RegCORE Client Alert

EBA publishes report on diversity practices and the gender pay gap at the level of the management body of banks

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Banking Supervision

EBA reports growth in female representation on banks' boards but laments slow growth overall and warns that imbalances remain

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QuickTake

On 7 March 2023, one day prior to International Women's Day, the European Banking Authority (**EBA**) published its report on "The Benchmarking of Diversity Practice and the Gender Pay Gap – at the level of the management body at European Union level" (the **2023 Report**).[1] The EBA's analysis is delivered pursuant to the EU's Capital Requirements Directive (**CRD -** in particular Article 91)[2] and uses data as of 31 December 2021 gathered from 662 credit institutions and 192 investment firms selected by national competent authorities (**NCA**s) in the EU-27, Liechtenstein and Iceland on the basis of common criteria set by the EBA.

Financial institutions have been obliged to introduce diversity strategies since 2014. Many banks have set their own targets, for example to increase the proportion of women in management. Some EU countries have passed concrete laws with clear benchmarks to this end. Gender balance in Northern and Eastern Europe is generally better than in other parts of the EU.

In short, in the EBA's view the proportion of women in bank management is growing too slowly. Women still remain strongly underrepresented in the top management of European banks. The results speak a clear language: of 689 bank CEOs, only 78 are women - that is 11.32 per cent. In 2018, it had only been 8.53 per cent. Overall, the share of women in top management positions, including CEOs, is only 18.05 (2018: 15.13) per cent. According to the 2023 Report, women in top management at banks also earn a median of 9.43 per cent less than their male colleagues. For non-executive directorships, the median gender pay gap is 5.90 per

[1] Available here and should be read in conjunction with further details here.

[2] To summarise, Article 91 CRD IV states that the management body must have "a suitably broad variety of experiences" (Art. 91(1)) and "enough collective knowledge, skills, and experience to understand the institution's activities, including the key risks" (Art. 91(7)). Furthermore, "Member States or competent authorities shall require institutions...to put in place a policy for the purpose of promoting diversity on the management body" (Art. 91(10), and competent authorities shall collect and provide relevant information to the EBA to allow for Union-wide benchmarking of diversity practices (Art. 91(11)).

cent. Moreover, although all institutions are now obliged to implement diversity strategies, 27.05 per cent of the banks surveyed still do not have such regulations, according to the EBA – in 2018 this number stood at 41.61%.

Nevertheless, with clearly disappointing data, the EBA has repeated its criticism from previous years[3] on lack of diversity, inclusion and gender pay gap performance in the EU's banking sector. According to the EBA, enforcing the rules will not only make firms more equitable, but also safer by combating groupthink. The European Central Bank (**ECB**) acting in its role at the helm of the Single Supervisory Mechanism (**SSM**) of the EU's Banking Union has long agreed with that approach and has thus embedded a focus on how Banking Union supervised institutions (**BUSIs**) deliver on the EBA's previous findings and reports as part of the ECB-SSM's supervisory focus on BUSIs' governance.

Following the disruption and pauses on reform efforts caused by COVID-19, the EBA's 2023 Report is likely to reinforce this focus of ECB-SSM supervisory scrutiny as well as efforts of NCAs across the wider EU. The EBA's 2023 Report is clear that it will hold NCAs to account in particular to check whether supervised firms' (banks but also other types) remuneration strategies are gender neutral as prescribed and has not ruled out applying more capital requirements and corporate limitations on supervised firms that fail to comply.

Key findings in the 2023 Report

Building on the obligations in the CRD and other requirements in force since 2014, the EBA together with the European Securities and Markets Authority (**ESMA**) have enshrined diversity and inclusion and notably gender balance in its "Joint ESMA and EBA Guidelines on the Assessment of the Suitability of Members of the Management Body" (the **Joint Guidelines**) and NCAs have had to apply these throughout the EU from 30 June 2018.

Those Joint Guidelines provided additional clarification and signalled the direction regarding the EBA's diversity policy expectations, including that supervised institutions' diversity policies should address at least: (1) educational and professional background; (2) gender; (3) age; and (4) geographical provenance, particularly for institutions with international operations. Consistent with sound diversity strategy and the principle of good governance practice as an effective means of advancing diversity objectives, the Joint Guidelines specifically state that supervised institutions' diversity policies should include quantitative targets for gender representation, a timeframe for meeting the targets set, and a methodology for meeting the specified targets. Those Joint Guidelines have subsequently been reinforced, at least within the Banking Union, by the ECB-own SSM's Guidelines and supervisory expectations on diversity in management functions.

In a stark warning, the 2023 Report detailed the excruciatingly sluggish progress made by banks and investment firms in boosting the diversity of their top management teams and supervisory boards, which are still nearly 75% male and pay males more than women for their services. Acceptance of the policies to meet the requirements first introduced in 2014 and reinforced by the Joint Guidelines and ECB-SSM supervisory expectations was identified as higher among larger institutions, with 94% compliance among a group primarily consisted of large banks. However, the EBA criticised that group's approach to setting mandated targets, finding that almost 40% had set "extremely low" goals, including some that aimed to less than 25% female presence on boards.

As part of its 2023 Report, the EBA highlighted that it had assessed the adequacy of average age-demography of the board, its education and professional background and geographical origins as well as the (lack of) diversity that this brings to the decision-making process. The distribution of directors in different age categories, which varies widely across Member States, has not changed significantly since the EBA's previous review and 2020 Report. Yet, according to 2015 data, the proportion of non-executive directors over the age of 60 has consistently climbed in keeping with the EU's demographic development and rising life expectancy.

Despite the increasing relevance of information and communication technology in the financial services sector, the EBA found there is insufficient coverage of these sectors within management bodies; just 6% of directors have such a background, and they are mostly concentrated in major institutions.

In terms of geographical provenance, the EBA found that the data gathered demonstrates that a relatively high percentage of institutions have geographical business activities that do not fully match the geographical

[3] See in particular the 3 February 2020 report using data from September 2018 (available here) and an earlier inaugural report dated 8 July 2016 (available here).

provenance of the directors, with slightly better coverage in the supervisory function than in the management function of the management body.

The EBA's conclusions in the 2023 Report reminded NCAs and thus also all supervised institutions and not just those required to provide data that further improvements of gender balance and, more in general, of the diversity at institutions management bodies are needed. Hence, further work by institutions and NCAs is needed to overcome the identified shortcomings.

The EBA reminded quite strongly that all institutions must adopt a diversity policy and many need to improve the gender diversity of their boards in the short to medium term, including through the setting of appropriate gender balance targets. Other aspects of diversity, e.g., regarding the educational or professional background, were highlighted by the EBA as warranting further improvement in particular in the context of larger boards.

The EBA also stated in the 2023 Report that it is important that NCAs review institutions' diversity policies and their implementation, including the recruitment processes for members of the management body and take appropriate measures where shortcomings are identified, e.g., in the context of the supervisory review and evaluation process or of the assessment of fitness and propriety of members of management bodies. The EBA also indicated that it will continue to monitor diversity in management bodies and issue periodical benchmark studies on diversity and on the gender pay gap at the level of the management body.

Outlook

It is anticipated that the ECB-SSM will also embed these findings and key messages in the discharge of its own SSM duties vis-à-vis directly supervised BUSIs as well as, together with NCAs, with indirectly supervised BUSIs. It remains to be seen if the EBA's sister authorities (ESMA partly but the European Insurance and Occupational Pensions Authority perhaps more pressingly) will look to also drive forward similar dialogue with NCAs as that being pushed forward by the EBA and ultimately the ECB-SSM. Other supervisory authorities in the EU and elsewhere may opt to follow suit if they are working within their own institutional and legislative responsibilities.

As we approach a more stringent enforcement period following the end of COVID-19, it will be interesting to see how the EBA (and NCAs across the EU-27, as well as the ECB-SSM in the case of Banking Union) will translate the key findings into actual supervisory monitoring and enforcement (and at what point - i.e. at authorisation/approval or equally also during on-going supervision). This is in particular the case in situations at supervised firms where there are gaps in what has been documented by a supervised firm in diversity policies and associated governance policies and practices but perhaps not fully delivered into and across the workplace including post-authorisation and/or post-approval of a candidate. The EBA clearly indicated that NCAs should do both i.e. in the context of the supervisory review and evaluation process (SREP) or the assessment of fitness and propriety of members of management bodies.[4]

The ECB-SSM has committed to using various desk-based and on-site inspection instruments to examine firms' compliance and governance performance as part of its 2023-2025 Supervisory Priorities applicable to both ECB-SSM directly as well as indirectly supervised BUSIs. Adequate decision making, as well as diversity and inclusion, are likely to be considered more prominently in these assessments focusing on governance, especially given the more challenging "polycrisis" world in which supervised firms now operate in over the next supervisory cycles.

What ought to be clear for supervised firms is that this is the third time the EBA has published a disappointing scorecard on the bulk of the industry's efforts. Now is the time to act. The problem, which perhaps the EBA does not sufficiently address in the 2023 Report and previous iterations is that a more diversified pool of potential candidates for positions may not be readily available in all EU-27 Member States which also suggests that supervised firms will need to redouble their efforts on internal training to facilitate organic growth within existing ranks.

The execution and implementation of an effective diversity strategy is complex, necessitating the collaboration of experts from various disciplines, as well as a new understanding and appreciation of the intersection of regulatory law, corporate governance, and compliance practices on the one hand, and diversity and inclusion as a specialised discipline on the other. As a result, firms will want to take note of the 2023 Report and respond, especially as competition for core employees and fresh prospects heats up, while they face more supervisory scrutiny.

[4] See periodic updated coverage from our EU RegCORE on both those two supervisory tools and processes available here.

Firms, with the assistance of regulatory compliance and governance counsel who are familiar with best practises in diversity and inclusion, may want to consider forming a taskforce to assess the current state of compliance and identify avenues to advance change and enhance compliance through effective governance practises and human capital initiatives.

About us

PwC Legal is assisting a number of financial services firms and market participants in forward planning for changes stemming from these developments.

We wish all of our readers a happy International Women's Day 2023 and are very proud that in addition to being unique in our multijurisdictional qualifications and legal expertise we are one of the few teams of financial services lawyers in Germany that includes 75% female and more than 35% multicultural colleagues.

If you would like to discuss any of the developments mentioned above, or how they may affect your business more generally, please contact any of our key contacts or PwC Legal's RegCORE Team via de_regcore@pwc.com or website.

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