

COVID-19 and the Fight for Racial and Economic Justice:

Reflections for the Investment Management Industry

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A central focus of our firm's core values over its 30+ year history has centered on diversity – how to create more meaningful opportunities for minority and women-owned investment firms (“MWBEs”) in investment management and literally “change the face of the investment management industry”. We have done this in several ways – through advocacy to trustees and policymakers; through advising institutional clients on diversity and inclusion best practices; and more fundamentally through our investment work managing assets on behalf of institutional clients in our multi-manager investment portfolios. The latter has allowed us to develop a two-dimensional proof statement. One, to identify diverse investment management firms that can perform and handle direct institutional mandates. And two, to combine these firms into portfolios that produce positive net of fee investment performance track records that confirm diversity and investment excellence are not mutually exclusive.

The intersectionality of the twin pandemics of COVID-19 and Racism-2020 occurring within the past few months has been painfully revealing. The COVID-19 pandemic has had disproportionate impacts upon African American and Latinx communities and poor people. It has exposed great racial and economic disparities in health outcomes as well as the fragility and inadequacy of our overall health care delivery system. The recent global protests about the murders of George Floyd, Breonna Taylor, Ahmaud Arbury and too many others, and in support of Black Lives Matter movement, has pulled the covers back once again on systemic racism and racial inequities in all facets of U. S. life. From health disparities to wealth and income, employment, housing, education, entrepreneurship and access to capital, there is a need for affirmative actions to adopt antiracist policies and practices to address systemic racism and to improve life opportunities for communities of color. And the end for both pandemics is nowhere in sight.

Our investment management industry is not immune from racial disparities. A recent study noted that just over 1 percent of almost \$70 trillion dollars is currently managed by MWBE investment managers across multiple public and private market strategies. This is true even though there is no statistically significant difference in the investment performance of MWBEs vs. the industry¹.

Our Company has ended its investment advisory work on behalf of institutional clients. However, we remain committed to urge asset owners to create greater opportunities for MWBE investment managers. And, the fierce urgency of the current times compels us to share some of the insights and best practices we've learned from many years of experience working on these matters. Our hope here is to offer ideas about policies, practices and people that can be part of the solution to help the institutions that now claim to seek greater diversity in investment management to address racial and economic justice issues.

¹“*Diversifying Investments: A Study of Ownership Diversity and Performance in the Asset Management Industry*”. January 2019. Prof. Josh Lerner and the Bella Research Group.

POLICY

Create Diverse Boards/Trustees/Key Decisionmakers: Policymakers should continue to appoint trustees of color and women to asset owner/institutional investor Boards. This is particularly true for corporations, foundations and larger non-profits where African American representation is sorely lacking.

- Active employees, retirees, women and people of color should seek to be appointed to Investment Committees on corporate, public fund, foundation and non-profit boards
- Asset Owner Boards should incorporate diversity, equity and inclusion (DEI) and bias training into their annual board training and/or professional development agendas. For example, at one well-known California Foundation, every Board meeting includes some topic/speaker or Agenda discussion item on racial and social justice themes.

The need for anti-bias training to address racial bias in our industry should not be overlooked. A 2019 study by Illumen Capital and Stanford Psychology Professor Jennifer Eberhardt and her colleagues found that race influenced asset allocators to adversely evaluate VC funds led by people of color with strong credentials and performance vs. funds led by white males with identical credentials². And even after getting on Boards or Investment Committees, the anti-racism work doesn't end. Beware of the language used when MWBE investors are discussed. Often, language like “performance challenges” or “fund number, asset or firm size”, or themes like “restructure portfolios for more efficiency”, or “consolidate the number of external managers” or “reallocate from active to passive” management are red flags that can cover for bias or biased decisions that can adversely affect opportunities for MWBE investment firms.

Integrate Diversity into Investment Policy Statements and Other Governance Frameworks: Investment Policy Statements (“IPS”) govern an institutional investor’s overall investment practice. To ensure a consistent diversity focus, institutional investors should incorporate diversity, racial equity and/or racial justice statements into their respective IPS and other governance frameworks. Regardless of Board composition over time, having robust and inclusive governance standards in place will require Boards and staffs to systematically address diversity and equity considerations in investment practice over the long-term.

Support Legislative Policies to Promote Diversity, Equity and Inclusion: Policymakers should conduct fact-finding hearings where applicable, and ultimately enact legislation to mandate greater racial equity and MWBE investment firm participation in managing assets. Several states have done this including Maryland, New York, Illinois and California. Perhaps the most successful of these has been the Illinois legislation (Public Law 96-0006 in 2009). This law has given rise to annual State Senate oversight hearings that have been instrumental in sustaining opportunities for MWBE investment firms with Illinois and Chicago public pension plans. A recent California example is the law requiring the UC Regents to direct its Office of the Chief Investment Officer to diversify its staff, launch an emerging manager program and to report to the appropriate legislative policy committee chairs about its efforts to achieve these diversity goals.

² “It’s Not Just A Pipeline Problem: Illumen Capital and Stanford SPARQ Study Finds that Race is A Factor in Investment”. Bloomberg Business Wire. August 12, 2019.

Another upcoming opportunity to address racial and economic equity for MWBEs in public contracting is the vote on California Proposition 16 on the November 2020 ballot. If successful, passage of this statewide proposition could lead to increased opportunities for MWBE investment firms with California public pensions at the state and local levels.

PRACTICES

Allocate More AUM to MWBE Investment Firms: As the nation addresses the historical pandemic of systemic racism, one of the big ideas in the debate is reparations. What does reparations mean for the asset management industry? While this is a complicated question for which there is no easy answer, I do know that simply providing greater access to capital for MWBE firms in both public and private markets is the opportunity. Reparations in asset management might just look like creating new initiatives or just directing consultants or staff to allocate more assets under management (“AUM”) to Black investment firms. Remember, we will only get a different future if we are willing to invest differently and more inclusively. This is consistent with a fiduciary’s obligation to seek out all sources of investment return to diversify risk, and not just rely on the overconcentration of assets (and opportunities) that reside with less than 10 percent of the industry firms that manage over 80 percent of the industry’s assets. Investors should let performance drive the size of their allocations to MWBE investment firms – and not let artificial considerations like firm or fund AUM size, or the number of prior private equity funds, constrain their mandate decisions about increased allocations.

Fund Impact and Other Strategies to Invest in and Scale Black-Owned Businesses and Transform Communities of Color: Institutional investors (Foundations, Corporations, major Non-Profits, etc.) should fund Impact investment strategies that seek to target and transform “place”, e.g., low income communities, in measurable ways. Similarly, investors should provide capital for strategies to fund Black-owned small businesses. Black and Latinx-owned businesses have been disproportionately hurt by the COVID-19 pandemic at 2-3 times the rate of white small businesses. They have also been denied an equitable share of the PPP and other federal resources designed to assist small businesses. To efficiently scale, African American-owned and other MWBEs need access to both equity and debt capital. Impact investments can support innovation as well as public-private partnerships to spur local community development as well as job and wealth creation.

Demand Greater Accountability, Transparency and Oversight: *“Power concedes nothing without a demand”*. So said the great Abolitionist and Civil rights Leader of his time, Frederick Douglass. Asset owners should demand greater diversity accountability from all external stakeholders – especially those they fund. Institutional investors should hold their investment consultants accountable for results that enhance diversity and opportunities for MWBE investors. The Silicon Valley Community Foundation (“SVCF”) for which I serve as trustee and former Investment Committee Chair provides a replicable model of active consultant engagement to drive greater accountability and transparency. And it started by simply

asking questions of our consultant and requiring the consultant to report back to the Investment Committee with data. Over time this periodic oversight and transparency has yielded greater MWBE investment firm participation within our Foundation portfolios. Annually, we've required our consultant to report on how many pipeline-building research meetings were conducted with MWBE investment firms; how many MWBEs the consultant included in its searches, recommend for hire or hired; and, if hired, for what percentage of the consultant's assets under advisement. The results of this experience spurred SVCF's investment consultant, Colonial Consulting, to become one of the leaders among its peers in utilizing MWBE investment firms for SVCF as well as its other Community Foundation clients³.

One of the most productive oversight models for any Board is what occurs annually with the Illinois State Senate Committee on Public Pensions and State Investments that reviews the diversity initiatives of Illinois and Chicago Public Pensions. The oversight hearings are part of the State Legislature's oversight role as outlined in the statute noted above. But the real "teeth" in accountability is the statute's required annual reporting of data about MWBE participation in each Fund's overall portfolio, and the probing, astute oversight questioning by the Illinois Senators. The Senate Committee Chair was Sen. Kwame Raoul, now Illinois State Attorney General; the current chair is Senator Iris Martinez. By their active engagement, the Illinois Senators have made the Illinois public fund representatives more accountable and amenable to providing real opportunities for MWBE investment firms. The annual reporting has also sought and received disaggregated data – not just on "emerging manager" participation – but specifically on Black, Latinx, and Asian/API-owned firm participation and opportunities. In this way, disaggregated data can help to hold institutional investors and asset owners accountable for their walk as well as their talk in measurable ways about how much Black Lives should matter to them.

Use the "Garcia Rule" for All Consultants' Investment Firm Searches: Patterned after the NFL's so-called "Rooney Rule" for head coaching vacancies, MWBE investment firm founder Gilbert Garcia has suggested something comparable for asset management: That a MWBE investment firm be included for every institutional search conducted by any consultant. In other words, for each potential hire, there would be a MWBE investment firm among the finalists presented to institutional investor decision makers. This would at least spur Consultants to conduct more MWBE investment firm research coverage and expose decision makers to more MWBE investment choices. Bringing investment consultants within the scope of federal regulation through the SEC or FINRA may be another way to get greater transparency and mandate more inclusive practices for these so-called "gatekeepers".

PEOPLE

Diversify Staffs: Require investment consultants and institutional investor staffs to be more diverse. For example, asset owners could require annual diversity profile reports. Another opportunity would be to have private equity GPs report on the diversity staffing profile of each of their respective portfolio company

³ "Racial Equity & Social Justice". Silicon Valley Community Foundation. August 2020.

<https://www.siliconvalleycf.org/racial-justice>; "Investment Manager Diversity". Silicon Valley Community Foundation. August 2020. <https://www.siliconvalleycf.org/manager-diversity>.

investments. Similarly, investment consultants could be required to report on the diversity profile of each of their recommended investments with some minimum standard that needs to be met before a consultant recommendation can be hired.

Create Executive Compensation Incentives to Foster Greater Investment Diversity: It is often said that we should only pay for what gets measured and achieved. Trustees and Boards should ensure that Chief Executives, Chief Investment Officers and other senior investment staffs have measurable diversity and equity metrics as part of their annual assessments. Further, any annual pay for performance system should make achieving these investment diversity and equity goals a meaningful part of overall executive compensation.

Mentorship and Internships: Mainstream Investment firms and investment consultants should develop mentorship and internship opportunities for diverse professionals and MWBE college/grad students. Through this exposure, underrepresented communities of color can learn about employment and career opportunities in asset management. My own experience is instructive: I was in my 30's and working as an attorney for one of the California Assembly legislative committees in the mid-1980's before I ever heard about the investment management industry. There are many others with the raw potential to make a mark in investments who are simply unaware and/or don't have an opportunity to get started. MWBE investment firms have often been one of the few places professionals of color could get an entry opportunity and meaningful exposure to our industry – another reason to support their growth. The historically Black colleges and universities (HBCUs) are an often overlooked yet excellent source of motivated talent who are hungry for new opportunities.

CONCLUSION

As the world now knows, Black Lives Matter. In our industry context Black investment firms matter, too. But who are our advocates? And where are the decision makers willing to provide growth opportunities for Black investment firms with proven track records? Do we need to have Wall Street or state capital protests for racial and economic justice for African Americans and other industry professionals of color? Too few new Black investment firms are being formed; and too few of those that survive have had opportunities to scale and thrive. NASP, NAIC and other industry affinity groups should unapologetically advocate for African American investment firms and their industry interests. If investors adopt new anti-racist policies and practices that benefit Black investment firms, then Latinx, AAPI and women will benefit as well. Many Foundations and Corporations have issued statements of solidarity and support for the Black Lives Matter movement. Large banks and mainstream investment firms like BlackRock, State Street, JP Morgan and T. Rowe Price have also issued solidarity statements. Eventually the protests will subside although systemic racism in our industry will persist as it has in the U.S. for over 400 years. But will the industry's commitment to greater racial equity and social justice exist beyond this current moment? We will only get the future in which we are willing to invest and commit capital. Consistent with support for Black Lives Matter, will large mainstream investment firms be willing to forgo their white privilege and actively support

(or even facilitate) greater AUM allocations to black and other MWBE investment firms? Will all stakeholders embrace creation and development of Black-owned businesses? Our hope is that asset owners and institutional investors – Foundations, Corporations, Large Non-Profits, Public Pensions – will walk the talk of these times and address these issues meaningfully for the long-term. But for now, our struggle continues during a moment of great uncertainty yet opportunity. As we engage this reality, to use the words of the late Cong. John Lewis, “We should not lose hope. And, we should never give up, give out or give in.” My hope is that the policies and practices suggested here, along with other initiatives, can support *actions* to create a better, antiracist future for the investment management industry.