent needed to run the organisation in the long-term. Our supervisory work is, therefore, being enhanced as follows:

- We can assess whether boards and the executive are taking responsibility for actively promoting diversity and inclusion at all levels of the firm, to improve decision-making and how this, in turn is impacting on behaviour and culture.
- We will review the policies that are put in place to deliver this outcome. We will analyse data showing the outcomes from a firm and a sector perspective on an annual basis. We expect to publish data in this regard this coming March.
- We are including aspects of diversity in the upcoming Behaviour and Culture Review of the retail banks. This is a major step forward in our approach, which we will apply in other reviews in different sectors. It puts the Central Bank at the forefront, internationally, of the regulatory work on diversity.
- We are reviewing our governance codes and requirements to be more explicit in terms of

expectations regarding diversity policies.

- We will also be considering whether our own actions are inhibiting change. For example, in our consideration of fitness and probity applications, are we considering exclusively on an individual basis or a more rounded consideration of the construct and diversity of the board, executive and so on? That is not to say that we should lower our standards, but that we will be enhancing how we consider the effectiveness of the board and the executive as a whole.

Risks and barriers

I would accept that change is not without risk or challenge. There are deeply entrenched issues that need to be overcome – many of which are societal. Recent studies of the gender pay gap affecting Uber drivers[25] are interesting in highlighting deep rooted issues and behaviours that go beyond an individual firm's, no matter how large, ability to change.

There is also more controversial research which shows correlation (and argues causation) between higher levels of diversity and higher levels of societal mistrust[26]. Whatever the drivers for this mistrust, it is clear that an organisational level and a more macro level, a focus on inclusion is critically important too.

But these risks and barriers are relatively small compared to the potential benefits at both a system wide level and an individual firm level if they can be overcome.

Conclusion

In my role I am focused on ensuring that the Central Bank is safeguarding stability and protecting consumers, and delivering a vision whereby the financial services system in Ireland delivers for both the economy and its customers in a sustainable way over the long term. There is clearly more to be done to have confidence in the achievement of this vision for the Irish financial services system.

Diversity and inclusion has a role to play in achieving this vision. This includes through ensuring that regulated firms have appropriate and effective governance, risk management and control frameworks in place, that their actual cultures are consistent with their stated aspirations, and that their business models are sustainable over the longer term.

In other words, meaningful and sustained improvements in diversity and inclusion can help to improve the safety and soundness of financial services firms and contribute to the restoration of trust in the financial system in Ireland. Diversity and inclusion are therefore critically important to the Central Bank's mandate of safeguarding stability and protecting consumers, and will continue to be high on my list of priorities both internally within the Central Bank, and externally as a regulator and supervisor of the financial services sector.

I am also committed to continuing to enhance the Central Bank as a place to work, where all our people can bring their whole serves to work, and achieve their full potential. Our diversity and inclusion work will continue to have a strong part to play in achievement of this vision too.

Thank you for your attention.

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1 With thanks to Siobhán Kirrane for assistance in preparing my remarks.

2 Speaking at the *Importance of Diversity in Financial Services* event of the FuSIoN Network, 13 February 2018.

3 Just a quarter of LGBT staff feel comfortable at work. Karen Higginbottom. Forbes 2016.

4 Central Bank of Ireland data.

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