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Impact and influence

Raising awareness of diversity and inclusion in financial services

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“Diversity and inclusion influence everything we do—how we recruit, train, and grow our people, orchestrate the delivery of our work, engage in corporate citizenship, and build public trust.”

– Lynne Doughtie, U.S. Chairman & CEO, KPMG

Diversity and inclusion are now critical to accountability and transparency

New diversity and inclusion standards will drive financial services organizations to enhance internal and third-party compliance practices to integrate new diversity and inclusion policies, metrics and reporting. As part of the changing regulatory environment and ongoing reform of the financial sector, six[1] financial regulators recently issued Joint Standards that financial services firms may follow to assess, report and publicize their diversity and inclusion efforts.[2] The new diversity and inclusion reporting is part of a larger move toward increased transparency within the financial services industry and growing pressure for board members and senior management to lead their organizations in cultural change. The U.S. action also comes amid a global trend toward legislating diversity and inclusion requirements in the financial services industry.

Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or Dodd-Frank Act) required covered[3] regulatory agencies to establish individual Offices of Minority and Women Inclusion (OMWI) to increase diversity and inclusion within each agency and to develop standards for assessing the diversity and inclusion policies and practices of the firms they regulate. Accordingly, six of these agencies published a joint policy statement in June 2015 outlining standards the agencies will use for assessing the diversity and inclusion programs related to the U.S. operations of the entities they regulate as well as in the service providers of those entities. The standards became effective when published, and regulated entities should anticipate reviews of their programs to be forthcoming.

Although the standards are voluntary,[4] the agencies note that financial organizations with "successful diversity policies" will assess their diversity and inclusion policies and practices on at least an annual basis, provide that information to their primary federal financial regulator, and publicize it on their website. The Joint Standards do not specify the content or format of the information, and the agencies sought input on the collection of information in a second notice released in November.[5] The Joint Standards leave it to individual organizations—taking into account their "size and other characteristics"—to determine what information to report and how to report it. They also allow individual organizations to define key terms. For example, the use of the term "diversity" in the Joint Standards is consistent with the Dodd-Frank Section 342 definition in its reference to minorities and women, but the standards allow organizations to use a broader definition of "minority."[6] Also, the term "inclusion" refers to a work environment that "values individual similarities and differences," a definition that invites broad interpretation.[7]

> **"The new standards will help drive diversity and inclusion at financial services organizations. For companies that do not have a framework in place, they can use the standards as a starting point to help guide the implementation of a program. For those that have a program in place, the standards are a good measurement tool."**
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> – Kelly McNamara Corley, Executive Vice President, General Counsel and Secretary of Discover Financial Services

[1] The six agencies that participated in the Joint Standards are the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Consumer Financial Protection Bureau (CFPB), Securities and Exchange Commission (SEC).

[2] Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, Federal Register, vol. 80, no. 111, June 10, 2015.

[3] The covered agencies are the Departmental Offices of the Department of the Treasury, FDIC, Federal Housing Finance Agency, Federal Reserve banks, Federal Reserve Board, NCUA, OCC, SEC, and CFPB.

[4] The agencies state that "[t]his document is a general statement of policy under the Administrative Procedure Act, 5 U.S.C. 553. It does not create new legal obligations. Use of the Standards by a regulated entity is voluntary. The Agencies will not use their examination or supervisory processes in connection with these Standards."

[5] Agency Information Collection; Submission for OMB Review; Joint Comment Request; Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies, Federal Register, vol. 80, no. 215, Nov. 6, 2015. The agencies sought input on the necessity of the information collection, accuracy of the estimated burden on regulated entities, how to enhance the quality and usefulness of the information, how to minimize the information collection burden, estimates of start-up and operational costs of maintenance and purchase of services to provide information.

[6] Section 342 defines "minority" as "Black Americans, Native Americans, Hispanic Americans, and Asian Americans."

[7] The agencies define "inclusion" as "a process to create and maintain a positive work environment that values individual similarities and differences, so that all can reach their potential and maximize their contributions to an organization."

The under-representation of women and minorities

While women lead half of the six U.S. agencies that issued the Joint Standards,[9] the number of women and minorities in senior management positions in the industry, agencies, and Federal Reserve Banks did not change substantially between 2007 and 2011, according to a 2013 report from the U.S. Government Accountability Office (GAO).[10] The GAO found that in 2011 minorities still held only about 11 percent of senior-level management positions and about 20 percent of lower-level management positions, while women in overall management remained at about 45 percent.[11] The 30% Club, an organization launched in the UK to promote women on corporate boards, found that women held only 19.2 percent of positions on S&P 500 boards.[12]

Kelly McNamara Corley, Executive Vice President, General Counsel and Secretary at Discover Financial Services, noted that the standards provide uniform guidance on diversity-related programs while also recognizing that diversity and inclusion should be tailored to each firm's particular characteristics. "The new standards will help drive diversity and inclusion at financial services organizations," McNamara Corley said. "For companies that do not have a framework in place, they can use the standards as a starting point to help guide the implementation of a program," she said. "For those that have a program in place, the standards are a good measurement tool."

Federal agencies in financial services must evaluate their own programs consistent with the requirements in Dodd-Frank Section 342. Notably, the Consumer Financial Protection Bureau (CFPB) issued a strategic plan that is broader than the Joint Standards and has more specific requirements.[8]

As the regulators supervise individual companies—in areas such as governance and culture, overall management compliance, and fairness principles—they may evaluate diversity and inclusion practices as well as look to identify diversity and inclusion trends and leading industry initiatives. While the Joint Standards are a set of recommended practices, failing to adhere to them could increase reputational risk at a time when many firms are under regulatory and public scrutiny with respect to culture and business conduct.

What agency heads are saying

"As an employer, the Fed is very serious about meeting its obligation to provide equal opportunity, and I also believe that diversity makes the Fed more effective in carrying out its mission..."

– Janet Yellen, Speech at the National Summit on Diversity in the Economics Profession, October 30, 2014

"Let us be clear at the outset, this is not a pipeline issue. We [women] are here—in numbers, and we are qualified—in numbers. And yet, there are comparatively very few of us in corporate boardrooms—17.5 percent in FORTUNE1000 companies and 19.2 percent for the S&P 500."

– Mary Jo White, Chair of the SEC, Keynote Remarks at the Women's Forum of New York Breakfast of Corporate Champions: "The Pursuit of Gender Parity in the American Boardroom," November 19, 2015

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8 CFPB Diversity and Inclusion Strategic Plan 2016-2020, Consumer Financial Protection Bureau, October 2016.

9 Janet Yellen, Chair of the Board of Governors of the Federal Reserve System, Mary Jo White, Chair of the SEC, Debbie Matz, Chair of the NCUA.

10 Diversity Management: Trends and Practices in the Financial Services Industry and Agencies after the Recent Financial Crisis, U.S. Government Accounting Office, April 2013, GAO-13-238.

11 GAO-13-238, p 1.

12 30% Club (http://30percentclub.org/). The 30% Club, founded in 2010, established its U.S. chapter in 2014.

The importance of self-assessments

Self-assessments are the centerpiece of the recommendations in the Joint Standards. Financial services organizations should establish and conduct ongoing self-assessments to determine what improvements are needed based on the four main categories in the Joint Standards: (1) organizational commitment to diversity and inclusion; (2) workforce profile and employment practices; (3) procurement and business practices; and (4) transparency.

1. **Organizational commitment to diversity and inclusion:** The Joint Standards state that an organization with "successful diversity policies and practices" has leadership that "demonstrates its commitment to diversity and inclusion." Senior management and the board should both approve and support the diversity and inclusion policies, receive regular updates on the policies, and ensure that the employees receive regular training and educational opportunities. The standards also recommend that a senior level officer with dedicated resources oversee the organization's diversity and inclusion efforts.[13] An organization's commitment to diversity will be reflected in the pool of candidates considered for hiring, recruiting, retention, and promotion, as well as in the selection of board members, senior management, and other senior leadership positions.
2. **Workforce profile and employment practices:** The standards anticipate that an organization will actively work to create diverse applicant pools for internal and external opportunities. This may include outreach to minority and women organizations and educational institutions as well as participation in events to attract minority candidates. Organizations with "successful diversity and inclusion programs" will regularly evaluate their programs and identify areas to be improved, including the use of both quantitative and qualitative measurements to assess workforce diversity and inclusion efforts. They will also hold management at all levels accountable for implementation of the policies, "for example, by ensuring that such efforts align with business strategies and individual performance plans."[14]
3. **Procurement and business practices—supplier diversity:** Supplier diversity should be a part of an organization's diversity and inclusion policies, and bids for all types of third-party contracts should actively solicit a broad and diverse applicant pool. As with employment practices, methods and metrics will aid in evaluating the effectiveness of a supplier diversity program, including measures such as the share of procurement spending awarded to contractors and sub-contractors by race, ethnicity and gender. As part of this policy, the organization should also promote a diverse supplier pool through various outreach efforts.[15]
4. **Practices to promote transparency of organizational diversity and inclusion:** The Joint Standards emphasize transparency in an organization's diversity and inclusion activities through publication of information related to its diversity and inclusion strategy and policy, data on its progress toward its goals, and promotion of diversity through employment and procurement opportunities. These opportunities may include current and potential employment and procurement opportunities as well as mentorships and developmental programs for employees and contractors.[16]

Self-assessments will help financial services firms become aware of how their own practices compare to leading practices in the industry and provide benefits beyond meeting regulatory expectations. "This self-awareness is critical to driving diversity and inclusion at the personal, team and institutional levels," said Amy Matsuo, National Leader of KPMG's Regulatory Risk Practice. "Financial services organizations that truly make a commitment to ongoing self-assessments and change will not only recognize enhancements to both internal and third-party compliance, but will strengthen their culture and brand."

[13] Final Interagency Policy Statement, p. 33023.

[14] Ibid.

[15] Ibid., p. 33023-33024.

[16] Ibid., p. 33024.

Meeting regulatory expectations in diversity and inclusion

Underlying the four main categories of the Joint Standards is a focus on holding the board and senior management accountable for diversity and inclusion efforts. Leadership in these organizations should include the Joint Standards as part of an approach to drive greater accountability and transparency and adapt their current efforts to these new recommendations.

Diversity and inclusion initiatives should demonstrate steps toward transforming culture, developing and improving data and metrics on workforce profile and employment practices, and improving supplier and third-party diversity through supplier risk management frameworks.

Promoting cultural transformation: The Joint Standards state the need to "foster[] a corporate culture that embraces diversity and inclusion."[17] Regulators have come to view the culture of the financial services industry as the root cause of market misconduct and are looking for boards and senior management to push organizations toward cultural change.[18] As part of their firm's self-assessment, leadership should evaluate the organization's culture to determine if it reflects diversity and inclusion policies and if the stated values, goals and expectations related to diversity and inclusion should be strengthened.

Leadership can also promote a change in corporate culture through policies aimed at recruiting and employee development. Analyzing applicant data is part of the CFPB plan to develop strategies to maximize recruiting from a diverse pool of applicants. This recruiting plan also includes partnerships with educational institutions and organizations, the involvement of management in recruiting efforts, and the development of flexible staffing policies to attract more diverse applicants. Following CFPB guidelines, organizations should also implement leadership development programs that focus on diversity and inclusion, enhance mentoring and training programs at all levels, and develop a succession planning process that promotes diversity in senior positions.

[17] Ibid., p. 33023.

[18] See *Approaching the Crossroads of Conduct and Culture: Improving culture in the financial services industry*, KPMG, 2015.

Overall, developing a corporate culture that embraces diversity and inclusion requires a firm to demonstrate the values of integrity, trust and respect while keeping the customer's best interests at the center of its business model. Indictors of a "good culture" include:[19]

- **Focus on the customer** – Doing what is "right" (i.e., right price, right allocation, equal treatment) and keeping the customer's best interests at the heart of the business model.
- **Tone from the top** – The board and senior management set the core values and expectations for the firm, and their behavior is consistent with those values and expectations.
- **Accountability** – All employees know the core values and expectations as well as that consequences for failure to uphold them will be enforced.
- **Effective challenge** – At all levels, decision making considers a range of views, practices are tested, and open discussion is encouraged.
- **Incentives** – Financial and nonfinancial compensation rewards behaviors that support the core values and expectations.

"Having a successful global diversity and inclusion strategy promotes a strong culture within the organization," said Deborah Bailey, National Leader for Risk Culture in KPMG's Regulatory Risk Practice. "It could also be a competitive advantage in attracting and retaining top talent, stronger relationships with global partners and customers, improved morale, and better utilization and leveraging of strengths and skills across the firm."

[19] Ibid., p. 4.

Developing data and metrics on workforce profile and employment practices: The Joint Standards state that an organization should use both quantitative and qualitative measurements in its self-assessment(s).[20] While organizations already subject to the recordkeeping and reporting requirements of the Equal Employment Opportunity Commission (EEOC) and the Office of Federal Contract Compliance Programs can use this information as part of their self-assessment,[21] firms that are not subject to these requirements may not have this data readily available. Given the lack of uniform metrics to assess diversity and inclusion practices, organizations will need to develop diversity and inclusion metrics to evaluate their efforts. For example, diversity and inclusion metrics could include demographic data, hiring and promotion data, complaint and grievance data, and employee surveys.

The CFPB has noted that data and metrics should be used in performance measurements for executives, senior officials, managers, supervisors, and employees to ensure the proper execution of the organization's diversity and inclusion strategy. This can involve developing a diversity and inclusion dashboard as a management tool for workforce planning and reporting and establishing processes to ensure timely reporting. Performance metrics should also include measures for the organization to refine its annual strategic goals at the business-unit level.

Improving supplier diversity through supplier risk management frameworks: The Joint Standards discuss the need for an organization's supplier diversity policy that "provides for a fair opportunity" for women and minorities in supplier selection for all types of contracts as well as in evaluating the suppliers themselves.[22] Because the financial services industry has moved toward an increasing use of third-party providers, it is critical for organizations to have third parties that support their diversity and inclusion efforts.[23] Financial services organizations should enhance existing supplier risk management frameworks to incorporate their supplier diversity policy and be able to demonstrate to their regulators that they are considering a broad and diverse pool of third-party suppliers and contractors.

Additionally, risk management principles could be adapted to evaluate the diversity and inclusion practices of the third parties themselves. For example, the OCC[24] and the Federal Reserve[25] have provided principles-based guidance for reassessing third-party relationships. Notably, the OCC's guidance includes risk reporting to boards on third-party relationships. This effectively integrates third parties into an organization's enterprise risk management (ERM) and compliance framework. The Federal Reserve's guidance is intended to address the characteristics, governance and operational effectiveness of a financial institution's service provider risk management program for outsourced activities that are beyond traditional core bank processing and information technology services.

> **"Despite the intense focus in recent years, we have not seen nearly enough progress in the boardroom for women or minorities. The number of women on U.S. boards of S&P 500 companies has, for example, increased only four percent over the past five years. To be sure, 19.2 percent represents an impressive increase from 1.8 percent in 1981. But it does not begin to approach parity and the U.S. also lags behind many other developed countries."**
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> – Mary Jo White, Chair of the SEC, Keynote Remarks at the Women's Forum of New York Breakfast of Corporate Champions, November 19, 2015

[20] Final Interagency Policy Statement, p. 33023.

[21] Ibid.

[22] Ibid., p. 33024.

[23] See *The New Third-Party Oversight Framework: Trust but Verify*, KPMG, 2014.

[24] OCC Bulletin 2013-29, Third-Party Relationships: Risk Management Guidance, October 30, 2013.

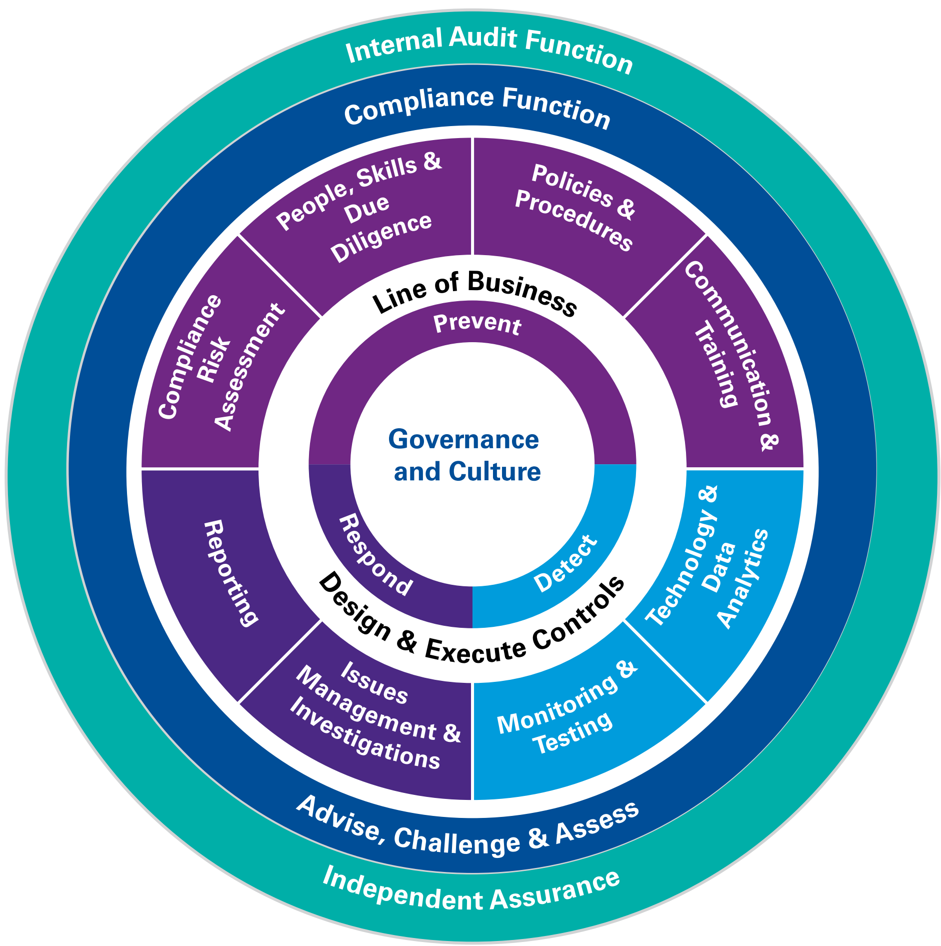
[25] Supervision and Regulation Letter 13-21, Guidance on Managing Outsourcing Risk, December 5, 2013

Three lines of defense to improve accountability and transparency

As part of ongoing enhancements to compliance programs and practices, the strengthening of diversity and inclusion efforts can help demonstrate an organization's compliance governance and culture. The organization's diversity and inclusion self-assessments then tie to the core elements of a compliance framework, which includes eight key elements that drive prevention, detection and response, with governance and culture at the core.

- Compliance risk assessment
- People, skills & due diligence
- Policies & procedures
- Communication & training
- Technology & data analytics
- Monitoring & testing
- Issues management & investigations
- Reporting

In line with the focus on leadership accountability in the Joint Standards, compliance accountability starts with board and management support for a strong compliance culture that reaches across the traditional three lines of defense. The three lines of defense model provides a framework for governance and assurance by defining roles and responsibilities across the organization. In this model, the first line of defense is the business responsible for complying with processes and procedures. The second line is the compliance function that establishes, implements, and oversees the policies and procedures, and the third line provides independent and objective assurance that processes are adequate and appropriate. This model allows an organization to assess and improve its diversity and inclusion efforts on an enterprise-wide basis.



Conclusion: Staying ahead of a growing global issue

The Joint Standards promote diversity and inclusion practices that include a strategic plan and policy; broad application that includes the board, management, employees, and suppliers; and regular reporting, training, and outreach efforts. They also envision leadership from the board and senior management in assessing and improving an organization's diversity and inclusion policies. This represents a change in the industry that places diversity and inclusion as part of a holistic and integrated approach to increasing accountability and transparency. "Diversity and inclusion are important in all aspects of business—benefitting employees, clients and shareholders," said Jacqueline LiCalzi, Managing Director and Global Head of Regulatory Relations at Morgan Stanley. "It is all of our responsibility to make a more diverse and inclusive workforce and environment a reality at our companies and across the industry."

The reporting of the industry's diversity and inclusion practices is intended to raise awareness among organizations in order to stimulate a reassessment of current practices. The voluntary nature of the Joint Standards was itself a source of criticism from some regulators who thought the standards "failed to take meaningful steps to advance diversity and inclusion in the financial services industry."[26] Nonetheless, with the current focus on culture in the financial services industry, there is a question as to how regulatory agencies will use diversity and inclusion metrics as an indicator of other issues that fall under their supervisory and enforcement authorities.

Perhaps most significantly, diversity and inclusion efforts are taking on a global dimension [see page 9]. While the Joint Standards have not set specific requirements as have other jurisdictional regulations, leading financial services organizations with a global footprint could already have experience in this area.

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– Jacqueline LiCalzi, Managing Director and Global Head of Regulatory Relations at Morgan Stanley

[26] See, e.g., Commissioner Luis A. Aguilar, "Dissenting Statement on the Final Interagency Policy Statement: Failing to Advance Diversity and Inclusion," U.S. Securities and Exchange Commission, June 9, 2015, http://www.sec.gov/news/statement/dissent-interagency-policy-statement-diversity.html.

A move toward global minimums for women on corporate boards

The focus on diversity and inclusion is part of a global push toward achieving minimum representation for women on corporate boards. The European Union has considered measures to mandate a 40 percent minimum for women on corporate boards.[27] Germany recently adopted a law that requires 100 of its top companies to reserve 30 percent of board seats to women starting in 2016.[28] Norway, Spain, France, and Iceland all have 40 percent minimum requirements for women on corporate boards; Italy has a one-third quota; Belgium has a 30 percent quota; and the Netherlands has a nonbinding 30 percent target.[29] In the UK, voluntary efforts have shown progress, as the share of women on FTSE-100 boards has risen from 12.5 percent to 26.1 percent since 2011, according to the *Davies Review*.[30] The British Bankers' Association stated that banks in the UK are taking diversity and inclusion very seriously.[31] The BBA also noted that diversity is more likely when there is accountability for these efforts.[32] Globally, research by KPMG (UK), in collaboration with YSC and the 30% Club, shows significant differences in how the move toward diversity and inclusion is progressing in other regions, including China, Africa, Latin America, Australia, India, and the Middle East.[33]

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27 Alison Smale & Claire Cain Miller, "Germany Sets Gender Quota in Boardrooms," *New York Times*, March 6, 2015

28 Ibid.

29 Ibid.

30 *Improving the Gender Balance on British Boards*, Women on Boards Davies Review Five Year Summary, October 2015.

31 *Diversity and Inclusion in Banking*, BBA, November 2015, p. 4.

32 Ibid., p. 46.

32 KPMG (UK), YSC, & 30% Club, View from the Top: How CEOs are *Cracking the Code on Gender and Diversity within Multinational Organizations*, 2016, p. 6-9.

Amy Matsuo

National Leader

Financial Services Regulatory Risk Practice

Amy Matsuo is a leader in advising financial services firms on regulatory risk as well as in promoting diversity and inclusion at KPMG. As the national leader of KPMG's Regulatory Risk Practice, she leads a group that advises companies on compliance, consumer protection, capital markets and asset management regulation, and safety and soundness. She also leads a cross-functional and cross-industry initiative for compliance transformation. She is a member of KPMG's Network of Women (KNOW) and Women's Advisory Board. In 2014, she received the Women Leaders in Consulting Award for client service.

Deborah Bailey

National Leader for Risk Culture

Financial Services Regulatory Risk Practice

Deborah Bailey is a leader in promoting cultural transformation in the banking industry. She is a Managing Director and the leader of Risk Culture for financial services companies in KPMG's Regulatory Risk Practice, where she advises both domestic and foreign banks on regulatory issues relating to compliance, governance and risk management, and capital adequacy. Previously, she was a deputy director of the Division of Banking Supervision and Regulation at the Board of Governors of the Federal Reserve. In this position, she led policy development around key areas of regulatory governance and risk management and led the 2009 Supervisory Capital Assessment Program for the 19 largest U.S. bank holding companies. She also served at the Office of the Comptroller of Currency.

Contact us

For further information, please contact:

Amy Matsuo
Principal and National Lead
Financial Services Regulatory
Risk Practice
T: 919-380-1509
E: amatsuo@kpmg.com

Deborah Bailey
Managing Director
Risk Culture Lead
Financial Services Regulatory
Risk Practice
T: 212-954-8097
E: dpbailey@kpmg.com

kpmg.com/socialmedia

kpmg.com/app