



INSTITUTE OF DIRECTORS  
IN IRELAND

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# Briefing

## Spotlight on Diversity and Inclusion in Financial Services Regulation

Diversity and inclusion (“D&I”) continues to be a key focus for regulators with both the Deputy Governor of the Central Bank of Ireland (the “CBI”) and the President of the European Central Bank (the “ECB”) emphasising that further progress is needed in this area.

In this briefing, we will look at the regulator focus on D&I, recent examples of European and domestic initiatives and also highlight the challenges for policy-makers in progressing the D&I agenda.

### Regulator Focus on D&I

As a starting point, it is helpful to consider how regulators define D&I. In the UK, the Financial Conduct Authority (the “FCA”) recently consulted on a proposed definition of ‘diversity’ which focused on ‘diversity of thought’ or ‘cognitive diversity’. ‘Diversity of thought’ is referred to as “*bringing together a range of different styles of thinking among members of a group*”<sup>1</sup>.

Diversity is, of course, just one side of the D&I coin. So what do regulators mean when they refer to ‘inclusion’? The CBI has said that an inclusive culture is one which “*facilitates and supports individuals to contribute, irrespective of their differences, so that diverse views are shared. An inclusive environment may help promote internal challenge and create a safe environment for people to speak up, encouraging critical challenge at all levels of the organisation and an openness to change where there is a ‘no blame’ culture. This in turn may drive more effective decision-making and improve governance and risk management within the firm.*”<sup>2</sup>

- 1 P7, Diversity and Inclusion in the Financial Sector – Working Together to Drive Change ([here](#))
- 2 P10, Thematic Assessment of Diversity & Inclusion in Insurance Firms ([here](#))

Both the CBI and the ECB have highlighted the many benefits of D&I from a regulatory perspective. On 6 May 2022, the Deputy Governor of the CBI stated that:

*“Diversity can help move us away from groupthink, poor risk assessment and insufficient challenge. And diversity needs to be taken into account on many levels, from the decision makers in firms and on boards, to policymakers, to students and to the very data we collect.”<sup>3</sup>*

On 27 April 2022, the President of the ECB focused on gender diversity and stated that it is her *“deeply held belief that many of the qualities the world needs today are those that women in particular can bring to the table, which speaks to the benefits of governments and companies alike embracing more female leadership.”* Ms. Lagarde added that *“unfortunately, we still have a long way to go until female leadership is as prominent as it should be – and needs to be – if we are to mobilise all our talents to solve today’s global problems.”<sup>4</sup>*

The EBA has emphasised that more diverse management bodies can help to improve decision-making in relation to strategies and risk-taking, as those management bodies incorporate a broader range of views, opinions, experiences, perceptions, values and backgrounds. The EBA states that a more diverse management body reduces the phenomena of ‘group think’ and ‘herd behaviour’<sup>5</sup>. The EBA also analysed the correlation between the profitability of a credit institution and the composition of the executive directors within the management body and noted that credit institutions that have executive directors of both genders appear to have a higher probability of a return on equity (“**ROE**”) at or above the average of 6.42% than credit institutions with executive directors of only one gender.<sup>6</sup>

The regulator focus on D&I reflects a wider focus in the market. A 2020 McKinsey report which followed the trajectories of hundreds of companies since 2014 confirmed that the relationship between diversity on executive teams and the likelihood of financial outperformance had strengthened over time and in the context of the COVID pandemic: “Companies whose leaders welcome diverse talents and include multiple perspectives are likely to emerge from the crisis stronger. In short: diversity wins, now more than ever”<sup>7</sup>.

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## European Initiatives



D&I initiatives continue to be incorporated into European financial services legislation space, in particular, in the environmental, social and governance (“**ESG**”) sphere. The table below sets out examples of D&I initiatives within the European legislative framework.

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|---|---|
| 3 | CBI speech of 6 May 2022 <a href="#">here</a>   |
| 4 | ECB speech of 27 April 2022 <a href="#">here</a>  |
| 5 | P5, EBA Report on the Benchmarking of Diversity Practices at EU Level under Article 91(11) of Directive 2013/36/EU ( <a href="#">here</a> ) |
| 6 | P6, IBID  |
| 7 | Preface, ‘Diversity wins How inclusion matters’ ( <a href="#">here</a> )  |

Examples of European Initiatives	
<p><b>ESG</b></p>	<p>As regulated firms will be aware, ESG reporting is a key focus of European regulators/legislators with the development of the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation and the Corporate Sustainability Reporting Directive (the “<b>Sustainability Framework</b>”). Our briefing <a href="#">here</a> provides further detail on reporting requirements under the Sustainability Framework. The ESG legislative focus so far has primarily centred on environmental disclosures, however the next stage is development of a social taxonomy (that is a classification system for economic activities which contribute to social objectives).</p> <p>The Platform on Sustainable Finance (“<b>PSF</b>”) recent ‘<i>Final Report on Social Taxonomy</i>’ (<a href="#">here</a>) proposes a structure for a social taxonomy within the Sustainability Framework. The PSF report noted that “<i>there is a widely recognised need for better working conditions, dialogue and diversity in the workplace</i>” and proposes including ‘<i>Decent Work</i>’ as a social taxonomy objective which would, in turn, include a sub-objective of ‘<i>Diversity and Inclusion</i>’.</p>
<p><b>Capital Requirements Legislation</b></p>	<p>The Capital Requirements Directive<sup>8</sup> introduced requirements for in scope institutions to take into account the diversity of the management body when recruiting new members, to implement a diversity policy, to set a target for the representation of the under-represented gender in the management body and to take measures to increase their number in the management body to meet that target.</p> <p>On 4 February 2020, the EBA published its benchmarking report on diversity practices in credit institutions and investment firms analysing data as of September 2018 (<a href="#">here</a>). The EBA noted that, notwithstanding CRD requirements, a significant proportion of institutions had still not adopted a diversity policy and not all institutions that had adopted a diversity policy promoted gender diversity by setting a target for the under-represented gender. The EBA stated that it would continue to monitor diversity in management bodies and issue periodical benchmark studies on diversity.</p>
<p><b>ECB Supervision</b></p>	<p>Pursuant to the ECB’s guide to fit and proper (“<b>FAP</b>”) assessments (<a href="#">here</a>), the ECB assesses gender diversity as a “<i>component of collective suitability</i>” whenever national law allows. The ECB also takes diversity of experience and background into consideration in its FAP assessments. In Member States where national law requires institutions to make appointments in line with their internal policies or requires institutions to have a fixed percentage of members of the management body representing the underrepresented gender, the ECB makes a recommendation or imposes an obligation in the FAP decision to respect gender quotas in the current or upcoming appointments.</p>

8 Directive 2013/36/EU

## Examples of European Initiatives

<p><b>ECB Supervision (cont'd)</b></p>	<p>The ECB FAP assessment is also interlinked with day- to-day supervision. The ECB states that any identified failure in respect of gender quotas is brought to the attention of the supervised entity in ongoing supervision.</p>
<p><b>ESMA-EBA Guidelines (CRD/MiFID)</b></p>	<p>Under current joint ESMA and EBA Guidelines<sup>9</sup> diversity is required to be taken into account when selecting and assessing members of management bodies, recognising that diversity leads to a broader range of experience, knowledge, skills and values. The Guidelines also state that:</p> <ul style="list-style-type: none"> <li>• policies promoting diversity of the Board should refer to at least the following aspects: education and professional background, gender, age and geographical provenance where relevant;</li> <li>• firms that set targets for the underrepresented gender must specify a timeframe to meet the target; and</li> <li>• all firms should implement a diversity policy for staff, including career planning and measures to ensure equal treatment and opportunities for staff of different genders.</li> </ul>
<p>Other</p>	<p>Other areas of European financial services legislation include specific diversity requirements, for example, Article 26(1) of the Investment Firms Directive requires remuneration policies and practices to be gender neutral and Article 27(4) of the Central Securities Depositories Regulation requires the management body of a central securities depository (“<b>CSD</b>”) to be composed of suitable members of sufficiently good repute with an appropriate mix of skills, experience and knowledge of the entity and of the market. In addition, the non-executive members of the management body of a CSD must decide on a target for the representation of the under-represented gender in the management body and prepare a policy on how to increase the number of the under-represented gender in order to meet that target.</p> <p>More recently, a political agreement was reached between the European Parliament and Council on a proposed Directive aimed at improving the gender balance among directors of publicly listed companies. The Directive will require listed companies to ensure, by 30 June 2026, that members of the under-represented sex hold a minimum of 40% of non-executive director positions or 33% of all director positions and also requires companies with a lower share of the under-represented sex among non-executive directors to introduce pre-established, clear, neutrally formulated and unambiguous criteria in selection procedures for those positions in order to attain that objective. The Directive is expected to be formally adopted very soon and then Member States will have two years to transpose its provisions into domestic law.</p>

<sup>9</sup> On the notions of suitability, as required by Article 91 (12) of the CRD and Article 9 (1) of MiFID II and on the assessment of suitability by institutions and competent authorities ([here](#))



## Initiatives in Ireland

The D&I agenda is also progressing domestically, whether through transposition of European legislation highlighted above or the introduction of 'standalone' initiatives.

CBI corporate governance requirements for credit institutions ([here](#)) and insurance undertakings ([here](#)) both include a requirement that the Board, or nomination committee where one exists, of an institution must establish a written policy on diversity with regard to selection of persons for nomination to become members of the Board.

The CBI has also taken practical steps to improve D&I issues once identified. For example, the CBI's *'Thematic Assessment of Diversity & Inclusion in Insurance Firms'* in July 2020 ([here](#)) identified "a serious imbalance in gender diversity across insurance" noting low levels of women in senior leadership roles and significant gender pay gaps across the sampled firms. As a result, the CBI issued risk mitigation programmes to each of the relevant firms requiring each firm to submit a detailed action plan to address the specific issues identified and to ensure those issues were appropriately resolved.

On 27 April 2022, the Minister of State at the Department of Finance, launched Ireland's first *'Women in Finance Charter'* ([here](#)). The Women in Finance Charter was developed between the Government and industry (Financial Services Ireland, Insurance Ireland, Banking & Payments Federation Ireland and Irish Funds) and is open to all financial services firms operating in Ireland. By signing the Charter, signatories commit to improving the number of women in management and Board level positions to achieve better gender balance and a more inclusive working environment. Signatory firms set and report on yearly targets of levels of female participation in their workforce. The data will then be collected and reported on by the Economic and Social Research Institute ("ESRI").

Following the Gender Pay Gap Information Act 2021 (the "Act") being signed into law on 13 July 2021, the Minister for Children, Equality, Disability, Integration and Youth recently announced the key reporting requirements for employers in respect to their gender pay gap. The mandatory reporting obligations will apply to private and public sector employers with 250 + employees. Employers will need to carry out a headcount of all persons employed on a snapshot date in June 2022, including employees not rostered to work on that date and employees on leave, to determine if the reporting obligations apply. In-scope employers will be required to publish, concurrently with the relevant gender pay gap information, the reasons for such differences, the measures (if any) taken or proposed to be taken by the employer to eliminate or reduce such differences. Employers will be required to produce their gender pay gap information within 6 months of their snapshot date. Reporting requirements will commence from June 2022. Organisations will therefore need to identify any potential pay gaps and establish an action plan to tackle their gender pay gaps.



## The Challenge for D&I Policy Development

It is clear from the above that regulators and legislators recognise the benefits of D&I and the importance of progressing same. However, a key challenge for regulators and legislators is developing policy beyond gender diversity to capture the wider ambit of D&I, including, age, ethnicity, sexual orientation, education, nationality, disability and beliefs. In addition, regulators have identified the challenge of developing policies addressing ‘*intersectionality*’, defined by the FCA, as “*the interconnected nature of social categorisations such as race, class, and gender, regarded as creating overlapping and interdependent systems of discrimination or disadvantage.*”<sup>10</sup>

The principle challenge in creating policy in this area is the limited data available to regulators and legislators. For example, the recent CBI ‘*Demographic Analysis 2021 Applications for Pre-Approval Controlled Function (PCF) roles within Regulated Firms*’ ([here](#)) primarily focused on gender diversity as the CBI stated there is limited data on other forms of diversity (beyond age). While the CBI noted that gender diversity is a critically important one and is strongly indicative of wider diversity trends, there is no doubt that further data is needed to develop robust and effective D&I policy. The FCA has said that good data is “*critical to understand the current state of play, monitor progress, identify potential barriers to progress on diversity and inclusion, and select the most effective interventions.*”<sup>11</sup>

On a practical level, regulated firms have identified difficulties in collecting data on D&I, both in terms of the HR systems in place and in terms of concerns regarding the collection and processing of sensitive information.<sup>12</sup> In the ESG sphere, the PSF’s report referenced above states that “*it might prove difficult to develop criteria for furthering diversity on boards, not least because gathering information on employees’ ethnicity or sexual orientation is forbidden by law in some countries.*”<sup>13</sup>

The FCA has acknowledged that, from a practical perspective, a key issue for data collection is the requirement that firms may need to approach staff to complete a questionnaire, require individuals to self-identify and individuals may be reticent to do this. In 2021, the FCA, the Prudential Regulation Authority (the “**PRA**”) and the Bank of England issued a pilot data collection survey to firms which had a number of objectives, including testing firms’ ability to provide a more comprehensive set of D&I data.<sup>14</sup> The outcome of this exercise will be of interest to other regulators and policy-makers.

<sup>10</sup> P55, Diversity and Inclusion in the Financial Sector – Working Together to Drive Change

<sup>11</sup> P26, IBID

<sup>12</sup> [P31, Thematic Assessment of Diversity & Inclusion in Insurance Firms](#)

<sup>13</sup> P63, Final Report on Social Taxonomy Platform on Sustainable Finance

<sup>14</sup> [Here](#)

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## Comment

D&I will continue to remain a key focus of regulators and legislators at both a European and domestic level, in particular, given the continuing focus on and evolution of the Sustainability Framework. The key challenge which policy makers now need to grapple with is how to develop and implement effective and proportionate D&I policies which capture the broader remit of D&I beyond gender diversity and ensure firms are in a position to comply with those policies.

In McCann FitzGerald LLP, diversity and inclusion is at the heart of our culture. We believe that our workplace should reflect the diversity of our wider society as both a moral and a business imperative, and that all individuals who work for or come into contact with our firm should be treated equally, fairly and respectfully.

*Further information is available from*



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