



## DIVERSITY FROM AN INVESTOR'S PERSPECTIVE

WHY AND HOW THE MOST FORWARD-LOOKING ASSET OWNERS ARE ADDRESSING DIVERSITY AND INCLUSION

November 2017

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*> Diversity is moving up the agenda for asset owners globally – and asset managers need to prepare to answer their clients' questions on their own approach to diversity*

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## What this report is about

Diversity is firmly on the corporate agenda, with a growing body of research showing that it leads to better decision-making and financial performance – yet much of the capital markets industry has been slow to act. This report looks at how and why asset owners, such as pension funds, insurers and sovereign wealth funds, approach diversity (in the people sense of the word rather than in terms of investment diversification), because asset owners are an essential source of capital for financial markets, and their needs and actions have a big impact on how the whole system operates.

This research was inspired by two things. The first was a public statement from the New York City pensions system in May 2015 saying that it was formally including diversity among its criteria for manager selection – we wanted to know if other schemes were taking similar measures and how were financial intermediaries responding? The second was an event where New Financial was presenting data on female representation in financial services, at which a panellist said the industry would not do anything until clients asked them to – we wondered if clients were asking, and if so, what and why?

The aim of this report is to address the following questions:

- What are the motivations of asset owners seeking to improve diversity?
- How are they going about it:
  - across their trustees, the investment function and wider workforce?
  - by engaging on diversity themes with the companies in which they have long term shareholdings?
  - by using diversity criteria as part of their due diligence process for appointing external fund managers?
  - as a theme for portfolio allocation?

We also aim to offer asset owners suggestions and ideas on how to approach diversity and prompt financial intermediaries to act.

## Methodology

New Financial conducted desk research on 100 asset owners (see appendix for a full list) globally, selected by size, activity and availability of information, with combined assets under management of more than \$8 trillion. We analysed publicly available information (eg. websites, annual reports, responsible investment reports, press releases). We also conducted more than 40 interviews with a range of market participants, including asset owners, investment consultants, trade bodies, proxy voting services, asset managers and corporate governance experts.

## Acknowledgements

We are very grateful to:

- our interviewees who made time to answer our endless stream of questions.
- our institutional members for their support, and particularly Columbia Threadneedle Investments, Hermes Investment Management and Brown Brothers Harriman for funding this research.
- the Pensions and Lifetime Savings Association for their input and collaboration on this project.
- Kristine Bell who laid the groundwork for this research.

New Financial is a think tank and forum that believes Europe needs bigger and better capital markets to help drive its recovery and growth.

We believe diversity in its broadest sense is not only an essential part of running a sustainable business but a fundamental part of addressing cultural change in capital markets.

We provided data to Jayne-Anne Gadhia's government-backed review of senior women in financial services, *Empowering Productivity*, and we are working with HM Treasury to review the progress of signatories to the HMT Women in Finance Charter.

New Financial is a social enterprise that launched in September 2014. We are funded by institutional membership.

For more information on New Financial, or to offer feedback on this research, please contact:

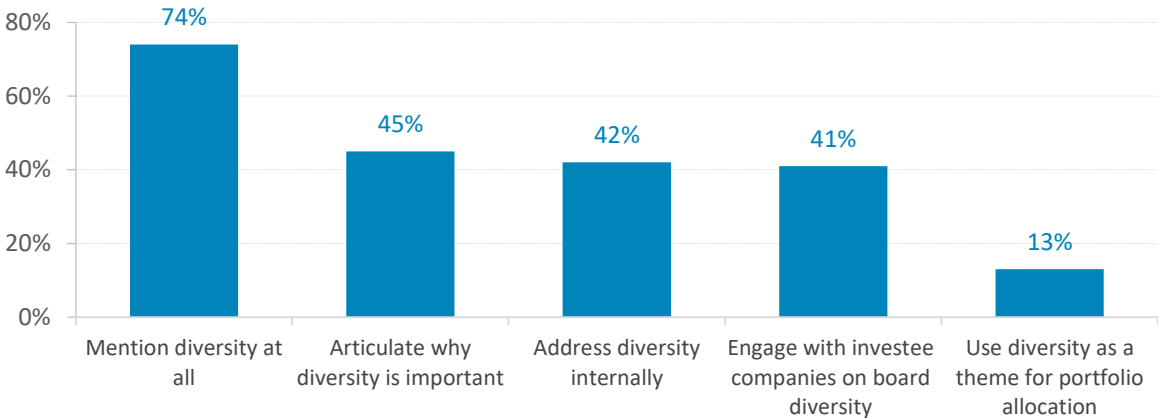
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Fig. I How do asset owners approach diversity?

Percentage of asset owners in our sample that:



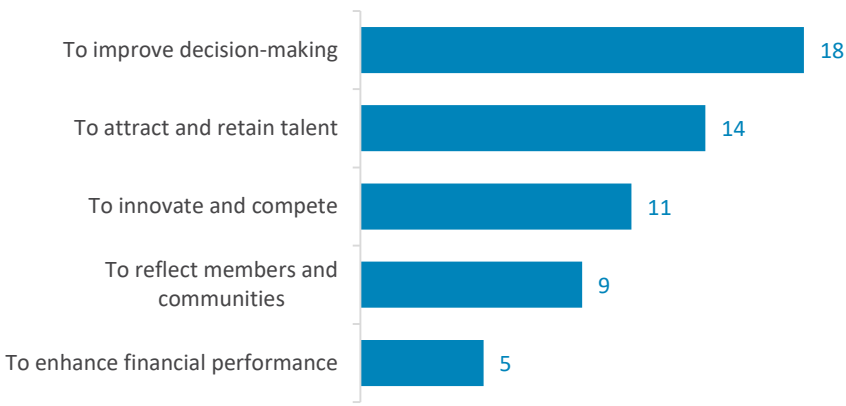
### Highlights of the report

1. Diversity is moving up the agenda of asset owners globally, with interest and activity accelerating in the past two years. Nearly three-quarters of our sample (74%) of asset owners mention diversity in their annual reports, even though the topic is relatively new and is rarely top of their agenda.
2. For those that are thinking about diversity, most are at the early stages of working out how diversity fits into their strategy. Almost half (45%) of our sample explain why diversity is important to them. But there are still many people and organisations throughout the investment chain who are unconvinced and believe a focus on diversity compromises financial performance.
3. The big US public pension schemes are leading the charge on diversity, and there are numerous examples of best practice from asset owners in North America, Australia, Denmark, the Netherlands and the UK.
4. Much of the headline thinking on the importance of diversity to investment has already been done. There is a wealth of information, materials and toolkits offering asset owners guidance and action points. The diversity research pipeline is now focused on answering increasingly granular and nuanced questions.
5. Efforts around the topic of diversity are generally initiated by passionate individuals, but increasingly their conviction is being translated into processes, structures and policies to formalise asset owners' commitment to diversity, both internally and externally.
6. Asset owners are tackling diversity internally (across their investment function and on trustee boards), and externally (by stepping up engagement with investee companies, as well as raising diversity as a theme with their investment consultants and asset managers).
7. Diversity is beginning to influence manager selection. Diversity questions are coming up more frequently in requests for proposal, there are more of them and they are more focused. Investment consultants are also including diversity criteria. However, the response from asset managers is varied – some are working on their diversity data while others remain reluctant to share it.
8. The interaction between asset owners and their asset managers is evolving from a purely transactional relationship to a more collaborative one. Some asset owners are actively challenging their investment managers and working with them to improve their diversity, as well as supporting diverse managers.
9. Investor networks and coalitions on the theme of diversity are growing, as is their impact. They are more vocal and increasingly turning their words into actions, prompting market participants to take them seriously.
10. Some of the ideas raised in this research will sound familiar – for example, improved decision-making has long been cited as a motivation for tackling diversity. However, this research is the first time we are hearing these ideas from asset owners. Their opinion counts, and all financial services providers will have to listen.

# WHY DIVERSITY IS IMPORTANT TO ASSET OWNERS

Fig.2 Motivations for tackling diversity

The five most common reasons why asset owners are acting on diversity (number of mentions by asset owners in our sample)



There are different reasons why asset owners believe diversity is important, different ways it is being incorporated into strategy and different ways it is being approached as an investment theme, both internally and externally.

Of the 45 asset owners in our sample that articulate why they believe diversity is important, the most popular response is diversity improves decision-making. While some emphasise the importance of diversity specifically in the context of the board room, others focus on how diverse perspectives can help to challenge group think and lead to better outcomes throughout their activities.

The second most common reason is to help attract and retain talented staff. Some schemes are more proactive than others, with the most forward-looking promoting flexible working practices, putting pressure on their recruiters to provide diverse candidate lists and participating in research to improve diversity across the investment industry.

The third reason is the belief that diversity helps to drive innovation and creativity. Nine schemes in our sample expressed a desire to reflect the diversity of scheme members, but we found scant detail about how they were doing so.

Only five asset owners in our sample said diversity enhances financial performance. For them, the business case is clear, e.g. Comptroller Scott Stringer from the New York City pension system said: “Diversity is a fiduciary duty... It has strong economic value for our investments. We want the companies in which we invest to harness the economic and financial benefits of diversity.”

Others argue diversity itself has value. Ian Baines, head of pensions at Nationwide Building Society said: “To just lead on why it adds [financial] value is missing the point. People do make economic returns and financial outcomes arguments but really, for us, it is just the right thing to do. It sticks out from other responsible investment themes for this reason.”

But at the other end of the spectrum, our research found that there is still a widely-held and deeply-entrenched belief that improving diversity compromises returns. One UK head of pensions said: “We still have deficits. Investment performance has been front of mind. We are not using diversity criteria yet.”

“Diversity (including on the grounds of gender, expertise, experience and age) **benefits balanced decision-making.**”  
ABP

“Diversity **expands our recruitment potential** and ensures a wide range of skills in managers and employees.”  
ATP

“Diversity is one of our first priorities – being open to different perspectives changes us, makes us **more creative, more innovative**, and helps us to have more impact.”  
Wellcome Trust

“Our workforce must reflect the **communities and countries** where we do business to be relevant across our global markets and to attract the right talent.”  
CPPIB

“Diversity isn’t a box to be checked — it’s a **strategy for economic success**. Diverse perspectives matter, and companies that embrace that ethos perform better.”  
New York City’s pensions system

“We believe everyone wins with diversity. Embracing difference in thought and perspective introduces new and better ways of doing business. This, in turn, creates **superior returns** for our members.”  
AustralianSuper

“Diversity in the boardroom is not a social issue, but is about **improving company performance** for shareholders by mitigating risk, improving accountability and enhancing a company’s long-term sustainable value.”  
CaISTRS

# TACKLING DIVERSITY INTERNALLY

## Looking within

Our research of asset owners' annual reports gives us an indication of how they are approaching diversity amongst their own staff.

We found the nature and format of diversity disclosure in our sample varied enormously. Almost half (42%) disclose information which suggests they are addressing workforce diversity internally and a third (33%) noted initiatives in place to attract, retain and promote diverse staff.

A fifth (22%) disclose how many women are on the board of trustees or equivalent structure. We found the composition of the investment function was less frequently disclosed than the board or, in the case of a corporate scheme, wider workforce.

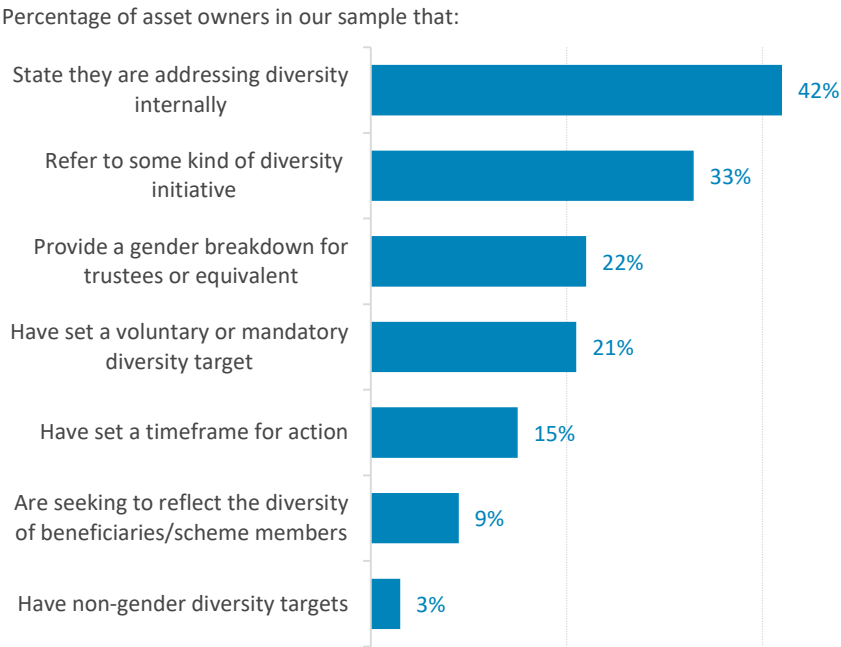
Some schemes are leading on diversity disclosure – for example, the UK Environment Agency Pension Fund has for the first time in 2017 published not only the gender ratio of its pension function but also the proportion of ethnic minority staff.

## Setting targets

A fifth (21%) of asset owners are going one step further by setting themselves diversity targets, mostly related to improving female representation. For example, Canada's AIMCo has a policy objective of gender parity, and a target of at least 30% female representation among its directors. Dutch scheme ABP is addressing both gender and age diversity, targeting one member of board of trustees to be under age 40 and at least three women.

Most of those who set a target also set a deadline for achieving it – for example, AMF Pension Sweden plans to narrow its gender pay gap by the end of 2018.

Fig.3 How schemes describe their internal diversity efforts



## Reflecting scheme members

A common reason that corporates give for tackling diversity is to better reflect and meet the needs of their customers. For pension schemes, their “customers” are their members. Only 9% of asset owners in our sample disclose information to suggest they are seeking to reflect the diversity of scheme members. Our research found there is room for asset owners to improve their understanding of their members, who they are and what they value. There are a handful of schemes already putting a lot of thought and energy into representing their members as stakeholders – for example, AustralianSuper is using a standardised reporting framework to communicate with members on its economic, environmental, social and governance performance, and surveys its members to gain insight into their priorities.

CalSTRS in the US has been a longstanding supporter of the Association of Asian American Investment Managers, which is dedicated to the advancement of Asian and Pacific Islander leadership. Harry Keiley, chair of CalSTRS' investment committee said at the scheme's 2017 diversity forum that he was proud of CalSTRS support “especially when there are over 25,000 active CalSTRS members who identify as Asian American and Pacific Islander”.

## Learning from a corporate sponsor

Our research shows there are corporate pension funds actively seeking to align their diversity efforts with those of their corporate sponsor. The pension fund of the UK-based building society Nationwide is an example of a scheme being challenged by its sponsor to do more on diversity. The scheme's trustees this year participated in the same unconscious bias training as Nationwide staff.

# IMPROVING TRUSTEE DIVERSITY

*"The first thing trustee boards should do is get their own houses in order. If this is an issue we believe the companies we invest in should be attentive to, then we should have those discussions as part of our own governance, in terms of our own representation as a board."*

**Pamela Carlton,**  
Board member,  
Columbia Mutual Funds \*

*"The profession that takes on the challenge of helping everyone achieve a better income in retirement needs diverse leaders."*

**Lesley Williams,**  
Chair (outgoing), PLSA,  
and group pensions director,  
Whitbread PLC

## The UK's homogenous trustee boards

Research shows UK pension fund trustee boards are overwhelmingly pale, male and stale. More than four out of five (83%) trustees in the UK are male, according to the Pensions and Lifetime Savings Association's 2017 annual survey of their members. While nearly half (49%) of trustees that responded to the survey said their board was diverse in terms of gender, just over a quarter (28%) said their board was ethnically diverse. Age is also a factor. Research conducted by investment consultant Aon Hewitt and Leeds University in 2017 found that the average UK trustee is 54 years old and has been a trustee for 10 years.

The Pensions Regulator's 2015 trustee survey found that trustee boards suffered from skills gaps that reduced their ability to challenge their advisors – 82% said they rarely or never disagreed with their advisors, with 14% sometimes disagreeing and 1% always disagreeing. Increased diversity could play an important role in contributing to a culture of challenge.

Faced with this evidence, the PLSA this year launched its *Breaking the Mirror Image* campaign to highlight the potential for group think on trustee boards and encourage wider, more diverse participation across the pensions industry. Diversity was the theme of PLSA's annual investment conference in March 2017. It is running a series of workshops and events focused on this theme, for example, its diverse leadership training programme supports potential industry leaders to be more self aware, encourage more diverse representation and improve their communication skills.

## Learning by example

Asset owners do not have to go back to the drawing board to find solutions to the problem of homogeneity, as the thinking has been done elsewhere.

The Dutch pension sector faces a similar challenge – according to an academic paper (Shi, Swinkels and Van der Lecq), 35% of the 200 largest Dutch schemes had no female trustees in April 2014 and 60% lacked trustees aged under 40. In response, the governance *Code of Dutch Pension Funds* now requires schemes to seek diversity on a comply or explain basis. The Code states: "The board of trustees will adopt concrete measures to ensure the fund's bodies have a diverse composition. In addition, the board will indicate how and within which terms it intends to achieve the desired level of diversity in respect of age and gender. The board must lay this down in a diversity policy. Annually, the board will assess the extent to which the objectives of this policy have been achieved. Once every three years, the board will review its diversity policy."

The Dutch model is similar to the diversity reporting introduced under the UK's *Corporate Governance Code*. The PLSA suggests in its 2017 discussion paper on good governance that pension fund trustee boards can learn from what has already worked for corporate boards: "The Corporate Governance Code for listed companies sets out expectations in relation to five key themes of leadership, effectiveness, executive remuneration, accountability and shareholder relations, with considerable emphasis on board appointments and the balance of skills, diversity and independence of the directors... We believe that pension funds could similarly gain from a move in regulatory focus towards governance inputs."

\* speaking at a Harvard Kennedy School webinar, 2016

# CHALLENGING EXTERNAL INVESTMENT MANAGERS

## Manager selection

Asset owners are in a strong position to challenge investment managers on how they approach diversity.

Our research found that while some form of diversity criteria may already have been part of manager selection, the discussion now is increasingly framed under the term 'diversity', there are more questions that are more focussed and they come up more frequently. For example, Illinois Municipal Retirement Fund and Chicago Teachers routinely ask their investment managers, consultants and suppliers to provide a breakdown of race and gender ratios of staff in various roles.

Diversity criteria are evolving from tick-boxes to more narrative disclosure, which opens the door to discussions between asset owners and their managers. While our research found diversity questions are not yet standard on Request for Proposal documents in the UK, some asset owners are considering it. Diandra Soobiah, head of responsible investment at UK scheme NEST, said: "We have agreed to formalise our commitment in our next RFP."

Forward-looking asset managers are stepping up to meet the challenge head on. Dei McLaughlin, head of global account management at Columbia Threadneedle Investments, said: "There will be an increasing risk attached to not answering diversity questions. We are now in a position to answer them. Maintaining this data and gathering ethnic diversity data are priorities." However, not all asset managers respond well to such probing. One firm said: "We don't always have robust information or indeed historic information." Others said HR was reluctant to share data, or claimed data protection laws prevented them from providing data.

Fig.4 Sample RFP questions

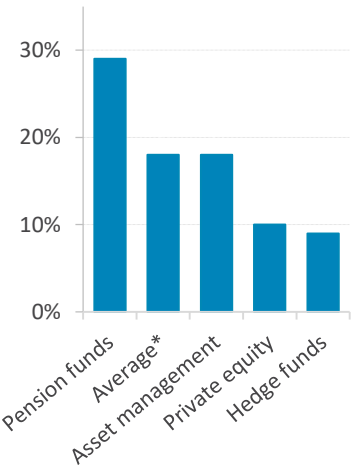
Asset managers will need to step up preparations to answer questions about their approach to diversity when pitching for mandates. Below is a selection of questions taken from actual Request for Proposal documents that we collected from our discussions with asset managers. Those firms already focussing on diversity and culture more broadly will have a competitive advantage in increasing their scores on RFPs.

- Do you have an equal opportunities policy? If yes, please provide the policy.
- Does your organisation have policies in place that promote diversity in the workplace?
- Are you compliant with equal opportunities policies?
- Please provide details of your equal opportunities policy.
- Do you actively recruit from diverse backgrounds?
- What is your commitment to gender equality?
- Please give a brief overview of the corporate commitment to diversity at your firm.
- What specific actions have you undertaken to support diversity in the work force e.g. training, networks, targets?
- How are you addressing cognitive diversity?
- How are you promoting equality?
- How are you addressing work-life balance?
- Please describe any programmes, partnerships or initiatives that promote or foster diversity in your organisation.
- What does your firm plan on doing to increase diversity in the future at all levels?
- How is cognitive diversity and inclusive culture being promulgated throughout the organisation?

## Overcoming resistance: private equity and hedge funds

Fig.5 Industry laggards

Average female representation on executive committees across European capital markets, %



\*Average across 12 different sectors

Source: New Financial's *Counting Every Woman 2017*

Asset owners are also well placed to encourage alternative asset managers to tackle diversity. Pension funds now account for 30% of capital raised by European private equity and venture capital funds, according to trade body Invest Europe, and 43% of UK hedge funds assets, according to Preqin.

Hedge funds and private equity have the lowest female representation on executive committees of the 12 sectors in our research *Counting Every Woman 2017* (see Fig.5). Invest Europe said in its *Handbook of Professional Standards 2015*: "Diversity is becoming an increasingly important consideration, including amongst regulators, and GPs [general partners, i.e. private equity fund managers] should stay prepared and carefully consider the issue of diversity." However, it accepts that GPs are not yet under pressure on diversity.

# CHALLENGING MANAGERS: A CASE STUDY

*“We did not see it [diversity] as a matter of fairness, although of course that was important. We were also concerned about what impact the lack of gender balance would have both on the size of the talent pool available to us and on our fund managers’ overall decision-making.”*

**Jackie Turpin,**  
Head of Finance,  
Joseph Rowntree Charitable Trust

*“The investment industry is slowly moving away from a transaction-based approach to a more relationship-driven approach. Asset owners are choosing to partner with their managers.”*

**Mark Walker,**  
Global chief investment officer,  
Unilever

## Case study: Joseph Rowntree Charitable Trust

Our research found that when asset owners raise diversity in quarterly or annual manager reviews, it tends to be on an informal basis. The Joseph Rowntree Charitable Trust in the UK is a notable exception as it has recently begun to actively challenge its investment managers to improve diversity by setting targets.

The Trust uses its £200m endowment to address the root causes of conflict and injustice. Looking for additional ways to fulfil its mission, in 2016 it asked its committees to think about their work through a gender lens. The issue that stood out most clearly for the investment committee was gender imbalance in the fund management industry. Despite the relatively small size of its mandates, the Trust decided to formalise its commitment to diversity by working with its investment managers to improve the gender balance within the teams that manage its funds.

The Trust brought its investment managers together to collaborate on seven demanding gender diversity targets, which it subsequently published. Jackie Turpin, head of finance at the Trust, said managers welcomed the challenge, and the discussion has been an iterative educational process on all sides. The original seven targets have been revised into eight as listed below. The Trust is now working with the Charities Responsible Investment Network to share their ground-breaking work more widely.

### Fig.6 The Trust’s eight targets for its asset managers

1. To conduct a gender-blind pay analysis for analysts and fund managers, to be shared with female and male colleagues.
2. To establish a formal mentoring scheme for female analysts and fund managers such as those promoted by the *30% Club Mentoring Scheme* and *Lean In Circles*. To the extent that you struggle to find senior female fund managers able to provide such mentoring, we would encourage you to consider mentors from outside the investment world. We would also encourage you to establish peer networks internally or seek to access them externally. The cost of external support should be provided by your organisation.
3. To have “correcting gender imbalances in the team” worked into the targets of those who are responsible for recruitment, mentoring, promotion and retention, for example through bonus targets. Our belief is that what gets measured gets done.
4. To ensure that at least 20% of your “sustainability team” managers comprise females within five years, in order to create the right culture within your organisation.
5. To ensure that 75% of any graduates or analysts hired comprise females, with a 75% retention rate over five years, to help correct what we see as a gender imbalance at fund manager level. We recognise that this is a particularly challenging target and may involve you revisiting how you attract female applicants, for example through university and even earlier outreach. It will also require buy-in across your organisation.
6. To ensure bias free selection policies and processes.
7. To ensure robust policies and processes for retaining women such as flexible work practices, a return to work programme and assistance with childcare provision.
8. To ensure that at least 30% of the members of your own board and advisory committees comprise females. This is in line with what we hope your expectations are of investee companies.

# CHALLENGING MANAGERS: ROLE OF CONSULTANTS

*“If ever there was a free lunch in investing, we think it’s very likely that the secret sauce in this dish would be diversity. We have upgraded and downgraded managers where diversity has been a factor in the decision.”*

**Michael Kinney,**  
Senior research specialist,  
Mercer

*“Diversity is a significant factor, but it is not a mandate-critical factor. If the score is low this will be reflected in the overall score. If the asset manager doesn’t know the composition of their workforce or is not happy to disclose it then that is a red flag – it may not be worth doing the due diligence.”*

**Luba Nikulina,**  
Global head of manager research,  
Willis Towers Watson

*“Diversity is not just about gender or age – it is also about diversity of approach and thinking and we can draw on research into corporate boardrooms which has shown that diversity leads to better decision-making and financial outcomes.”*

**Lynda Whitney,**  
Partner,  
Aon Hewitt

## Incorporating diversity into manager selection

Investment consultants play an influential role providing advice to asset owners on asset allocation and manager selection. We asked the big three consultants – Mercer, Willis Towers Watson and Aon Hewitt, which the Financial Conduct Authority estimates account for two-thirds of the advisory market – how they approach diversity, and if and how they incorporate diversity into their manager selection process. We found that investment consultants are very clear on the benefits of diversity and are allocating more resources to the theme. Consultants are being asked to include diversity criteria more often by their clients – but while diversity is of increasing importance, it is not yet mandate-critical.

**Mercer** is convinced diverse teams are more likely to outperform. It has been looking at elements of diversity as part of its manager selection process for a number of years, however in December 2016 it published a paper emphasising and communicating why diversity is important. Mercer assesses diversity in the context of idea generation, avoiding group think, reducing risk in portfolio construction, and how well a business is managed. Below is a list of questions Mercer asks prospective asset managers related to diversity.

### Fig.7 Mercer’s questions to asset managers

#### Team make up

- Does the team have a dominant leader, or is there a low level of challenge within the group, regardless of any surface-level diversity?
- When a team is under pressure from poor performance or from client outflows, is it more vulnerable to groupthink?
- How does the team reach decisions, and how does it manage any mistakes it has made?
- What is the team leader’s attitude to diversity?
- Is there an illusion of unanimity where, in reality, team members are hesitant or reluctant to disagree?
- How does a team work through dissenting views?
- Does any recent staff turnover tell us anything about team dynamics and the value placed on diversity?
- Does the remuneration structure (team versus individual bonus) have any implications for how a team reacts to challenge or debate or the way the team manages dissenting views?

#### Policies

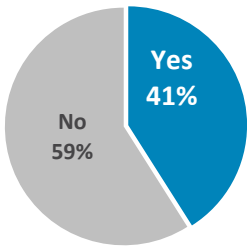
- Does the manager have a formal diversity and inclusion policy?
- Does the firm have mandatory unconscious bias training for staff?
- Does the manager have a staff referral bonus system and, if so, does this help or hinder diversity?
- What are the firm’s recruitment practices?
- Does the manager conduct open market searches for staff using a head hunter, or does the firm just call in people they already know to interview?
- Which of these approaches is more likely to result in a diverse team?
- How does the firm avoid unconscious bias during the interview process?

**Willis Towers Watson** last year introduced diversity criteria into the due diligence process for asset managers it is considering for its high conviction strategy recommendations – this list includes about 500 strategies from around 350 firms. Otherwise diversity is part of manager selection process only if clients specifically request it, however Willis is considering applying diversity criteria to manager selection more widely.

**Aon Hewitt** has commissioned independent research from the University of Leeds exploring the role of bias in trustee investment decision-making, and is planning more work in this area.

Fig.8 Challenging boards

% of asset owners in our sample that stated they are engaging with investee companies on board diversity



*“Diversity is now a very difficult topic to push back on. We are going to keep researching and building the business case but perhaps the strongest argument, that the more enlightened will understand, is that if you’re not taking diversity seriously you are just wasting talent.”*

**Leon Kamhi,**  
Head of responsibility,  
Hermes Investment Management

## Gender diversity at the highest levels of decision-making

Board diversity may be an established corporate governance theme with companies, but it can still prove a challenging topic on which to engage.

Much of the work in the UK has focussed on improving female representation at senior levels. The UK government-backed *Davies Review* of women on corporate boards in 2011 provided stakeholders with a framework, the language and increased confidence to challenge investee companies with few or no women on their boards. The 2016 *Hampton-Alexander Review* of women in senior management has continued to support shareholders to engage on gender imbalance in the executive pipeline. Church Commissioners and Railpen are two examples of UK-based asset owners that have integrated these review recommendations into their voting templates and engagement policies.

The 30% Club, which has campaigned for more women on corporate boards since 2010, has an investor group focussed on diversity from an asset owner’s and asset manager’s perspective. The group’s toolkit offers asset owners a systematic way to engage on diversity, and in 2016 it made a statement of intent to support 30% female representation on FTSE350 boards and in FTSE100 senior management.

Asset managers (including Hermes Investment Management, Aviva Investors and Legal & General Investment Management) have responded to the reviews by escalating their stewardship activities individually and through networks and coalitions. They will vote against annual reports and accounts, board chairs and nomination committee chairs at companies where there is insufficient progress on gender diversity. This year, BlackRock, State Street and Vanguard, the biggest passive asset managers, have also stepped up a gear on board diversity – for example, voting against boards with poor disclosure, calling on companies to increase the number of women on boards, and advocating for more effective corporate governance including more diverse boards.

## Developments in diversity engagement

The main thrust of diversity engagement so far has been to improve female representation at the biggest companies, however this thinking is evolving:

- The UK government has introduced compulsory gender pay gap reporting from March 2018 – it will be interesting to see how asset owners and asset managers respond.
- The 30% Club investor group is encouraging diversity disclosure from smaller listed companies and those considering a listing.
- The UK government launched the Parker review of ethnic diversity of boards in 2016 and the McGregor-Smith review of issues affecting black and minority ethnic groups in the workplace in 2017, and the findings are filtering into shareholder engagement – for example, Hermes EOS, which advises asset owners on corporate governance issues, is engaging on ethnic diversity at board level and beyond.

The discussion has also started to move beyond the board and executive pipeline to human capital management and workforce composition:

- ShareAction, the responsible investment charity, launched its *Workforce Disclosure Initiative* in 2016 to create a framework for comparing listed companies’ workforce policies and practices. The initiative brings together 79 institutional investors with nearly \$8tn of assets under management.
- The PLSA has also published a toolkit for pension funds looking to provide better stewardship on human capital reporting.
- Hermes EOS is focusing on the hiring policies and practices of investee companies, and whether they improve diversity of the wider workforce.

# DIVERSITY AS A THEME FOR PORTFOLIO ALLOCATION

## An investment opportunity

One in eight (13%) of the asset owners in our sample are promoting diversity by allocating capital to diverse groups.

The US public schemes in our sample carve out a portion of their portfolio to allocate to investment managers and invest in businesses owned and/or managed by women and minorities. The motivations of US schemes include redressing social injustice, democratising capital, reflecting beneficiaries, encouraging economic development and enhancing returns. The allocations range from 1% of total assets under management up to 35% in the case of Chicago Teachers' Pension Fund. The money is invested across multiple asset classes, often via an emerging managers scheme to identify the next generation of investors. According to *Diversifying Investments*, a 2017 study of ownership among US asset managers, women and/or minority-owned firms represent just 1.1% of the \$71.4 trillion of assets under management.

Several asset owners in our sample are aligning their investments with the United Nations Sustainable Development Goals, which include gender equality and empowerment of all women and girls. For example, Sweden's AP2 has invested \$30m in a fund to increase access to capital for female entrepreneurs and promote lending in emerging economies. California State Teachers' Retirement System made its first social bond investment – \$5m to finance women-owned enterprises and projects for low-income communities in emerging markets.

## Targeting women

There is a small but growing niche of investment products that index companies based on gender equality criteria, such as female representation in executive leadership, career development opportunities, equal pay and work-life balance schemes. These products are by no means a replacement for active engagement, but may be attractive to heavily indexed asset owners.

Research from Veris Wealth Partners and Women Effect estimate this niche has grown from \$400m in 2014 to \$600m in 2016. Examples include Equileap's gender equality indices, the Pax Ellevest Global Women's Index Fund and State Street's Gender Diversity Index (SHE) ETF seeded with \$250m from CalSTRS. In July 2017, Japan's \$1.2tn Government Pension Investment Fund said it would allocate 3% of its passive domestic equity investments (about \$9bn) to ESG indices including MSCI's Japan Empowering Women Index, which tracks companies that encourage women to work.

## Case study: New York City's pensions system

The New York City Retirement Systems (which is overseen by the NYC Comptroller) has a long standing commitment to diversity and inclusion.

It currently allocates \$12bn of its \$175bn of assets to investment firms and businesses owned by women and people of ethnic minority backgrounds. This allocation has increased by 25% since 2013.

Under the leadership of Comptroller Scott Stringer, the fund has become more vocal and public in its conviction of the value of diversity and inclusion. For example, in May 2015, Stringer announced New York City pension funds would be the first public pension system in the US to ask every investment manager pitching for mandates to disclose the diversity of their leadership team and investment team as part of the Comptroller's Office's due diligence process.

The fund's approach to diversity is not based on race or gender – instead its working philosophy is to level the playing field for everyone. The fund's starting point is that inequality (due to cultural, institutional and often legal barriers) is an issue for every institution, whether public or private, and all organisations need to change the way they do business from being exclusive to becoming inclusive by actively removing institutional barriers – for example, when contracts come up for renewal, the language, the wording and the people solicited must change.

*"The New York City Pension Funds intend to help set a standard and push the envelope for how pension funds and asset managers alike engage on diversity on a holistic level. As our society and economy become dramatically more diverse, so too must our investors and our investments. The opportunities of tomorrow won't be captured using the business practices of yesterday. Diversity is a fiduciary duty and these funds are poised to prove that."*

**Scott Stringer,**  
New York City Comptroller

New Financial is a think tank and forum that believes Europe needs bigger and better capital markets to help drive its recovery and growth.

We believe diversity in its broadest sense is not only an essential part of running a sustainable business but a fundamental part of addressing cultural change in capital markets.

We provided data to Jayne-Anne Gadhia's government-backed review of senior women in financial services, *Empowering Productivity*, and we are working with HM Treasury to review the progress of signatories to the HMT Women in Finance Charter.

New Financial is a social enterprise that launched in September 2014. We are funded by institutional membership.

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## 10 suggestions for debate

Our research shows that over the past two years more asset owners and the wider investment industry have stepped up their engagement on diversity, and the message is reaching an ever-wider and more receptive audience. This report is a part of a broader discussion on the importance and impact of improving diversity. Here are some suggestions to feed into the debate:

1. **Growing pains:** Diversity is going through the same growing pains that climate change and environmental factors did before becoming an established part of investment criteria. Just as with the environment, decision-makers need to maintain pressure to keep diversity on the agenda.
2. **Convincing the naysayers:** Those that believe in diversity are almost evangelical, but our research found that there is still a widely-held and deeply-entrenched view that improving diversity compromises returns. Leaders must be prepared to work hard to challenge the status quo.
3. **A strategic goal:** The starting point for every asset owner is to work out why diversity is important to their individual strategy and purpose. And they do not have to start from scratch – there are resources freely available from industry bodies, investment networks and thought leaders setting out best practice guidelines for constructive engagement.
4. **All shapes and sizes:** Diversity is not just for the biggest asset owners with significant resources at their disposal. Even the smallest can take steps to improve their approach to diversity.
5. **Part of the process:** Diversity efforts are often driven by passionate individuals. Asset owners need to integrate diversity into processes, structures and policies to formalise their commitment to diversity, both internally and externally.
6. **Trustees:** The widespread lack of diversity on trustee boards should be viewed as a governance issue. Asset owners can learn from what has already worked for improving the effectiveness of corporate boards in terms of leadership, balance of skills and diversity of perspectives.
7. **The gatekeepers:** Investment consultants have a pivotal role to play in pushing the diversity agenda. They can proactively advise asset owner clients on the importance of diversity, as well as question and challenge asset managers to improve diversity as part of the manager selection process.
8. **Setting standards:** Asset owners could collaborate to standardise diversity questions in Request for Proposal documents and when reviewing existing asset managers and service providers.
9. **Prepare to bare:** Asset managers need to be prepared to answer both quantitative and qualitative questions about diversity across their investment function and more widely, as appetite from investment consultants and clients grows.
10. **Dipping a toe:** US public pensions schemes are setting aside a portion of their portfolios to back female and minority owned and/or managed funds, and their allocations are growing. If other schemes took a similar approach, it would send a strong signal of intent to the asset management industry.

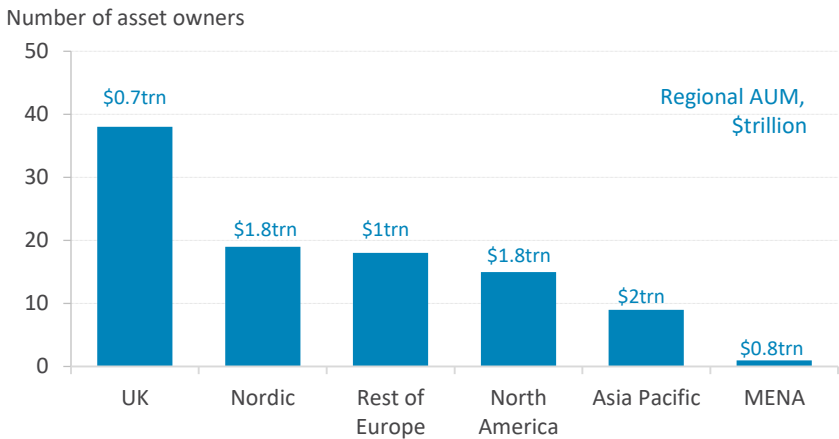
# APPENDIX: METHODOLOGY

## Methodology

New Financial conducted desk research on 100 global assets owners, with particular focus on the UK. The sample includes pension funds, insurance companies, sovereign wealth funds, and endowments selected by activity and availability of information. They have combined assets of more than \$8 trillion.

We also conducted more than 40 interviews with a range of market participants, including asset owners, investment consultants, trade bodies, proxy voting services, asset managers and corporate governance experts. We are very grateful for their time and input.

Fig.9 Regional breakdown of asset owners in sample



## List of asset owners in the sample:

ABP  
Abu Dhabi Investment Authority  
AIMCo (Alberta Investment Management Corporation)  
Alecta  
AMF Pension  
AP Fonden 1  
AP Fonden 2  
AP Fonden 3  
AP Fonden 4  
ATP  
Commonwealth Superannuation Corporation  
AustralianSuper  
Aviva Staff Pension Scheme  
BAE Systems  
BBC  
BP  
British Airways  
British Coal  
BT Group  
CalPERS (California Public Employees' Retirement System)  
CalSTRS (California State Teachers' Retirement System)  
CareSuper  
Cbus  
Chicago Teachers  
Church Commissioners  
Co-operative Group Ltd. UK  
CPPIB (Canada Pension Plan Investment Board)  
Connecticut Retirement Plans & Trust  
Daimler  
Danica Pension  
Diageo

Environment Agency  
Florida State Board  
FRR (Fonds de Réserve pour les Retraites France)  
Ford Motor Company  
Future Fund  
GlaxoSmithKline  
Government Pension Fund  
Government Pension Investment  
Greater Manchester  
Lloyds Banking Group  
HESTA  
HSBC Bank  
Illinois State Board of investment  
IMRF (Illinois Municipal Retirement Fund)  
Ilmarinen Finland  
Industriens Pension  
ING Pensioenfonds  
Keva  
KLP (Kommunal Landspensjonskasse)  
KZVK  
Legal & General (Contract-based schemes and Master Trust)  
London Pension Fund Authority  
Merseyside  
NEST (National Employment Savings Trust)  
National Grid UK Pension Scheme  
Nationwide Building Society  
New York City Retirement  
New York State Common  
NOW:Pensions  
New Zealand Superannuation Fund  
Ontario Municipal Employees  
Ontario Teachers  
Oxford Endowment  
Pensioenfonds Detailhandel

PMT (Pensioenfonds Metaal en Techniek)  
Pensioenfonds PGB  
Pensioenfonds Vervoer  
Pensioenfonds van de Metalektro  
Pension Protection Fund  
PensionDanmark  
PKA (Pensionskassernes Administration)  
People's Pension  
PFA Pension  
PFZW  
PUBLICA  
Rabobank Pensioenfonds  
Railpen  
Sampension  
Royal Dutch Shell  
Shell Oil  
SmarterPensions  
SPW  
Standard Life (Contract-based schemes and Master Trust)  
SURS (State Universities Retirement System)  
Storebrand  
Strathclyde  
Swiss Federal Social Security Funds  
British Steel Pension Scheme  
Texas Teachers  
Temasek  
Tesco  
UBS  
USS (Universities Superannuation Scheme)  
Unilever  
VER State Pension  
Varna  
Wellcome Trust  
West Midlands Metropolitan  
West Yorkshire

# APPENDIX: RESOURCES AND FURTHER READING

Below is a list of reference materials we used in compiling this report, many of which we have referred to in the text, including hyperlinks where available.

- [30% Club UK Investor Group: Toolkit for Engaging Boards on Diversity](#)
- [30% Club UK Investor Group: Investor Group Statement of Intent \(October 2016\)](#)
- [Aon Hewitt and Leeds University Business School Mapping the trustee landscape: understanding trustee decision-making \(February 2017\)](#)
- [Aon Hewitt and Leeds University Business School Selecting fund managers and consultants – what do trustees look for? \(June 2017\)](#)
- [Aon Hewitt and Leeds University Business School Cost, fees, and trustee decision-making \(July 2017\)](#)
- [CalPERS and CalSTRS Diversity Forum \(June 2017\)](#)
- [Corporate Board Diversity: How Pension Funds are Engaging Companies on the Business Case for Diverse Boards \(October 2016\)](#), Harvard Initiative for Responsible Investment webinar, Harvard Kennedy School
- [Credit Suisse The CS Gender 3000: Women in Senior Management \(September 2014\)](#)
- [Davies Review Women on boards: 5 year summary \(October 2015\)](#)
- [Diverse Asset Managers Initiative Fiduciary Guide to Investing with Diverse Asset Managements and Firms \(March 2017\)](#)
- [Equileap Gender Equality Indices](#)
- [Hampton Alexander Review Improving gender balance in FTSE leadership \(November 2016\)](#)
- [Invest Europe ESG Due Diligence Questionnaire for private equity investors and their portfolio companies \(November 2016\)](#)
- [Invest Europe Guide to Private Equity and Venture Capital for Pension Funds \(October 2016\)](#)
- [Invest Europe Handbook of Professional Standards \(November 2015\)](#)
- [Knight Foundation Diversifying Investments: a study of ownership diversity in the asset management industry \(May 2017\)](#)
- [McKinsey 'Women Matter' Series \(2011-2014\)](#)
- [Mercer report for the Diversity Project Diversity in investment management benchmarking study \(September 2017\)](#)
- [Mercer Research Perspectives Vol 4, Issue 3 Newsletter \(December 2016\)](#)
- [New Financial Diversity Disclosure \(September 2015\)](#)
- [New Financial Counting Every Woman \(June 2017\)](#)
- [Parker Review A report into the ethnic diversity of UK boards \(November 2016\)](#)
- [PLSA Breaking the mirror image: harnessing talent through diversity for better pensions \(March 2017\)](#)
- [PLSA Good Governance – How to get there \(August 2017\)](#)
- [PLSA Understanding the worth of the workforce: A stewardship toolkit for pension funds \(July 2016\)](#)
- [The Code of Dutch Pension Funds \(January 2014\)](#)
- [The UK Corporate Governance Code \(April 2016\)](#)
- [The UK Government Equalities Office Gender pay gap reporting: overview \(March 2017\)](#)
- [The Pensions Regulator Trustee landscape quantitative research \(October 2015\)](#)
- [Board Diversity and Self-Regulation in Dutch Pension Funds, Lin Shi, Laurens Swinkels, Fieke Van der Lecq \(2017\)](#)
- [Veris Wealth Partners and Women Effect Project Rose \(2016\)](#)
- [ShareAction Workforce Disclosure Initiative](#)