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DIVERSITY FROM AN INVESTOR'S PERSPECTIVE 2019

WHY AND HOW PROGRESSIVE ASSET OWNERS ARE ADDRESSING DIVERSITY AND INCLUSION – AND WHY THE INVESTMENT INDUSTRY SHOULD CARE

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> Diversity is firmly on the agenda of asset owners globally. They are becoming more vocal, stepping up their activities – and asset managers need to prepare to respond.

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INTRODUCTION

What this report is about

Diversity is firmly on the corporate agenda, with a growing body of research showing that a diverse workforce leads to better decision-making and financial performance – yet much of the capital markets industry has been slow to act. Asset owners are an essential source of capital for financial markets, and their needs and actions as the ultimate clients (or "end users") of the industry have a big impact on how the whole system operates.

So in November 2017, New Financial published our ground-breaking *Diversity from an Investor's Perspective* research to understand if, why and how the most progressive asset owners were addressing diversity and inclusion, both internally and externally, using a combination of desk research and qualitative interviews with market participants.

Our research found a wide, receptive and thoughtful audience. We received a tremendous amount of feedback on our findings, and interest in turning our words into actions. In this updated *Diversity from an Investor's Perspective 2019* research, we have captured how thinking and actions have progressed (in some cases quite rapidly) in the past 18 months.

This report addresses the following questions:

- Why is diversity important to asset owners? Is there evidence diverse managers deliver outperformance?
- How are asset owners approaching diversity:
  - Internally – within the investment function and their workforce
  - Internally – across trustee boards
  - Externally – by using diversity criteria as part of their due diligence process for appointing external fund managers, including the role of consultants
  - Externally – as a theme for portfolio allocation and investment
  - Externally – by engaging on diversity themes with the companies in which they have long term shareholdings

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

Methodology

In 2017 we conducted desk research on 100 asset owners globally, selected by size, activity and availability of information, with combined assets under management of more than $8 trillion. We have since updated our research for those identified as the most progressive on diversity. We analysed publicly available information (eg. websites, annual reports, responsible investment reports, press releases). We also gathered information from more than 100 market participants (including asset owners, investment consultants, trade bodies, proxy voting services, asset managers and corporate governance experts) via desk research of public information (websites, press releases, industry research) plus interviews and discussions. For further information on methodology, click here or contact New Financial.

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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 fundamental to addressing cultural change.

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- Wendy Garcia, Chief Diversity Officer at the New York City Comptroller's office, whose ground-breaking vision continues to inspire us.

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SUMMARY

Highlights of this report

1. **On the radar:** Diversity is firmly on the agenda of asset owners globally, although priorities and approaches vary. There are many examples of best practice from asset owners in North America, Australia, Scandinavia and the UK, but there is a considerable gap between the leaders and the rest.
2. **Thought leaders:** Progressive asset owners globally are doing more than ever to promote diversity and set an example, both internally and externally. They are increasingly vocal, transparent and confident on the subject of diversity and how it benefits the whole investment ecosystem, and their communications and advocacy are more explicit.
3. **Motivations for tackling diversity:** Asset owners' understanding of why diversity is important to them is improving and becoming more nuanced, with improved decision-making as the top reason given for acting on diversity. However, views on the value of diverse managers to enhance fund performance remain polarised.
4. **Inclusion and culture:** For those addressing diversity internally within the investment function, the discussion is beginning to encompass inclusion and cultural change more broadly. Asset owners are drawing on common corporate action points to drive change, for example gathering more granular data across diversity strands and introducing flexible working.
5. **Trustee diversity:** Awareness of the need for and benefits of trustee diversity is growing and slowly turning into action, with a particular focus on encouraging more young people onto trustee boards.
6. **Influencing manager selection:** While not ubiquitous, more asset owners are asking questions of their potential and existing managers. Diversity queries are rising in number and frequency in requests for proposals, and discussions are becoming more difficult for asset managers to ignore.
7. **Role of investment consultants:** Thinking on diversity is evolving for the biggest firms. They are raising the topic in discussions with clients and being challenged on their own diversity by clients. Diversity and culture criteria are being integrated into manager assessment, but the approach is inconsistent across different consultants, asset classes and regions.
8. **Mandate critical at the margin:** Some asset managers take responses to diversity questions more seriously than others. High scores on diversity criteria may not be core to a mandate, however, answering diversity questions well could be the marginal difference between winning or losing a mandate when rivals are otherwise evenly matched.
9. **An investment opportunity:** The trend amongst US public pensions to allocate directly to diverse managers is growing, with schemes increasing allocations to emerging managers programmes. Diversity as a theme for investment analysis is also developing, with more indices and more products as the quality and quantity of data improves.
10. **Gender takes priority:** Diversity efforts are largely concentrated on boosting female representation, as this is where both qualitative and quantitative data is best established. Shareholder engagement activity is focused on board diversity, with some extending their discussions to the wider workforce and diversity strands other than gender.

"We have a responsibility to allocate our funds wisely – and bringing growing, talented, and diverse investors, including minority and women-owned firms, to manage our portfolio is the right strategy for the future."

Scott Stringer,
New York City Comptroller

"The CalSTRS Investments Branch worked to increase awareness and advance understanding of diversity and inclusion internally and externally among staff, external managers, portfolio companies and service providers through ongoing education, relationship building, networking and direct engagement."

CalSTRS

"Diversity discussions form an integral part of our research process, and in numerous cases, a manager's diversity (or lack of it) has contributed to a rating change – sometimes up, other times down."

Michael Kinney,
Senior research specialist,
Mercer

"Where two managers are deemed to have equal investment capabilities, being more progressive around inclusion and diversity can help tip the selection decision."

Juliet Bullick
Global head of consultant relations,
Fidelity International

WHY DIVERSITY IS IMPORTANT TO ASSET OWNERS

Fig. 1 Motivations for tackling diversity

The five most common reasons why asset owners are acting on diversity

1) To improve decision-making
2) To attract and retain talent
3) To innovate and compete
4) To reflect members and communities
5) To enhance financial performance

(ranking based on 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. Above we list the top five motivations for addressing diversity given by asset owners in our sample.

The most commonly stated reason is to improve decision-making, however these five reasons are not mutually exclusive; rather they overlap and reinforce each other. Our research found that for asset owners globally, their own understanding of why diversity is important is improving, their motivations are becoming more nuanced, and discussion is evolving from representational diversity to culture and inclusion and the need for a broader cultural shift.

The most progressive are more actively and explicitly communicating about the need to improve diversity both internally and externally.

And their words are being heard. The asset owner perspective on diversity is increasingly reflected by asset managers themselves – New Financial's 2018 research *Diversity in Portfolio Management* found broad consensus across the investment industry that diverse voices enhance investment performance by increasing diversity of thought, which in turn improves decision making, investment idea generation and guards against group think.

"HESTA believes diverse teams make better decisions. Ensuring we have gender diversity across all teams involved in making decisions to drive value in our investments will help improve our members' retirement outcomes."

HESTA

"Our view is that diverse groups are essential to our ability to fulfil our mission and achieve our goals. With diversity, we receive different perspectives in our work, which enables us to keep up with what is happening and make wise, well-grounded decisions when faced with difficult choices. It also makes us better representatives for our customers."

Alecta

"Active equality and diversity work in the Fund contributes to increased motivation and satisfaction among employees, which in turn increases the Fund's competitiveness and possibility of generating a good return."

AP2

Understanding scheme members

A small number of schemes, such as the Canada Pension Plan Investment Board, mention the need to reflect members and communities (fig.1).

Our research found few examples of asset owners seeking to improve their understanding of their scheme members – who they are and what they value – to better meet their needs; indeed surveying members is controversial for many asset owners. ShareAction, a responsible investment charity, found UK pension providers tend not to survey their members and instead rely on their online platforms as a source of information for members, even though only a tiny proportion, typically 10% of members, actively register. This approach may have to change in the UK with the advent of auto-enrolment, which is bringing millions of workers into workplaces pension schemes.

"Our clients are at the heart of everything we do, and I think it's notable that of our more than 600,000 beneficiaries, well over 70% are women."

Dawn Turner, CEO,
Brunel Pension Partnership

"Over 80 % of HESTA members are women. As a gutsy advocate for our members, we invest to influence and advocate for policy change."

HESTA

"Diversity is good for business and, specifically, good for CalSTRS' investments. The business case for diversity is evident in the rapidly changing demographic profile of the United States as well as the continuing rise in purchasing power of women and various ethnic and racial groups. Diversity offers companies asymmetric protection – superior upside in growth markets and allows companies to make better decisions about strategy and managing risk."

CalSTRS

"There seems to be a misconception about diversity work: it is really just allowing access to competition. To run a safe and sound organisation you need to manage risk and protect your institution from overspending. That means oversight of everything you buy and who you buy it from. That includes fund managers."

Wendy Garcia,
Chief diversity officer,
New York City Comptroller's office

"We are concerned that the failure of fund management firms to draw on more diverse viewpoints may result in inferior investment performance."

Joseph Rowntree Charitable Trust

Convincing the sceptics

Our research found a notable division in mindset between those who believe diversity is important – whatever the motivation – and those who do not. Despite pressure from government, regulators, peers and society to challenge a lack of diversity in the workforce, there is still a widely-held and deeply-entrenched belief in the investment industry that improving diversity compromises returns, and/or comes at a cost that is not worth paying. Indeed, while some "believers" see diversity as part of their fiduciary responsibilities, others fear a focus on diversity could be a violation of fiduciary duty.

In the face of such polarised views, progressive asset owners and the most forward-looking firms from other parts of the investment sector are developing and refining their messages to bring sceptics round. While a few start with the social justice argument that "it's the right thing to do", most frame their commitment to diversity as an integral part of doing business; in terms of competition, performance, risk management and sustainable human capital management.

The ongoing quest for incontrovertible proof

For those asset owners in our sample that said diversity enhances financial performance, the business case is clear. But many among the unconvinced want to see hard data that using diverse fund managers will yield an uptick in returns. Such a data set is a tricky proposition and the evidence is unclear.

There are examples of performance data that support a case for diverse managers – one being *Citywire's Alpha Female Report 2018*, which found mixed-sex teams outperform single-sex teams, producing three-year returns that are 4.3% higher on average than female teams and 0.5% higher than male teams.

However, the latest *Diversifying Investments* research from the Knight Foundation, a US grant-making organisation that allocates a third of its own endowment to diverse managers, found diverse-owned funds perform at a comparable level to non-diverse peers. For the Knight Foundation, this is adequate evidence that diversity does not compromise performance. But others may only act if they feel they stand to make a gain – there appears to be a higher bar for diverse managers compared to the mainstream.

Another factor in presenting a counterfactual to the status quo is that the number of diverse managers is so small. Citywire's report found that about 10% of the 16,084 active fund managers in its database are women and women manage less capital than men; while the Knight Foundation's report found just 1.3% of the $69 trillion asset management industry is managed by firms owned by women or minorities.

The Knight Foundation identifies the lack of data on diverse ownership or management and systematic tracking of diversity as the biggest barrier to high quality research on the impact of diversity on fund performance.

"Diversity and inclusion is a priority area at Wellcome. We are changing some of our internal structures and practices in order to broaden the diversity of people we fund, engage with and employ. Many of these changes will also help to reduce, and eventually eradicate, our gender pay gap."

Wellcome Trust

"Diversity can't just be a diktat from the board and senior management… it is about getting every voice in the room involved and requires an organisational culture."

David Rix, Chief executive, BP Pension Trustees

"Over the course of 2018/19 we will develop and embed a culture…based on a public service ethos of openness, accountability, professionalism, honesty, integrity, fairness and trust…to attract the right kind of staff…and ensure the company is perceived by partner funds, staff and the wider stakeholder community as aspirational, ambitious and inspiring."

LGPS Central

"We arranged discussions in all working groups at Alecta on unequal, unfair and abusive behaviour and how we can avoid such problems. This initiative is part of our diversity efforts and is aimed at raising awareness of what abusive behaviour is, how we can prevent it at Alecta and what can be done if it happens nonetheless."

Alecta

"Diversity in the management of investments is accomplished with an investment staff of 151 individuals who are multiethnic, multicultural and possess myriad worldviews and investment perspectives."

CalSTRS

A shift towards inclusion and culture

Half of the asset owners in our sample disclose information in their annual reporting which suggests they are addressing workforce diversity internally. Our research found clear trends: schemes' commitment to diversity is more explicit, the discussion touches not only on diversity but also on culture and inclusion, and there has been an increase in data collection and transparency.

For example, the Wellcome Trust, a £26 billion UK foundation, ranks diversity and inclusion top of its list of eight priority areas in its *2018 annual report*, and is actively applying a D&I lens across all its activities. The Trust refreshed the diversity data it collects from its staff, is rolling out training to all employees to mitigate bias in their work, and is embedding D&I into its strategy so it can be sustained. Notably, the Trust is subject to UK gender pay gap reporting requirements, and it acknowledges its bonus pay gap of 83% is due to how it pays its senior investment team, who are mostly men.

The Trust says it is aiming to make parental and adoption leave gender-neutral, and make flexible working possible at all levels. Similarly, BP Pension Trustees is also offering flexible working to encourage women to return to work, and Dawn Turner, chief executive of the £30bn Brunel Pension Partnership has sought to establish a flexible working culture.

Both Brunel and the £40bn LGPS Central fund are new pooled schemes, which combine many smaller UK local government pension funds into fewer, larger funds to reduce administrative overheads and increase access to investment opportunities. They are aiming to draw on the best parts of public sector culture, such as diversity, transparency, value for money and well-paid regional jobs – LGPS Central includes developing "a corporate culture based on transparency and fairness to clients, employees and shareholders" as one of eight objectives outlined in its *2018 annual report*. It will be interesting to see if and how these pooled schemes seek to take a lead on issues such as diversity as they establish themselves and their governance priorities.

More granular data and a wider focus

While asset owners tend to focus on addressing gender balance first (as has been the case with diversity initiatives across the public sector and corporate world), the more advanced are beginning to address ethnicity, age and even socioeconomic background.

CalSTRS, the second largest public pension fund in the US with $230bn of assets, has long been a champion of diversity in its approach to investment. In its *2018 progress report*, in addition to publishing data on its investment staff's gender and ethnicity across six levels of seniority, for the first time it has also provided a break down by age and gender, including the average number of years of service. CalSTRS also built on its existing mentoring programme for students of diverse backgrounds with a new investments internship targeting diverse groups "which tend to be under-represented on Wall Street". The intern scheme was so successful CalSTRS plans to expand it.

"Governance is about the resources, structures and processes which support decision-making – for pension funds, this means having a skilled board or committee, with a good balance of knowledge and experience and the cognitive diversity which that brings, supported by a properly-resourced executive function.

These are the key 'inputs' into scheme governance. The 'outputs' are the processes that governance bodies implement, determining the quality of management of the scheme and the outcomes experienced by scheme members.

The regulation of pension fund governance should focus on these inputs – if governance bodies are populated by the right people, situated within an appropriate and accountable structure, this maximises the likelihood of good decision-making, leading to good outcomes for scheme members."

Good Governance – How to get there
Discussion paper from the UK's Pensions and Lifetime Savings Association

A tough task: tackling the homogeneity of UK trustee boards

Trustee boards of pension funds clearly lack diversity – a typical UK trustee is male (83% of UK trustees, according to UK trade body the Pensions and Lifetime Savings Association) and close to retirement age (average age of 54, according to *research* from Aon Hewitt and Leeds University), and this is by no means a UK-specific problem. Trustee recruitment and succession planning tends to be informal and opaque, and responsibility and accountability for trustee diversity is diffuse if it exists at all. But there are signs that awareness of the need for and benefits of trustee diversity is growing, and turning into action.

The PLSA launched its *Breaking the Mirror Image* campaign in 2017 to highlight the potential for group think on trustee boards and encourage wider, more diverse participation across the pensions industry. It also brought diversity into the broader debate in the UK around the need for better governance of pension schemes in order to make better decisions (see panel, left).

The Financial Conduct Authority, the Department for Work and Pensions and The Pensions Regulator have outlined the need for pensions to be governed and administered well. However, ShareAction, a responsible investment charity, argues in its 2018 research *The Engagement Deficit* that more needs to be done to promote diversity, and recommends that all three bodies "ought to encourage auto-enrolment pension providers to set targets to improve diversity on governance boards".

A youthful outlook

Auto-enrolment is having an important impact on the age profile of workplace pension scheme members. Millennials make up around 40% of the target group for auto-enrolment, and it has led to a doubling of participation of 22-29 year olds in pension schemes, according to *research* from the Pensions Policy Institute. Yet, young people are largely absent from pension trustee boards.

The PLSA is increasing activity to bring young people into the pensions industry, collaborating with the Young Pension Trustee Network and Next Gen Now, a group launched in October 2018 to champion younger voices in pensions. Similarly, the Pension Management Institute's Project 35 initiative supports young, up-and-coming talent in the sector.

Widening the appeal of becoming a trustee

There are useful free online resources such as The Pensions Regulator's *toolkit* to support both new and established trustees to get up to speed and *checklists* from investment consultancy Aon Hewitt to aid trustee decision-making. However, the industry needs a concerted, collaborative push to define what it takes to be a trustee, who can become one and how, and the benefits of being one, in order to broaden the appeal of joining a board of trustees and target more women, the next generation and people of diverse backgrounds – particularly as the role of pensions trustees evolves and professionalises.

"The investment manager survey will measure rates of gender diversity across a broad range of investment decision-making roles with the aim of encouraging more opportunities for women in the investment management industry."
HESTA

"Please reference your approach to diversity, and describe the culture of your firm and comment on how it is maintained, also detailing how important this strategy is to your business [10% of overall score]."
From an RFP issued by LGPS Central

"Please provide percentage ownership of firm by women, those from ethnic backgrounds and those with severe physical or mental disability."
eVestment database

"Where two managers are deemed to have equal investment capabilities, being more progressive around inclusion and diversity can help tip the selection decision."
Juliet Bullick
Global head of consultant relations, Fidelity International

Incorporating diversity criteria into manager selection

As clients, asset owners are perfectly placed to challenge investment managers about their (lack of) diversity. Our research found that while not all asset owners want to talk about diversity, more clients than ever before are asking questions of their potential and existing managers, particularly about the diversity of investment teams. The discussions are becoming more focussed, granular, nuanced and – crucially – more difficult for managers to ignore.

For example, HESTA, an Australian superannuation fund with A$43bn of assets, is surveying 70 of its investment managers about gender diversity across a range of roles from investment analyst to the investment committee, because "the fund sees diversity as an accurate indicator of a well-run company which is more likely to deliver strong performance results". HESTA plans to share the results and examples of best practices with its managers to encourage progress.

Several interviewees reported specific instances of senior investment staff in pitch meetings being put on the spot by prospective clients asking: "Where are the women on your team?" Interviewees said this direct challenge face-to-face had a far greater impact on their firm than questions in RFPs (requests for proposals).

Diversity questions in RFPs are also increasing in number and frequency, they are becoming more challenging and asking for more detailed data and narrative disclosures. Common questions focus on equal opportunities policies, how diversity fits into strategy, how managers address cognitive diversity, and specific actions they are taking to recruit, retain and promote staff of diverse backgrounds. While the diversity criteria are not necessarily essential to win a mandate, they can prove critical at the margin, as a manager that can answer these questions well might be at an advantage over a peer that is neck-and-neck on other areas.

Despite this, the data disclosed by asset managers in RFPs is often underwhelming. There is some evidence that submissions in gender fields is improving, but other diversity strands, for example ethnicity and disability, are too often left blank, and managers tweak their definitions of "investment professionals" or "decision-makers" to make their numbers appear more flattering.

On the radar of alternative investment managers

Private equity and hedge funds are laggards when it comes to embracing diversity. However, there is a glimmer of hope as these sectors begin to build data recognising the scale of the problem.

A 2018 survey of 178 firms from the British Venture Capital and Private Equity Association established a vital baseline on female representation, finding just 6% of senior investment roles were held by women. And a report from data provider Preqin found half of investors in alternative assets have diversity policies in place, while only 17% of managers do, with 21% planning to within five years.

In response, government and investors are at last taking note. The Institutional Limited Partners Association, which represents private equity investors, has added a template to its due diligence questionnaire for firms to measure and report the gender and ethnic diversity of their teams by seniority and role, and it has also expanded its code of conduct to cover harassment and discrimination. Meanwhile, the UK government has published two reports, the *Alison Rose Review of Female Entrepreneurship* and *UK VC and Female Founders*, which both reveal gender bias in start-up investment, not least because there are so few female investors.

Fig. 2 Willis Towers Watson's culture assessment

Below is a list of sample questions from Willis Towers Watson's culture assessment. There are three main components:

1) Employee value proposition
- How are you employing, engaging and retaining your employees?
- Are you providing good development opportunities for them?
- How are employees compensated?

2) Client value proposition
- How are you measuring client success?
- What is client success to you?
- How do you build trust with clients?
- How do you think about launching new products?

3) Leadership
- How empowering are leaders?
- Do they drive culture down throughout the firm?

Examples of general questions:
- Why do you do what you do?
- What makes your firm a great place to work?
- Who is the keeper of the culture?
- How do you consider the diversity and inclusivity of the team?
- What behaviours do you try to encourage within your team?
- What other value besides investment returns do you provide?
- How do you go about building a relationship based on trust?
- How well do your clients understand what you do?

How consultants are bringing diversity into their recommendations

Investment consultants play an influential role providing advice to asset owners on asset allocation and manager selection. We asked the three biggest consultants, Mercer, Willis Towers Watson and Aon Hewitt how their thinking and practice on this topic was evolving.

The consultants are increasingly being challenged on their own diversity by clients. They are bringing diversity into the assessment of more asset classes, collecting more data, digging deeper into the culture of investment teams and their organisations, and looking for opportunities to collaborate on diversity – all three are signatories to the HM Treasury Women in Finance Charter, aimed at increasing female representation in senior roles, and the Diversity Project, which champions diversity and inclusion in the investment industry.

However, these kinds of actions are yet to be embedded in assessment processes. Diversity still rests on the initiative of passionate individuals at these firms, and there is a lack of consistency in approach from the different consultants across different asset classes and regions.

Mercer assesses diversity in the context of idea generation, avoiding group think, reducing risk in portfolio construction, and how well a business is managed. Michael Kinney, a senior research specialist at Mercer, said the firm is seeing more incoming questions from clients, more requests for diversity data and is also collecting data in a more considered way. It has introduced women- and minority-owned filters to its database, and has explained to managers that capital is at risk if the quantity and quality of diversity data they submit to the database remains poor.

Willis Towers Watson's Luba Nikulina, global head of manager research, said her team actively brings diversity into discussions with clients. The firm brought diversity criteria into the due diligence process for its high conviction recommendations (a list including about 500 strategies from around 350 asset managers) in 2016, and last year introduced a rigorous culture assessment (see panel, left), based on data points and interviews: "Culture can be a really important tool to mitigate downside risk. We have seen clear links between a manager's successful culture actually impacting their long-term sustainability".

Willis has assessed more than 40 organisations and found the culture criteria generally reconfirmed their positive views, but there have been occasions where a manager failed to win the highest conviction rating. The firm is introducing a training programme to institutionalise this initiative, and is gradually embedding diversity and inclusion across all standard asset selection.

Aon Hewitt has also been increasing its engagement around diversity. In 2016, it presented research to regional and global investment committees highlighting the positive impact of diversity on investment returns, and initiated an "open door" policy for diverse fund managers resulting in more than 200 emerging and diverse manager fund interactions, according to Meredith Jones, partner at Aon. Aon is working with specific clients on diverse manager selection and is considering diversity metrics for mainstream asset managers.

An investment opportunity

There are progressive asset owners that see diversity, particularly gender, as an investment opportunity.

In the US, public schemes often carve out a portion of their portfolio to allocate specifically to diverse managers. Most do this via emerging managers programmes, where they actively seek up-and-coming managers and often target funds owned or run by women and minorities. For example, the $11bn Chicago Teachers' Pension Fund has invested 42% of its portfolio with minority, women and disabled-owned businesses, more than double its 20% goal.

We also found examples of asset owners aligning their investments with the United Nations Sustainable Development Goals, which include gender equality and empowerment of all women and girls. For example, last year Sweden's AP2 invested in a World Bank social bond focused on gender equality, and HESTA, which is a long-standing advocate of gender equality, is working to integrate the UN goals into its investment strategy and active ownership practices.

AP2 has also developed new internal indices for global equities, which include exposure to ESG factors such as equality and gender ratios. While AP2 said it was too early to tell, "there are indications that the factor of the proportion of women in the company from a global perspective has contributed to a positive return".

Growth of gender-lens investing

There is a small but rapidly growing niche of investment products that index companies based on gender criteria, such as gender ratios in leadership and career development opportunities. Notably, the leaders in this niche are women.

Research from Veris Wealth Partners found 35 gender lens investment vehicles worth $2.4bn, a steep increase from just $100m in 2014. Products include State Street's SHE ETF seeded with $250m from CalSTRS and RBC's RLDR ETF seeded with $100m from Ontario Municipal Employees Retirement System.

There has also been an uptick of active fund launches, including Legal & General Investment Management's "GIRL", the first gender-orientated UK equities fund seeded with £50m from L&G, and Axa Investment Management's Women Empowerment global equity fund.

Case study: New York City's pensions system

The New York City Comptroller's office oversees the City's five public pension funds (worth $195bn) and is a pioneer when it comes to diversity and inclusion.

The current Comptroller Scott Stringer was elected in 2013. He appointed New York City's first ever chief diversity officer, a C-suite level post, to identify ways to increase the number of minority and women-owned businesses in the City's supply chain, including the procurement of investment management services.

New York City was the first US public pension system to ask prospective fund managers due diligence questions about the diversity (including race and gender) of their investment decision-makers and the strength of their diversity policies. It has increased its allocation to emerging managers by 57% since 2014, and has increased assets committed to businesses owned by women and people of ethnic minority backgrounds by 40% since 2014.

And the Comptroller's office continues to break new ground. In 2018, it appointed the pension investments bureau's first director of diversity and inclusion dedicated to working with emerging managers, and set a goal of allocating 10% to emerging managers in every asset class. The bureau also announced it is working with its investment consultants to proactively identify, track and monitor qualified emerging and diverse managers.

The fund's approach to diversity is to actively unpick inequality and bias due to cultural, institutional and often legal barriers. This approach is quite unique, but it is still driven by data. For example, when the asset management bureau wants to issue a tender, it must first conduct a market analysis to understand which firms are in that particular segment. This analysis is then reflected in the tender criteria to ensure the tender is accessible to a far wider group of asset managers, rather than the same firms every time.

"Ensuring our access to the best investment talent available is part of our fiduciary duty; it promotes competition, diversifies our portfolio and makes our investments stronger. That requires searching for talent in less conventional places, and making sure that industry roadblocks don't keep our managers from hiring the best."

Scott Stringer,
New York City Comptroller

"We believe that companies with gender-diverse boards are more likely to achieve superior financial performance over the long-term. For that reason, engaging with companies to drive better corporate behaviours is a key part of CPPIB's mandate."

Mark Machin,
President and CEO,
Canada Pension Plan Investment Board

"Voting is a powerful tool that we can use to seek change, which can also open the door to future engagement and conversations. It would be great to see more investors taking action – a vote against a chair is taken very seriously by UK companies."

Clare Payn, Head of Corporate Governance, North America, Legal & General Investment Management

"Most directors serve out a full nine to 10 years… the ten year check point has become a de facto fixed term, which mitigates against the removal of underperforming directors or board renewal to inject greater diversity (including gender diversity) and to meet future strategic needs of the company."

Shaping the boards of the future, 30% Club, Australian Institute of Company Directors

Board diversity is the priority

Asset owners are becoming more vocal on board diversity at the companies in which they invest, with particular focus on increasing female representation, board effectiveness and governance, and updating voting policies.

More asset owners are stating publicly that they will vote against all-male boards, as well as committee chairs and directors where there is insufficient evidence of progress to improve gender ratios. For example, Universities Superannuation Scheme, the largest private sector pension scheme in the UK at £64bn, updated its voting policy last year, as did the New York State Common Retirement Fund and Canada Pension Plan Investment Board. CPPIB's sustainable investing team has also added board effectiveness to its five focus areas, to "better identify and address issues such as gender diversity that are key drivers of value for long-term investors".

Church Commissioners, which manages £8bn for the Church of England, is collaborating via the Church Investors Group to vote against nominations committee chairs where the board has less than 33% female representation and against all directors where the level is less than 25%. For the first time, the scheme publicised its voting intentions and generated considerable media coverage.

CalSTRS and the UK's Local Authority Pension Fund Forum are stepping up their stewardship activities by requesting meetings with investee companies to discuss how diversity is considered in processes around board nominations and succession planning, for both executive and non-exec directors.

Shareholder appetite for (and understanding of) granular data beyond the board is growing – albeit slowly. The UK's Pensions and Lifetime Savings Association has followed up its *Understanding the Workforce* toolkit, which outlined diversity metrics for pension funds to consider, with its *Hidden Talent* research assessing company reporting on workforce issues. Encouragingly, investor support for the Workforce Disclosure Initiative reporting framework, launched by UK charity ShareAction, has increased rapidly over the past year, growing from 80 to 120 institutional investors with $13 trillion of assets.

The asset manager perspective

Asset managers in turn are escalating their engagement, again with a focus on female representation. More than half (56%) of those surveyed by the Investment Association's *stewardship survey* engaged with UK companies on gender diversity, and 42% made a voting decision based on gender diversity.

For example, in his 2019 annual *letter* to CEOs, Larry Fink, chairman and chief executive of BlackRock, listed board diversity and human capital management as engagement priorities; Legal & General Investment Management voted against the largest number of UK chairs to date in 2018 on the issue of gender diversity, casting more than100 votes, up from 13 in 2016; and Columbia Threadneedle Investments has introduced a global policy to refuse support for committee chairs of companies with less than 15% women on their boards.

NEW FINANCIAL
Rethinking capital markets

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.

We provided data to the government-backed Gadhia review of senior women in financial services, *Empowering Productivity*, and we work as a data partner with HM Treasury to monitor 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 the most progressive asset owners are stepping up their advocacy and engagement on diversity. Below are 10 discussion points raised by our findings to contribute to a broader discussion of diversity:

1. **A tipping point:** The nature of the discussion around the importance of workforce diversity has changed rapidly over the past three years. There may still be notable asset owners remaining quiet on the topic now, but pressure is mounting and inevitably they will take a stand.
2. **Follow the leaders:** The most progressive asset owners are doing more than ever to promote the importance of diversity and challenge the status quo. All asset owners, no matter their size, can borrow and adapt ideas from the leaders to improve how they approach diversity.
3. **A holistic view:** The case for improving corporate board diversity is well established and widely supported by the investment community. This expectation should extend to those making investment decisions in the first place – trustees, consultants, and both internal and external managers.
4. **Must-have or nice-to-have:** Our research found a spectrum of investor opinion on if and how diversity fits into fiduciary duty. Investors need to challenge their perceptions and interpretations of what is or is not consistent with fiduciary duty and why, to gain clarity and confidence to act on diversity.
5. **Walk the talk:** While there are plenty of positive messages and intentions, in practice, the level of challenge on diversity is often weak and inconsistent. Diversity needs to be strategic, institutionalised into business and process rather than being driven by passionate individuals.
6. **Be bold:** Our research found interesting examples of asset owners using diversity as an investing lens. But to maximise the benefits of greater diversity, it needs to be brought into the mainstream of investment mandates and decision-making, not reside in niche allocations.
7. **Everyone's problem and solution:** Different parts of the investment chain are challenging each other on diversity: asset owners with consultants and managers; consultants with clients and managers; managers with companies in which they invest. This discussion needs to focus on rigorously holding each other to account and collaborating to identify and resolve systemic issues.
8. **Prepare to bare:** Asset managers will need to step up preparations to answer both quantitative and qualitative questions about the diversity and culture of their teams as appetite from clients and investment consultants grows – or risk the competitive disadvantage of lower scores on RFPs.
9. **Refreshing trustees:** As the role of pensions trustee evolves and professionalises, the industry will need to rethink the profile of a typical trustee in order to make the role more appealing and accessible to women, the next generation and people of diverse backgrounds.
10. **Asset management needs a revolution:** Our research reinforces the importance of diversity to the entire investment ecosystem. Financial intermediaries have an opportunity to embrace diversity as a means to offer clients better, sustainable performance, rather than wait until clients – or indeed regulators or governments – demand it.