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BNY Mellon Investor Solutions

**Diversity & Inclusion in
Investment Management:**
*Expanding the Dimensions of
Investment Diversification*

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INVESTMENT MANAGEMENT

I. Overview

Diversity and Inclusion (D&I) within the field of investment management is a subject of increasing importance. From an industry perspective, progress has been modest, particularly in the context of Diverse-Owned Investment Management firms (Diverse-Owned IMs). BNY Mellon Investor Solutions, LLC (Investor Solutions) strives to be a leader in advocating for Diverse-Owned IMs.

This paper makes observations on the level of demographic disparity in the industry, explores and dismisses areas that could serve as reasons behind the deviation and explains the framework Investor Solutions has in place to identify Diverse-Owned IMs.

II. Diversity & Inclusion Defined

Diversity refers to the differences between individuals that enable each of them to make unique contributions. These differences can include, but are not limited to, gender, ethnicity, age, religion, socioeconomic background, military background, family status and gender identity. **Inclusion** refers to establishing and maintaining a workplace culture where all employees are valued and respected, feel a sense of belonging and have equal opportunity to contribute to their full potential. Inclusion involves leveraging the diversity of individuals to create a fair, healthy and high-performing organization. An inclusive environment promotes equal access to resources and opportunities.

Diversity is about the differences between people, but inclusion is about a culture that allows an organization to take advantage of that diversity. If you have diversity without inclusion, this could actually have negative consequences as it may create an environment where individuals are disinclined to share their potential.

III. The Relationship Between Emerging Managers and Diverse-Owned Investment Managers

BNY Mellon defines **Emerging Managers** as having short firm tenures, strategy track records under three years and firm assets under \$2 billion, although the tenures and firm asset levels in this definition greatly differ amongst investors. BNY Mellon defines **Diverse-Owned IMs** as having greater than 50% ownership levels by minorities, women or other diverse groups. This ownership level is also not universally adopted, but it seems to be the predominantly referenced level. While some institutions combine these definitions for both practical and legal reasons, for the purposes of this paper we maintain the definitions as distinct and separate.

IV. Investment Management Industry Demographic Observations

Demographic information in the investment management industry is far from complete, accessible or transparent. While diversity extends beyond gender and race, data availability beyond these areas is almost non-existent. In addition, diversity represented by firm ownership and within the employee base (both administrative and investment professionals) both hold importance, yet diversity data outside of ownership is not typically available for public consumption. This data issue needs to be addressed through a concerted effort by investors of all types (institutional and retail) to demand this data from firms and third-party data providers.

Based on currently available data and studies, there is a clear disparity in the industry from an ownership, workforce and asset oversight perspective relative to the broader population. A comparison of data between the U.S. Census Bureau and U.S.-based asset managers in the eVestment database demonstrates the disparity:

U.S. Census Bureau Data	U.S.-based Asset Managers in eVestment
<ul style="list-style-type: none"> • 50% of the U.S. population is female 	<ul style="list-style-type: none"> • 27% have minority or women owners
<ul style="list-style-type: none"> • 40% of the U.S. population are people of diverse ethnicity (non-whites) 	<ul style="list-style-type: none"> • 47% do not report any firm ownership data, typically indicating either no meaningful ownership by diverse groups or a public ownership structure
<ul style="list-style-type: none"> • Approximately 36% of all businesses are women-owned 	<ul style="list-style-type: none"> • 11% of equity firms have ownership of 50% or more by a combination of women and minorities
<ul style="list-style-type: none"> • Approximately 29% of all businesses are minority-owned 	<ul style="list-style-type: none"> • 5% of fixed income firms have ownership of 50% or more by a combination of women and minorities

Sources: U.S. Census Bureau: American Community Survey Demographic and Housing Estimates 2019, U.S. Census Bureau: Statistics for All U.S. Firms by Industry, Gender, Ethnicity, and Race for the U.S., States, Metro Areas, Counties, and Places: 2012, eVestment, BNY Mellon. eVestment is a Nasdaq platform that provides institutional investment data, analytics and market intelligence covering public and private markets.

Despite this disparity, U.S. Department of Commerce and U.S. Census Bureau data indicate an educated hiring pool is widely present (based on attainment of bachelor’s and master’s degrees as a percentage of the demographic).

Information on allocations to Diverse-Owned IMs by institutional investors is also not widely available. The John S. and James L. Knight Foundation conducted a survey of the top 50 U.S. charitable foundations, of which 26 either responded or had public data available.¹ They found that of the approximately \$64 billion represented in industry assets, approximately 13.5% was invested with Diverse-Owned IMs. This study also indicated that across the industry, women- and minority-owned investment management firms only manage around 1.3% of the \$69 trillion in industry assets.

While there are additional studies and polls that further display the imbalance of industry representation, these examples clearly demonstrate industry disparity relative to the broader population.

¹Source: Professor Josh Lerner, Harvard Business School Bella Research Group, “Diversifying Investments: A Study of Ownership Diversity and Performance In the Asset Management Industry,” John S. and James L. Knight Foundation, 2019 and “Diversity of Asset Managers in Philanthropy”, Global Economics Group, John S. and James L. Knight Foundation, 2020.

V. Performance-Based Evidence

An internal analysis performed by Investor Solutions suggests that the gender and ethnicity gap within the investment management industry is not based on performance differences in Diverse-Owned IMs. Based on information available from the eVestment database and research spanning asset classes, gender and ethnic diversity, the data has shown no statistically significant performance differentials for Diverse-Owned IMs relative to respective peers, although one study did indicate potential outperformance within private equity.

As noted in the table, based on the equity and fixed income categories within eVestment and data as of the end of calendar year 2019, there are a limited number of Diverse-Owned IMs. It is also clear these firms have a much smaller asset base relative to the respective universe of firms. Based on average level of assets, the Diverse-Owned IMs are smaller organizations, while asset levels tend to be larger in fixed income relative to equities.

	# Unique Firms	Forms with No Ownership Date	Firms with Ownership Data >50% Women	Firms with Ownership Data >50% Minority
Equity:				
# Unique Firms	1,524	608	56	61
Average Firm Assets	74,467	119,954	5,255	3,027
# Firms with Asset Data	1,077	343	42	40
Fixed Income:				
# Unique Firms	706	330	17	32
Average Firm Assets	153,935	201,185	12,160	12,325
# Firms with Asset Data	523	206	15	25

In a review of the trailing 3-, 5-, 7- and 10-year absolute performance and Sharpe Ratios in the eVestment categories listed through the end of calendar year 2019, there was no clear indication or pattern of statistically significant performance differences relative to the full universe of strategies in each category. For these categories, average universe performance statistics were compared to the average statistics for firms with greater than 50% ownership by women or diverse ethnicities.

Asset Class Categories Reviewed
Equity:
eVestment U.S. Large-Cap Core Equity
eVestment U.S. Large-Cap Growth Equity
eVestment U.S. Large-Cap Value Equity
eVestment U.S. Small-Cap Core Equity
eVestment U.S. Small-Cap Growth Equity
eVestment U.S. Large-Cap Value Equity
Fixed Income:
eVestment U.S. Intermediate Duration Fixed Income
eVestment U.S. Core Fixed Income
eVestment U.S. Core Plus Fixed Income
eVestment U.S. Corporate Fixed Income
eVestment U.S. High Yield Fixed Income
eVestment U.S. Municipal Fixed Income - All Duration
eVestment U.S. Municipal Fixed Income - Intermediate Duration
eVestment U.S. Municipal Fixed Income - Long Duration
eVestment U.S. Municipal Fixed Income - Short Duration

VI. D&I Framework for Manager Research

While there is no guidebook on how D&I should be pursued within investment manager due diligence, we feel the following framework can enhance the communication with, and coverage of, Diverse-Owned IMs. Developed by Manager Research at Investor Solutions, this approach provides the building blocks necessary to address the varying D&I needs and objectives of institutional investors.

Manager Research D&I Framework:

- **Categorize and Define Diverse-Owned IMs:** We currently categorize Diverse-Owned IMs based on ownership level greater than 50% by a diverse group or combination of diverse groups (ethnicity, age, religion, socioeconomic background, military background, family status and gender identity). We believe categories of diversity will further develop to consider workforce and senior professional diversity as this data becomes more widely available.
- **Open-Door Policy for Diverse-Owned IMs:** We conduct initial due diligence meetings when contacted and on a proactive basis. We believe an open-door policy is inclusive, allows for more frequent reviews of Diverse-Owned IMs and continues to expand our universe of managers for mandate consideration.
- **Rooney Rule for Manager Searches:** This refers to a National Football League policy that requires teams to interview at least one or more diverse candidates for head coaching and other operational positions. As our clients' needs and objectives ultimately drive our manager research efforts, when official searches are conducted for manager allocations, we will identify at least one Diverse-Owned IM to be included within the search where practicable.
- **Identify Coverage Gaps of Diverse-Owned IMs:** We assess our coverage of Diverse-Owned IMs and identify categories where we believe clients could benefit from additional coverage of Diverse-Owned IMs.
- **Attendance at D&I Conferences:** Identify D&I industry conferences to attend each year with intent of building connections and identifying talent.
- **Research Report Integration:** Firm Background section may mention whether a firm has diverse ownership. "Corporate Responsibility" has been officially added as a sub-factor within the Organization section and this section may include references to whether firms have a stated commitment to D&I.
- **Data Collection Integration:** Our firm-level due diligence questionnaire includes an expanded set of questions focused on asset managers' D&I programs and representation. We will continue to make sure that our questionnaires capture all relevant questions and evolve with the best practices in the space.
- **Commitment to Finding Excellence:** Our due diligence efforts are applied equally across all firms and we are committed to finding excellence within investment management. We assess managers on the forward-looking ability to deliver on promised investment objectives.

In addition to this framework, we believe that asserting our influence, along with that of larger institutional clients, will help increase industry transparency and compel diversity data to have mainstream availability.

Operational due diligence (ODD) is an additional area of expertise that allows Investor Solutions to further review Emerging Managers that may also be Diverse-Owned IMs. Emerging Managers need to have operational practices aligned with industry best practices. ODD professionals expect well-defined procedures in areas such as cash controls, regulatory compliance, trading, allocation, business continuity providers and infrastructure. Investors open to Emerging Managers need to understand the manager's prior employment history, prior funds managed, track record and any capital commitments from the former firm. The manager needs to demonstrate a clear business plan with asset raising targets with sufficient resources and quality service providers (e.g., auditors, administrators, custodians, prime brokers) as many new firms outsource key functions to reduce operational costs. While operational due diligence vetoes are rarely caused by one item, having multiple failing control points will elevate the risk in an ODD review.

VII. Conclusion

There is much work to be done on D&I across the investor management industry. At BNY Mellon, we believe enhancing communication with, and coverage of, Diverse-Owned IMs is an important step forward. The Manager Research D&I framework we have outlined is a foundation for understanding the varying D&I needs and objectives of institutional investors.

D&I remains a key focus of senior leadership within BNY Mellon. Not only does BNY Mellon's Corporate Social Responsibility Report include D&I goals and key performance indicators, but leadership within Investor Solutions is dedicated to enhancing D&I within all aspects of investment manager research. Our history and experience with Diverse-Owned IMs is also evident as approximately 25% of our managers under research coverage have some diverse ownership representation while approximately 6% are considered Diverse-Owned IMs.

At our core, we at BNY Mellon believe D&I is vital to success and is part of the core stated values that codify our culture (Passion for Excellence, Integrity, Strength in Diversity and Courage to Lead). As we continue our research, we stand ready to support clients in their specific initiatives.

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