PAY EQUITY IN FINANCIAL SERVICES

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Pay equity is a hot topic again. Mercer's recent "When Women Thrive"[1] research has shown a link between pay equity and greater gender diversity. Moreover, regulators are showing renewed interest in the topic. Firms that do not choose to address the issue as part of their gender diversity strategy may find they are forced to as a matter of law.

The risk is substantial in financial services. According to a recent study[2], the gender pay gap for women in the United States is 7.2 percent in the insurance industry and 6.4 percent in the finance industry, after accounting for factors such as age, education, experience, location, occupation, job title, and company. These gaps are among the highest for the industries examined in the study.

Recent pay equity laws aim to speed up change by making it easier for plaintiffs to sue successfully and by raising awareness of disparities through the compulsory reporting of pay data. The California Fair Pay Act of 2015 is probably the best example of a law that strengthens the ability of plaintiffs to successfully sue for pay discrimination. Under this law, the definition of a relevant employee pool for comparison has been broadened to include employees performing substantially similar work based on a composite of skill, effort, and responsibility. Analyses cannot be limited to people doing the specific job of the complainant. In other words, the principle of "equal pay for equal work" is no longer interpreted as equal pay for the same work but as equal for substantially similar work.

Earlier this year President Obama announced several federal legislative actions to advance equal pay. Among them is a proposed requirement for all employers with 100 or more employees to report summary data on wages paid. The UK government has put forward similar reporting requirements. This trend towards more aggressive regulation of pay equity, coupled with evidence linking pay equity to better gender balance, is a stern call to action for employers in financial services firms. More specifically, it is a call to four actions, which we describe below.

1. CONDUCT PAY EQUITY ANALYSIS

Assess internal pay equity on a regular basis – at least annually. Focus on total compensation, given that significant bonuses are often paid in financial services.

In doing this analysis, do not take a simple average-pay-by-group approach. High-level tests, such as those that consider differences in averages, can produce false negatives (no issue is identified when there is one) and false positives (an issue is identified when one is not there). We recommend a robust statistical approach, such as multiple regression, to ensure that legitimate differences in pay – job-related skills, performance, experience, education, and so on – are accounted for in the assessment.

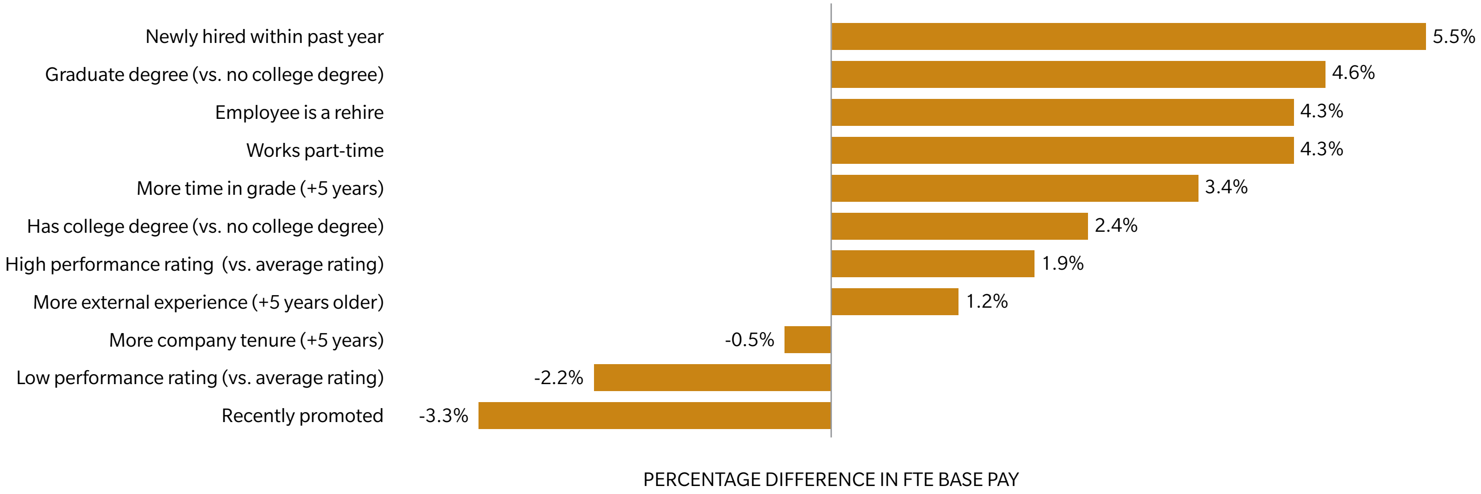
These analyses must take account of performance ratings. While some might argue that performance ratings could be tainted by discrimination, failure to account for them is likely to bias regression results. In our experience, it is common in financial services for women to receive higher ratings than men but lower levels of pay associated with those ratings. Unconsciously or not, there are managers who appear to provide more positive feedback to women while they award greater compensation to men. We recommend a separate examination of inequities in performance ratings and consideration of appropriate counters if inequities are found. These might include supervisory training or formalizing the link between performance scores and pay.

In addition to revealing pay gaps for groups protected under anti-discrimination legislation, a regression analysis may also reveal strategic issues related to pay and what your organization rewards. Excessive rewards for risk-taking activities can be harmful to the long term viability of a financial institution, as can too strong a link between pay and years on the job. Having data available to track these relationships allows a firm to tell whether its "pay philosophy" is being realized in practice. For example, Exhibit 1 shows a regression analysis, with the primary drivers

1 *When Women Thrive,* Mercer, 2016

2 Andrew Chamberlain, *Demystifying the Gender Pay Gap: Evidence from Glassdoor Salary Data*, Glassdoor, 2016

EXHIBIT 1: MULTIPLE REGRESSION ANALYSIS SHOWING DRIVERS OF PAY FOR A FINANCIAL SERVICES ORGANIZATION



Source: Mercer (disguised client case)
Note: Analysis also accounts for job and location (results not shown)

of pay enumerated for one financial services organization. This organization was paying relatively large premiums to new hires, resulting in a negative "return to tenure" for longer tenured employees. Whether this situation is optimal depends on whether the company's talent strategy is focused on building talent or buying talent.

Using a robust statistical approach to examine pay equity will enable financial institutions to spend their limited compensation dollars wisely by pinpointing the units and individuals with unexplained pay gaps. Recent research shows that only 35 percent of organizations have a pay equity process that is built on a robust statistical approach.[3]

2. REVIEW YOUR JOB STRUCTURE

As part of a robust statistical approach, ensure that employees can be grouped into meaningful pools for comparison purposes – not too narrow and not too broad. The provisions in the California Fair Pay Act are arguably vague (for example, in defining what is "similar"), but are a good starting point. We believe that few states and courts will continue to uphold a narrow "equal work" stance when evaluating pay gaps; a general relaxation of this standard towards California's "substantially similar work" is likely to occur. Moreover, clear delineations of skill requirements related to a job, as well as associated responsibilities, will help organizations ensure that pay for a specific job is driven by the requirements of the job and not by its gender composition.

3 *When Women Thrive*, Mercer, 2016

3. IMPLEMENT FORMAL REMEDIATION PROCESSES

Dedicate a team to assessing pay equity and implementing a formal remediation process. This team should conduct (or oversee) the pay equity assessment, identify groups with unexplained pay gaps, conduct targeted research on specific employees potentially requiring a pay adjustment, document explanations for making or not making adjustments, and ensure that adjustments are being made. Recent research shows that having a team responsible for pay equity, coupled with a process that relies on a robust statistical approach, is linked to improved gender-diversity outcomes. When evaluating incentive payouts, consider whether or not proposed payouts can be assessed before they are made.

4. BUILD AWARENESS AND CORRECT POLICIES THAT DRIVE INEQUITY

To help prevent pay gaps from re-emerging, we recommend that organizations reduce their reliance on salary history when setting starting pay for new hires – a practice which can import a gap from a prior employer. Firms should also rely less on negotiations in setting starting pay, as women are often cited to negotiate less aggressively. Where possible, set entry-level pay rates to the job, not the person. Employers should also ensure that employees taking leave are not inadvertently penalized on pay when they return to work. In financial services, we've seen that pay differences driven by a past leave of absence can persist indefinitely.

Ultimately, the most powerful strategy is to consider the strengths of women and ensure that these are associated with commensurate pay and opportunity. Since pay differences within job titles or even substantially similar jobs are dwarfed by differences in pay that occur as women and men progress at different rates, it's important to look at pay practices through a broad lens.

Achieving pay equity may not be easy, but financial services organizations can and must rise to the challenge.

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