CASTING A WIDER NET:

Increasing opportunities for minority and women owned asset managers in institutional investments

2016

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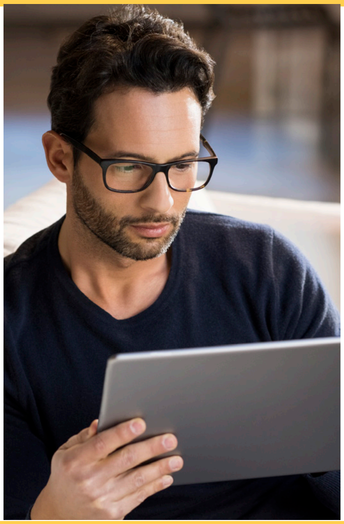


This report is available online at www.seiu.org/diversity

ABOUT THE AUTHORS

The ReFund America Project

The ReFund America Project tackles the ongoing impact the financial crisis has had on the financial health of America's cities and states and provides a dedicated campaign team to help local organizations restore the balance of economic power from Wall Street to Main Street.

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The Roosevelt Institute reimagines America as it should be: a place where hard work is rewarded, everyone participates, and everyone enjoys a fair share of our collective prosperity. We believe that when rules work against this vision, it's our responsibility to recreate them.

We bring together thousands of thinkers and doers—from a new generation of leaders in every state to Nobel laureate economists—working to redefine the rules that guide our social and economic realities. We rethink and reshape everything from local policy to federal legislation, orienting toward a new economic and political system: one built by many for the good of all.

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SEIU is an organization of 2 million members united by the belief in the dignity and worth of workers and the services they provide, dedicated to improving the lives of workers and their families, and creating a more just and humane society. These members participate in more than 50 state, county and municipal pension funds and 19 private Taft-Hartley funds with more than $1 trillion in assets. SEIU is deeply committed to ensuring the pension funds in which our members participate meet their fiduciary obligations to provide retirement benefits to plan participants.

The SEIU Capital Stewardship Program was created to facilitate a more active partnership between SEIU and the trustees, administrators, advisers and investment managers of our members' pension savings in the pursuit of prudent, responsible and financially sound investment policies.

Report Author: Talia L. Schank

EXECUTIVE SUMMARY

In recent years, concern about the need for greater representation and inclusion of racial and ethnic minorities has been growing in major institutions in the United States, from police departments to Hollywood studios to corporate boardrooms. This concern has now reached the capital markets, where various individuals and organizations are highlighting the issue in terms of the bottom line: research shows diverse representation in the boardroom leads to improved corporate performance.[1] On the flip side, the lack of diversity limits the talent pool of skilled people who can manage members' assets and leaves potential returns on the table. It also increases the likelihood of missing opportunities in an increasingly global, diverse world, and ignores the rapidly growing diversity of the country's—and world's—population.

This report focuses on the diversity conversation within the financial services industry and specifically on the role that investment consultants play in advancing financial performance through valuing diversity. The goal is to understand how investment consultants value diversity within their organization and how they advance diversity by recommending minority asset managers as solutions to the needs of large institutional investors.

Most pension funds hire consultants to help manage portfolios in accordance with their demands and needs. Pension funds ask consultants to introduce and evaluate asset managers, help develop investment policy statements and asset allocations, offer independent advice to boards, and essentially serve as an extension of the fund's investment office. This positions consultants as gatekeepers between pension funds and asset management firms, including those emerging firms led by women and racial and ethnic minorities. Emerging managers and minority-and women-owned business enterprises (MWBE) are newer and smaller asset managers where the majority of their ownership consists of minorities and/or women. Given this, consultants can play a critical role in promoting diversity in the financial sector if they choose to make it a priority—or if their clients insist that they do.

Significant Findings

To better understand how pension fund consultants are currently approaching diversity, the SEIU Capital Stewardship Program, which trains and advises pension fund trustees who serve on boards, surveyed investment consultants to gather data about their approach to racial diversity within their own firms and with the investment managers and opportunities they bring to clients. Fourteen of the 21 invited firms completed the survey. Nevertheless, this represents more than $1.3 trillion in assets under management, or 14 percent of the estimated $10 trillion assets under management that are professionally managed. The survey shows that:

- **There is a lack of diversity at major consulting firms.** On average, racial and ethnic minorities—especially African Americans and Latinos—are vastly underrepresented at consulting firms, especially at the management level. African American and Latino managers each represent approximately 4 percent of all management within the firms surveyed.
- **Most firms do not have systems in place to track, identify and endorse minority and emerging asset managers.** The survey asked each consultant about its policies and practices regarding outreach, recommendations and successful funding of emerging manager firms. A majority of the firms chose not to answer certain questions, gave vague and generalized responses, or responded that they did not track that information. Only five firms responding to the survey tracked the number of emerging managers that are ultimately funded.
- **Several themes emerged repeatedly when firms identified challenges to collecting data.** When asked about barriers to implementing robust emerging manager programs, many responses reflected commonly cited beliefs that consistently limit effective initiatives to promote these programs. For example, some believe that emerging managers underperform, while others put the onus on their clients, saying public pension funds simply do not value diversity as a priority. Neither of these beliefs is backed by current data.

We recommend several steps consultant firms can take to make an intentional, strategic commitment to programs that increase diversity—both diversity within their firms, and diversity of the asset managers they recommend. This commitment needs to come from firm leadership, and must be a core component of the firms' business model. Furthermore, it is vital that firms establish clear policies, processes, goals and measurable outcomes to create responsibility and accountability for the development and implementation of these programs.

This report aims to better understand the issues and opportunities regarding minority professionals working with institutional investments, either as consultants or asset managers. The findings of the survey, combined with our recommendations, can serve as a starting point for further research on diversifying the industry.

"...in communities across the country, changing demographics combined with stagnant wage disparities are galvanizing a new multinethnic workers movement to demand living wages, access to a union and reasonable benefits from their employers."

In the United States, several socio-economic trends are weaving together to impact low-income communities and the economy. First, in communities across the country, changing demographics combined with stagnant wage disparities are galvanizing a new multiethnic workers movement to demand living wages, access to a union and reasonable benefits from their employers. Simultaneously, in corporate boards, the C-Suite and among shareholders are being pressured to identify environmental, social and corporate governance risks and opportunities that will affect long-term returns. Both goals intersect at the need to be more inclusive in how companies consider marginalized communities and how diverse leaders are increasingly valued at the decision-making table. We believe when companies see diversity, equity and being inclusive as drivers of performance, both workers' livelihoods and their companies long-term financial performance will improve.

1. INTRODUCTION

Increasingly, the issue of greater diversity inclusion has been dominating traditionally underrepresented industries in the United States, from Hollywood to corporate America. This conversation is now alive in capital markets as various players and organizations seek to change the status quo and create a level playing field while reaping the benefits of addressing diversity and inclusion. A commitment to diversity is not only beneficial in principle: research on board and staff diversity shows a positive correlation of diverse representation in the boardroom with firm performance.[2] This research corresponds to general corporate commitments to diversity as the U.S. population grows increasingly diverse.[3] This commitment also extends throughout multiple industries, including finance. Diverse boards can enhance decision-making, broaden information networks, and increase creativity and innovation.

"Because investment consultants play a gatekeeping role in determining with which asset class managers pension funds do business, they are uniquely positioned to either promote or obstruct asset manager diversity."

As more investors prioritize racial, ethnic and gender diversity, questions arise regarding the pool of emerging managers and/or asset management firms that are minority- and women-owned business enterprises (MWBE) (see Appendix 1 for definitions of these terms). For the purposes of this report, we use the term "emerging managers" interchangeably with minority and women owned enterprises or diverse managers. As an important stakeholder in the arena of public pension funds, with more than 1 million members participating in these funds, the Service Employees International Union (SEIU) has long been a leader in advocating for greater diversity, equity and inclusion in the capital markets. SEIU's Capital Stewardship Program and its participation in the Diverse Asset Managers Initiative (DAMI) have highlighted the critical need for greater diversity in finance. Racial and ethnic minorities are severely underrepresented in this industry, and there is concern this will impact the long-term retirement security of plan participants.[4]

This lack of inclusion not only conflicts with SEIU's commitment to diversity and equity as fundamental social values, but it also can have a direct impact in an immediate fiduciary context. Lack of diversity leaves potential returns on the table by not capitalizing on talent pools of skilled people who can manage members' assets. It also increases the likelihood of missing opportunities in an increasingly global, diverse world, and ignores the rapidly growing diversity of the country's—and world's—population. In August 2015, SEIU International President Mary Kay Henry sent a letter to SEIU member trustees outlining best practices, and specifically called on them to "more fully reap the benefits of addressing racial justice and other forms of diversity."[5]

Because investment consultants play a gatekeeping role in determining with which asset managers pension funds do business, they are uniquely positioned to either promote or obstruct asset manager diversity. To better understand how consultants use that discretion, SEIU surveyed prominent investment consultants across the United States who have clients that are public and private sector pension funds. The results of the survey raise three overarching concerns:

1) There is a lack of diversity among consultant staff—specifically in management roles;

2) Most firms do not have systems in place to track, identify and endorse minority and emerging asset managers; and

3) Several themes emerged repeatedly when firms identified challenges to collecting data. Many firms either avoid questions about their work in promoting emerging manager firms, or claim to not have such data, which suggests that diversity is not a significant priority in the industry.

To address this—at the end of this report—we put forth recommendations for consultant firms to help them increase diversity among their own internal leadership and among the asset managers they recommend.

The data make clear an intentional strategy is needed industrywide to increase recruitment, retention and promotion of racial and ethnic minorities. Several firms cited oft-used reasons, which we believe are not supported by the evidence, for not strategically addressing the lack of diversity at their firms or promoting emerging managers. Instead of deflecting blame toward client requests or other stakeholders in the investment world, consultants need to take it upon themselves to be leaders in the field, and show they are willing to hold themselves accountable for promoting emerging managers and increasing the number of MWBEs being funded by large institutional investors.

These changes are crucial to ensure its members are not losing on potential returns and opportunities due to outdated practices prevalent in the industry.

2. PENSION FUND CONSULTANTS PLAY A VITAL ROLE IN PROMOTING DIVERSITY

It is a standard industry practice for institutional investors to hire pension fund consultants to find and match asset managers in accordance with investors' demands and needs. As of 2011, 94 percent of funds employed consultants.[6] This positions the leading consultant firms as gatekeepers to asset managers, wherein they wield significant power and control in determining who manages an institution's investments, and thus, the number of MWBE asset managers that are recommended to clients.

Pension funds look to consultants to adapt to changes in the marketplace, provide the appropriate investment strategies, and recommend asset managers to address those changes. Additionally, consultants help pension funds develop investment policy statements and asset allocations, offer independent advice to their boards, and essentially, act as (and are often treated as) an extension of the funds' investment offices. As such, consultant recommendations are particularly crucial for emerging managers as they build their asset bases. This means consultants can play a critical role in promoting diversity in the financial sector—but only if they choose to make it a priority.

3. SURVEY OVERVIEW

The survey was designed to assess several aspects of diversity regarding pension fund consultants, including: the representation of traditionally underrepresented staff at their firms; any policies or practices in place to promote emerging manager/MWBE firms; and challenges to implementing those policies or practices.

The survey consisted of 33 questions grouped in two sets. The first set of questions attempted to identify the level of diversity within consulting firms. Respondents were asked for the total number of minority employees at the firm, those in senior positions, and the firm's total workforce. This enables us to identify the representation of specific minority groups in relation to the firms' overall workforces. The survey also asked about specific diversity policies in place and whether the firm had a chief diversity officer.

The second set of questions attempted to understand how consulting firms identify and recommend MWBE asset managers to their institutional clients. In this part of the survey, firms were asked how they define emerging and minority- and women-owned asset management firms, the number of meetings the firm had with MWBE asset managers in the past five years and how many were actually recommended, and eventually funded, by clients.

Overall, SEIU invited 21 investment consultants to participate in this diversity survey, of which 14 responded (see Appendix 2 for the list of firms which chose not to participate in the survey). SEIU chose these firms because of their business with Taft-Hartley and public pension funds that manage workers' retirements. Although, the sample size is small in relationship to the number of firms in the industry, the 14 firms that completed the survey represent more than $1.3 trillion in assets under management (AUM) or 14 percent of the $10 trillion pension fund assets under management. While the seven firms that chose not to complete the survey report more than $2.3 trillion AUM or close to 24 percent of the $10 trillion pension funds AUM. Combined, these 21 firms, whether they chose to participate in this diversity survey or not, are estimated to represent 37 percent of pension fund AUM.

4. DISCUSSION

4.1 African American and Latino/a workers are significantly underrepresented

One critical finding of the survey is a significant lack of racial and ethnic diversity among employees of consultant firms, particularly among African Americans and Latino/a staff. Women are still underrepresented at the firms, but the disparity between their percentage at firms and their percentage of the national working population is not nearly as severe as that for African Americans and Latinos/as.

"...the 14 firms that completed the survey represent more than $1.3 trillion in assets under management (AUM) or 14 percent of the $10 trillion pension fund assets under management."

Respondents were asked to list the number of employees who identify as African American, Latino/a, Native American, and/or Asian American. The total number of minority employees comprises 23.8 percent of the total workforce at all the responding companies, which is substantially below the national working population of 35 percent (see Table 1 and Table 5). At all but one of the firms, minority workers accounted for less than 30 percent of the workforce. There was no strong correlation between the percentage of minority staff and number of total employees.

Underrepresented groups fare even worse among the top tiers of consultant firms; racial and ethnic minorities comprise only 14.9 percent of the total number of senior managers from all responding firms (see Table 2). Minorities made up 25 percent or less of the senior management team at 10 of the 12 firms that provided details about senior managers.

Though consultants have done a better job hiring women, the industry as a whole is still a long way from gender parity (Table 3). Women made up 35.7 percent of the total workforce at the firms that responded to the survey, and only 25.2 percent of the senior management teams. Female employees show the widest ranges of all groups tracked in the survey. Women comprised between 27.8 percent and 48.3 percent of the workforce at these firms. One of the firms did not have any women in senior management; at 8 of the other 12 firms that answered this question, women comprised less than one-third of senior managers.

Only Asian Americans are represented at greater averages relative to their percentage of the national working population of 6 percent; they make up 12.7 percent of total employees, and 6.7 percent of senior managers.[7] African Americans and Latinos/as are both represented at less than half their percentage of the working population, as are Native Americans.

The data are most striking regarding African American and Latino/a representation, both among total employees and senior management. African Americans comprise 5.7 percent of total employees, though they make up 12.1 percent of the national working population. Meanwhile, the disparity is greater among Latinos/as: they represent only 5 percent of total employees at the firms surveyed, while comprising 16.3 percent of the working population. At the senior management level, African Americans make up only 3.9 percent of senior managers, while only 4.3 percent are Latino/a.

The representation of African Americans and Latinos/as employed at consultant firms falls even below percentages in other occupations in the financial industry. Among selected financial occupations tracked by the Bureau of Labor Statistics, African Americans comprise 9.3 percent, and Latinos/as make up 8.8 percent.[8]

Results of the survey illustrate that while some individual firms have done relatively well in hiring and promoting women, as well as racial and ethnic minorities, other firms have a lack of racial and ethnic minorities in leadership positions.

Table 1 – Minority Representation in Consultant Workforce

Minority Representation in Consultant Workforce						
Firm	**African American**	**Latino/a**	**Native American**	**Asian/ Pacific Islander**	**All Minority Employees**	**Minority Percentage of All Employees**
1	8	6	0	37	51	27.7%
2	1	1	0	3	5	15.2%
3	13	12	0	17	42	16.8%
4	6	10	0	12	28	21.5%
5	3	0	0	3	6	18.8%
6	9	18	3	71	101	38.5%
7	6	6	0	1	13	21.7%
8	No answer	No answer	No answer	No answer	No answer	Did not specify
9	18	8	0	22	48	18.8%
10	2	3	2	6	13	26.0%
11	5	9	0	4	18	26.5%
12	10	4	0	8	22	21.0%
13	5	0	0	9	14	13.6%
14	4	3	0	9	16	29.6%
TOTALS	***90***	***80***	***5***	***202***	***377***	***23.8%***

Table 2 – Minority Representation in Consultant Management

Firm	African American	Latino/a	Native American	Asian/ Pacific Islander	All Minority Consultant Senior Managers	Total Number of Senior Managers	Minority Percentage of Senior Managers
1	1	0	0	0	1	5	20.0%
2	0	0	0	1	1	4	25.0%
3	3	4	0	3	10	87	11.5%
4	1	1	0	1	3	12	25.0%
5	0	2	0	2	4	23	17.4%
6	1	0	0	2	3	9	33.3%
7	4	3	0	1	8	17	47.1%
8	0	1	0	1	2	32	6.3%
9	0	0	0	0	0	Did not specify	Did not specify
10	0	1	0	0	1	18	5.6%
11	1	0	0	2	3	23	13.0%
12	No answer	No answer	No answer	No answer	No answer	Did not specify	Did not specify
13	0	0	0	2	2	19	10.5%
14	0	0	0	4	4	33	12.1%
TOTALS	***11***	***12***	***0***	***19***	***42***	***282***	***14.9%***

"Underrepresented groups fare even worse among the top tiers of consultant firms; racial and ethnic minorities comprise only 14.9 percent of the total number of senior managers from all responding firms." (see Table 2)

Table 3 – Representation of Women at Consultant Firms

Firm	Women's Percentage of All Employees	Women in Senior Management	Total Number of Senior Managers	Women's Percentage of Senior Managers
1	46.9%	2	5	40.0%
2	42.0%	2	4	50.0%
3	32.4%	17	87	19.5%
4	36.4%	5	12	41.7%
5	43.8%	7	23	30.4%
6	30.5%	2	9	22.2%
7	29.4%	3	17	17.6%
8	36.1%	10	32	31.3%
9	48.3%	7	Did not specify	Did not specify
10	42.9%	11	18	61.1%
11	27.8%	2	23	8.7%
12	No answer	No answer	Did not specify	Did not specify
13	33.3%	0	19	0.0%
14	29.1%	3	33	9.1%
TOTALS	***35.7%***	***71***	***282***	***25.2%***

Table 4 – Overall Summary of Minority Representation at Pension Fund Consulting Firms

Group	Total Number of Employees	Percentage of Total Workforce (n=1586)	Total Number of Senior Managers	Percentage of All Senior Managers (n=282)	Percentage of National Working Population*
African American	90	5.7%	11	3.9%	12.1%
Latino/a	80	5.0%	12	4.3%	16.3%
Native American	5	0.3%	0	0.0%	1.0%
Asian & Pacific Islander	202	12.7%	19	6.7%	6.0%
TOTAL - Racial & Ethnic Minorities	***377***	***23.8%***	***42***	***14.9%***	***35.4%*****
Women	*566*	*35.7%*	*71*	*25.2%*	*46.8%*

**Based on Bureau of Labor Statistics, Employment status of the civilian noninstitutional population 16 years and older by gender and race, 2014 annual averages*

***Total of national population percentages for preceding groups*

Table 5 - Minority Representation Among Total Employees (n=14)

Group	Median	Minimum	Maximum	Percentage of National Working Population*
African Americans as % of Total Firm Workforce	5.2%	3.0%	10.0%	12.1%
Latinos/as as % of Total Firm Workforce	4.8%	0.0%	13.2%	16.3%
Native Americans as % of Total Firm Workforce	0.0%	0.0%	4.0%	1.0%
Asians & Pacific Islanders as % of Total Firm Workforce	9.1%	1.7%	27.1%	6.0%
Totals of All Tracked Racial & Ethnic Minorities	21.6%	13.6%	38.6%	35.4%**

**Based on Bureau of Labor Statistics, Employment status of the civilian noninstitutional population 16 years and older by gender and race, 2014 annual averages*

***Total of national population percentages for preceding groups*

Table 6 - Minority Representation Among Consultant Management (n=14)

Group	Median	Minimum	Maximum	Percentage of National Working Population*
African Americans as % of Total Senior Managers	1.7%	0.0%	23.5%	12.1%
Latinos/as as % of Total Senior Managers	1.6%	0.0%	17.6%	16.3%
Native Americans as % of Total Senior Managers	0.0%	0.0%	0.0%	1.0%
Asian Americans as % of Total Senior Managers	8.5%	0.0%	25.0%	6.0%
Minority Employees as % of Total Senior Managers	15.5%	5.9%	49.5%	35.4%**
*Based on Bureau of Labor Statistics, Employment status of the civilian noninstitutional population 16 years and older by gender and race, 2014 annual averages				
**Total of national population percentages for preceding groups				

4.2 Most consultants do not have systems to identify and promote diversity

In addition to asking each consultant about its internal racial and ethnic workforce diversity, the survey also asked each firm's policies and practices regarding its outreach, recommendations and successful funding of emerging manager firms.

Questions included:

- "Over the past five years (summarized on an annual basis), please provide the number of meetings that the research group has had with emerging/minority asset management firms by asset class."
- "Over the past five years … how many emerging/minority asset management firms have been recommended by your firm broadly?"
- "Over the past five years … how many emerging/minority asset management firms have been funded?"

Although it varied from question to question, several firms provided detailed information.

Some companies have already embraced the development of emerging manager programs. As referenced earlier, one firm recently hired its first staff member for an emerging manager program. In the survey, that firm reported that clearly identifying the value of diversity, gaining the support of the firm's investment and management committees and simultaneously implementing risk mitigation plans were all fundamental components of its newly developed emerging manager program. Similarly, three other firms indicate they are also actively working to expand their emerging manager or minority asset management programs.

Yet, we also find it telling that a majority of the firms refused to answer certain questions, gave vague and generalized responses, or responded that they did not track this information, while others only recently began tracking such information (Table 7).

Table 7 – Outreach to and Promotion of Emerging Managers

Firm	# of Meetings with EM Firms (in past 5 years)	# of Recommendations of EM Firms	# of EM Firms Funded
1	150	2	2
2	50	46	Do not track
3	541	62	62
4	65	9	Does not separate recommended and funded
5	51	"Cannot report"	"Cannot report"
6	358	9	Do not track
7	240	260	82
8	13	13	Do not track
9	Do not track	"Cannot report"	Do not track
10	688	103	Do not track
11	258	2	3
12	Do not track	Do not track	Do not track
13	220	30	30
14	160	38	No answer
TOTALS	**2794**	**574**	**179**

"The scattershot tracking and reporting illustrated in Table 7 suggests to us that many consultants have not been prioritizing work with emerging managers, as not tracking such information makes it extremely difficult for a firm to report how they prioritize diversity."

The scattershot tracking and reporting illustrated in Table 7 suggests to us that many consultants have not been prioritizing work with emerging managers, as not tracking such information makes it extremely difficult for a firm to report how they prioritize diversity. Of 42 potential numeric answers to the questions in Table 7, only 28 are provided.

Especially concerning to us is that only five consultants track the number of MWBE firms that are ultimately funded, and only five firms provide numeric answers for all three questions listed in the table. Our suspicion about the lack of priority is reinforced by the fact that only one firm has explicit, concrete policies to promote emerging manager firms. Another firm only recently began tracking this data and hired a staff person to develop an emerging manager program.

Without detailed performance data on the number of emerging managers who are funded, it is difficult to identify effective strategies by which firms can be held accountable—either to themselves or their clients. Not tracking how many emerging managers achieve the ultimate goal of being funded tells us that not only are these firms not employing best practices; they do not even have sufficient information to identify what those best practices might be.

5. CONSULTANTS DEFER TO A SET OF BELIEFS TO AVOID ADDRESSING DIVERSITY

The survey results also reveal significant barriers that both consultant firms and emerging managers face in increasing diversity. When asked, "What challenges has your firm faced in implementing a more robust emerging/minority asset management firm program," many responses reflect commonly cited beliefs that permeate arguments against implementing effective emerging manager initiatives, including:

- "Emerging manager operating partners often have less institutional capital experience, nascent business platforms … and limited if any real time performance track record";
- "The key challenge … is identifying a sufficient number of qualified managers with significant experience (that will meet the needs of our clients)";
- "[T]hey are often unable to meet basic client requirements such as assets under management [or] length of track record";
- "Industry recognition of the importance of diversity is not as wide as it should be"; and
- "Balancing our fiduciary responsibilities and our client mandates."

These responses fall under two general arguments: 1) there are not enough qualified emerging managers with sufficient resources, experience and performance track records; and 2) other parties in the industry (such as clients) do not prioritize diversity. We believe these beliefs are based on the following myths:

Myth 1: There are not enough qualified asset managers with sufficient resources, experience and performance track records.

Fact: As of 2011, smaller funds managing less than $50 million returned an aggregate 13.1 percent on an annualized basis in the 15 years ended Dec. 31, higher than the 11.6 percent of funds with more than $1 billion over the same period.[9] Moreover, roughly one-third of the $9.7 billion Chicago Teachers' Pension Fund (CTPF), and approximately $11 billion of the New York City Retirement Systems funds are invested with emerging managers.[10] CTPF touts its emerging management firms have out-performed their respective benchmarks for five consecutive years. Similarly, the emerging manager portfolio for the Teacher Retirement System of Texas returned 14.5 percent in the year ended Sept. 30 [of 2014], compared to 11.6 percent for the entire fund. [11]

Myth 2: The rest of the industry does not prioritize diversity, which makes it harder for us to implement a strong emerging manager program.

Fact: This blame-shifting is particularly concerning. Placing the responsibility on other parties in the industry enables consultants to engage in a potentially continuous cycle of avoiding changes that could increase emerging manager/MWBE growth. These deflections also raise questions of what the client standards are, and how consultant firms gauge asset management firm performance, given that several examples show it is not uncommon for emerging managers to outperform their more established colleagues.

"Placing the responsibility on other parties in the industry enables consultants to engage in a potentially continuous cycle of avoiding changes that could increase emerging manager/MWBE growth."

In April 2015, the New York City Pension Funds, collectively the fourth-largest pension system in the country and the largest municipal pension fund, began to consider an initiative to evaluate the diversity of investment professionals at all firms as a criterion in investment manager selection. Scott Evans, Chief Investment Officer for the city's pension funds, outlined two basic points for the new plan: "Firms with diverse workforces are better protected against groupthink," and that "[d] iverse decision-making teams make better decisions."[12] Three of the city's pension funds have adopted and implemented this policy thus far, supplementing and building upon the longstanding NYC policy to seek strong MWBE and emerging managers across asset classes.

California State Teachers' Retirement System (CalSTRS), California Public Employees Retirement System (CalPERS), and the Maryland State Retirement and Pension System (SRPS) and other funds have also implemented various emerging and MWBE programs to value and prioritize diversity.[13]

The pervasiveness of these beliefs among responding firms affects not only emerging managers, but also consultant firms and investors that are eager, or at least willing, to pursue robust emerging/minority asset manager firm programs. These challenges are further exacerbated by the exorbitant power that pension fund consultants leverage over recommending asset manager firms to institutional investors.

6. RECOMMENDATIONS

Consultants do not hesitate to bring innovative investment strategies to their clients to separate themselves from their peers yet seem not to see the clear long-term value creating opportunity in developing equally innovative strategies to promote MWBE managers.

We therefore challenge consultants to rethink their responsibility, commitment and value proposition when promoting emerging managers.

To effectively prioritize minority diversity and emerging manager programs, leadership at consulting firms should make a clear commitment to increase the diversity at their own firms, and also increase opportunities for MWBE asset managers.

Recommendations to increase consultant firm diversity

1. **Senior leadership:** Assign a senior executive to lead the firm's diversity work internally and externally to increase accountability and performance.

2. **Shape culture:** Partner with diversity and inclusion experts who can provide expertise to assist in developing long-term, transformational programs that identify, recruit, train, retain and promote minority and women professionals throughout the firm and, in particular, into the firm's management roles.

3. **Inclusive practices:** Develop and promote clear and inclusive hiring and retention policies, procedures and performance measurements that build and celebrate staff diversity. This may include intentional approaches, such as: recruitment, mentoring and volunteer training, to become aware of unconscious bias and create an inclusive culture within the firm.

4. **Set diversity staffing goals:** Use the Rooney Rule (see sidebar) to shape internal staff recruitment, hiring and promotion strategies. This means ensuring all cohorts of recruits, final candidates for hire and internal promotions to management roles include at least one woman and/or minority candidate.

ROONEY RULE

In 2003, the National Football League implemented the Rooney Rule, requiring NFL teams to interview at least one minority candidate for head coaching positions. The rule was created to address the lack of minority head coaches throughout the league, and has since been expanded to cover general manager and other front-office positions; it has also been updated to include women in the interview mandate.[15] The concept has since been incorporated beyond the sports world; Amazon and Facebook are among those who adopted a version of the rule for their hiring practices.[16]

We find merit in applying the Rooney Rule to our recommendations. The goal of this rule is to ensure we do not allow latent biases or ongoing conditions in the investment industry to unnecessarily limit the pool of MWBE candidates. As outlined in our recommendations, our application of the Rooney Rule is one component of a wide range of tactics to strengthen organizational responsibility and accountability for increasing the number and promotion of minority and emerging managers.

Recommendations to increase MWBE asset manager opportunities

1. **Set MWBE asset manager goals:** Utilize the Rooney Rule to ensure minority and women asset managers are recommended to institutional investors. This means that consultants must be intentional and proactively increase the amount of MWBE managers that are recommended to their clients.

2. **Increase capital commitments to MWBE asset managers:** This may be accomplished through a variety of strategies, such as direct allocations to MWBE asset managers, depending on the specific needs of a particular plan. It is important, however, to avoid undersized allocations that appear to show diversification, but in reality do not help MWBE managers build meaningful portfolios or put them on an equal footing with other managers. Undersized allocations serve to create a headwind to raising capital and being competitive, while requiring an MWBE manager to attract more investors to get the same size portfolio. This situation creates longer startup times and increased costs for MWBE managers and decreases the likelihood of success.

3. **Co-Innovate new practices with clients that increase MWBE:** Develop innovative practices that help eliminate barriers to diverse asset managers. Possible examples include: proposing changes to institutional investor fund policies and requests for proposals that block access to diverse asset managers, such as minimum assets under management thresholds, as essential criteria for consideration.

4. **Partner with diversity and inclusion experts:** Seek financial industry experts, such as universities, associations, labor unions and nonprofits for ideas on how to: a) Increase the absolute number of, and assets under management by, minority- and women-owned asset management firms for institutional investors; and b) address the need to strengthen the pipeline of diverse professional talent entering the financial industry.

5. **Develop relationships with MWBE asset managers:** Cultivate and strengthen a cadre of diverse managers, across asset classes, with proven track records. Some suggestions for how to accomplish this include:

   A) Proactively communicate and update MWBE asset managers on how best to access opportunities to engage with investment consulting firms and fund staff/trustees;

   B) Build relationships with diverse asset manager trade associations, such as the National Association of Securities Professionals, the National Association of Investment Companies, New America Alliance, and The Association of Asian American Investment Managers. This includes frequently engaging MWBE asset managers at industry conferences.

6. **Update databases and produce performance reports:** Increasing MWBE asset managers, across minority groups and asset classes, requires a firm wide mandate to be inclusive in every search to increase MWBE asset managers in final presentations to clients. This requires developing a database of top tier diverse asset managers for funds to consider and includes updating the database to ensure searches yield MWBE asset managers for consideration by segmenting Latino/a, African American, Asian American, Native American, women and other minority managers. The goal is for consultants to be able to track the number of MWBE asset managers that are contacted, recommended and who receive allocations.

7. **Hold firms accountable:** Ultimately, institutional investor staff and trustees will need to hold their investment consultants accountable for their diversity goals. This can be achieved by ensuring that performance evaluations take into account how consultants performed/or failed to perform in identifying MWBE and emerging managers. Additionally, tying consultants' compensation and bonuses to the number of diverse firms where they allocate funds will also increase the number of MWBE asset managers awarded contracts.

We believe the implementation of these internal practices is crucial to effectively increase diversity of consultant firm staff and the asset management firms the consultants recommend. In fact, a 2016 Harvard University report analyzed the diversity initiatives of 829 midsize and large U.S. firms. The report found that boosting engagement among different groups through a combination of diversity managers, task forces, voluntary trainings, mentoring, college recruitment targeting women and minorities can contribute to improving the number of minority and women professionals.[14]

ROLE OF TRUSTEES

Pension fund trustees will also need to hold investment consultants accountable to achieving their diversity goals. This can be done by trustees engaging investment consultants in dialogues on ways to achieve diversity and performance. Here are some sample questions to ask one's investment consultants:

1. Does your firm have a diversity and inclusion executive responsible for developing and promoting diversity policies and goals?
2. How do you measure your firm's performance on diversity? How is your firm's progress this year compared to last?
3. What percentage of your executive leadership is comprised of minorities and women?
4. What percentage of your database is comprised of MWBE asset managers? What do you want this percentage to be in a year? What plans do you have to improve this percentage?
5. What percentage of your set of annual asset management recommendations is comprised of MWBE asset managers? Are some asset classes better than others? If so, why?
6. If your consultancy is selected, how do you plan to work with us to increase MWBE asset managers?

7. CONCLUSION

The survey results clearly indicate the internal practices of consultants are a barrier to greater manager diversity at pension funds. This will ultimately hurt the long-term sustainability of union members' retirements. While consultants are eager to develop innovative strategies and identify new asset classes and preferred asset managers, they are largely unresponsive to pension fund mandates that prioritize promoting emerging managers. The findings demonstrate a significant lack of diversity among staff at these firms; very few have meaningful policies in place for increasing diversity; and many of these companies are operating under the myths of shortages of minority asset managers and subpar performance.

We need our consultant firms to do better. Not only must they be more responsive to pension funds that prioritize diversity, they must also be proactive in promoting the value of emerging managers to all funds; so this value is instilled throughout all fiduciary conversations. To increase the diversity of the internal staff of consultant firms, as well as firms' asset manager selection, we recommend firms institute a series of internal policies that incorporate concrete qualitative and quantitative goals to measure their progress. Concurrently, we further recommend they expand their external partnerships to better promote emerging managers to their clients, and find innovative ways to measure and leverage the value of diversity for achieving the long-term value creation requested by institutional investors.

Acknowledgements

Refund America Project Team:
Talia L. Schank
Saqib Bhatti
SEIU Project Team:
Renaye Manley
Justin Rico Oyola
Edgar Hernandez
Keiana Greene-Page

The author and project team would like to acknowledge the valuable input provided by the following:
Diverse Asset Manager Initiative
National Association of Investment Companies
National Association of Securities Professionals
New America Alliance
Harvard Trustee Leadership Forum

Finally, we thank the firms who participated in the survey and made this report possible.

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8. APPENDICES

9.1 Appendix 1—Investment Overview And Glossary

Asset managers manage investments such as pension funds on behalf of the institutions.

Emerging managers: Many financial companies are adjusting their definition of emerging managers to include minority- and women-owned businesses, and this is the definition we use in referring to emerging managers in this report. In its strictest definition, emerging managers are newer firms with a small asset base (the tangible assets that firm holds). This is due partly to the considerable overlap between the two types of firms, as many MWBE management firms were founded in the 1990s.[17] The definition has also evolved as greater numbers of MWBE firms identify as emerging manager firms.

Emerging manager programs are projects that large established (nonemerging) firms such as JPMorgan Chase and Prudential have implemented to identify, develop, and in some cases, outsource investments to emerging managers; both firms include racial, ethnic and gender diversity in their definitions of emerging managers.[18]

Institutional investors: Groups such as private and public pension funds, insurance companies, banks and foundations. They pool funds on behalf of groups of individual investors, such as employees or customers, and invest them in a variety of assets to maximize the return on those investments.[19] Compared to individual investors, they are considered to be "more proficient at investing due to the assumed professional nature of operations and greater access to companies … because of size."[20] Of the various institutional investors, pension funds are one of the largest such groups, and as of 2014, controlled roughly 40 percent of professionally managed assets—more than $10 trillion. This gives them considerable power over markets as well as corporate governance.[21]

Minority-and women-owned business enterprises (MWBE): Firms where the majority of ownership consists of minorities and/or women.

Pension funds are one of the largest institutional investors, and as of 2014, controlled roughly 40 percent of professionally managed assets—more than $10 trillion. This gives them considerable power over markets as well as corporate governance.[22]

Pension fund consultants are often employed by institutional investors to match asset managers in accordance with the investors' demands and needs.[23] The consultants employ extensive screening methods of a large number of asset management firms. This also establishes pension fund consultants as gatekeepers of asset managers. Consultant recommendations are particularly crucial for emerging and MWBE managers, as these management firms are still building their asset bases.

9.2 Appendix 2—List Of Firms

The following firms were invited to participate and chose not to respond:

- Cambridge Associates, LLC
- Mercer, LLC
- Portfolio Advisors, LLC
- RV Kuhns & Associates, Inc.
- StepStone
- Towers Watson & Co.
- Verus

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Notes

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