

Diversity, equity and inclusion: An open letter to asset managers

We believe diversity is a crucial aspect of any investment team. This view has always been embedded in our management research due diligence process and four-factor framework. Our belief is that, cognitively, diverse teams, with a shared set of values, produce better outcomes¹: There is also academic evidence that supports this opinion². Going hand-in-hand with the theme of cognitive diversity are the benefits of identity diversity.

- *Diversity enhances decision-making, research suggests*
- *Diversity comes in many forms and is not always visible*
- *Females and minorities are under-represented in the investment industry*
- *Diversity extends beyond who manages an investor's assets*
- *The first step is better data transparency and benchmarking progress*

| What merits does diversity bring? |
|--|
| • Fosters better understanding of the marketplace |
| • Increases the likelihood of devising more innovative, creative solutions |
| • Strengthens the ability to challenge and debate ideas |
| • Helps to avoid “groupthink” (i.e., group consensus over individual preferences or alternative ideas) |

Citing better performance outcomes is a common reason why investors pursue diversity initiatives, but it is not the sole reason. Investors also prioritize the integration of Diversity, Equity and Inclusion (DEI) into their investment programs to provide access and opportunities for diverse individuals and firms. Our Hidden Figures³ paper suggests that globally, only 12% of key decision-makers at investment management firms are female.

In order to more explicitly and transparently support these two overarching goals, Mercer includes several specific questions in its global investment manager database, MercerInsight®, asking investment managers to provide information on their firm’s DEI policies and practices, as well as its identity diversity.

While asset managers have certainly been supportive of these efforts, the level of participation is below what Mercer management research had hoped. We think this has had some effect on how investors view and evaluate the investment managers they are considering hiring and/or retaining.

¹ Mercer Investments, How Diversity and Culture Impact Mercer’s Ratings Process, September 2019 [How Diversity and Culture Impacts Mercer's Manager Ratings.pdf](#)
² McKinsey, Diversity Wins: How Inclusion Matters, May 19, 2020 [How diversity, equity, and inclusion \(DE&I\) matter | McKinsey](#)
³ Mercer Investments, Diversity dressing, The hidden figures, May 11, 2020 [Mercer Diversity Paper.pdf](#)

1. Diversity in key decision-makers/investment strategy team

Mercer believes in all forms of diversity, such as ethnic, socioeconomic and cognitive diversity, and in the value that all its different dimensions can provide. Our interest in this topic stems from our work that suggests diverse teams lead to better decision-making when the problem at hand has many potential solutions; where the individuals involved are able to identify different possible solutions; and where the team is large enough to explore all possibilities.⁴

An attribute we look at is the composition and diversity of the investment strategy team — in effect, the key decision-makers (KDMs). For the purpose of collecting and analyzing this data, we define a KDM as any individual who is significantly involved in the key investment decisions of each strategy or fund. This includes portfolio managers, research analysts (where relevant) and investment committee members who are heavily involved in the management of a strategy. These KDMs drive the investment decisions and implementation of the portfolio and are accountable for the outcomes of the strategy.

| Key decision-maker questions in MercerInsight |
|---|
| • What proportion of your investment team is female? |
| • What is the makeup of your investment team from a diversity perspective (for example, culture, age, ethnicity, experience, social background, cognitive)? |
| • What proportion of your investment team is considered an ethnic minority in the country in which you operate? |

2. Diversity in ownership structure

The level of interest in information related to assets managed by women and minority-owned businesses (WMO), especially in the US, has increased significantly. While ownership structures may not necessarily correlate with diversity of thought, there is a view that, as an industry, much more needs to be done in terms of providing opportunities for people of all identities and backgrounds.

One study by the Knight Foundation⁵ shows that this cohort manages just 1.3% of the \$69 trillion assets within the investment management industry globally. Similarly, within our database, firms that are substantially female owned (>33%) and/or minority-owned represent a small fraction of the investment management universe (approximately 380 WMO firms managing approximately 1,200 strategies⁶). Although this data is based on managers who self-report (and primarily in the US), we continue to gather a global picture of women and minority-owned firms.

⁴ AB, AllianceBernstein and Scott Page, “The Difference” Princeton University Press, 2008

⁵ Knight Foundation, Diversifying Investments: A Study of Ownership Diversity and Performance in the Asset Management Industry, January 2019 [2019_KF_DIVERSITY_REPORT-FINAL.pdf \(knightfoundation.org\)](#)

⁶ Mercer Insight, as of November 2021

| Firm ownership questions in MercerInsight |
|--|
| • Does your Firm legally qualify as minority-owned? |
| • % ownership by women? |
| • % ownership by different ethnicities? |
| • What is the composition of your board of directors from a diversity perspective? |
| • What is the gender composition of your board? |
| Other Firm-level diversity questions |
| • Do you have a formal Diversity and Inclusion (D&I) policy? If so, please provide details. |
| • How do you measure diversity, and what metrics do you use? |
| • Has your organization set any diversity targets? Please describe them. What initiatives are you taking to achieve these targets? |

In addition to reflecting a firm’s ownership structure in MercerInsight, we strongly encourage women and minority-owned managers to regularly update the database with the quarterly performance data of all the strategies their firms offer. Our observation is that not all the WMO strategies in MercerInsight have a corresponding strategy track record. This absence of performance transparency significantly curtails the chances that we will undertake due diligence on a strategy or at a minimum, have the opportunity to monitor the strategy’s track record for future research consideration.

3. Diversity in portfolio investment

Diversity extends beyond those who manage assets and is just as relevant to a portfolio manager’s investment analysis and resulting investment ideas, in our view. Studies at the corporate level have shown that the greater the diversity of companies’ executive teams, the higher the likelihood of outperformance⁷. Investment managers are increasing their focus at the corporate level through 1) gender lens investing and 2) engaging in diversity across the board, C-Suite and workforce. This emphasis is being driven by:

- Investors addressing diversity across the value chain; i.e., what managers are doing at the firm level, at the team level and at the investment strategy level. This has led to a greater number of searches for investment strategies that emphasize diversity and, in particular, gender diversity in the past two years.
- As investment managers increase their focus on integrating diversity into their investment process, some are emphasizing gender-based factors in assessing portfolio investments to further advance gender equality through gender lens investing.

⁷ McKinsey, Diversity Wins: How Inclusion Matters, May 19, 2020 [How diversity, equity, and inclusion \(DE&I\) matter | McKinsey](#)

Within MercerInsight, the opportunity set is currently small but is growing strategies that employ a gender lens through quantitative and qualitative screens. Some managers might employ diversity screens as initial idea generation tools. In general, the quantitative metrics most commonly used seek companies that have more than 20% to 30% of women on the board and/or at executive level. However, it is often the qualitative metrics that further the conversation. Examples include evaluating the gender pay gap, data transparency, as well as the hiring, promotion and retention of women within an organization, among other areas of discussion.

Managers who participate in the public markets are further providing transparency on the diversity of their portfolios by showing gender statistics of portfolio companies' executive levels within their equity investment strategies and are using this as an engagement tool with companies. Other strategies adopt more of a stakeholder approach and may consider companies that offer products and services focused specifically on improving women's lives as part of their gender lens investment criteria. Diversity is a key topic of engagement for investment managers with portfolio companies, and from a voting perspective, DEI has ranked among the top five or top 10 themes for shareholder resolutions⁸.

For actively managed strategies that subscribe to a gender-focused philosophy, we expect to continue to see a concerted effort of engagement with portfolio companies or potential investment candidates to drive improvement in gender diversity. Interestingly, many of the strategies we have reviewed invest solely in companies leading on gender diversity. However, we think there is an argument to be made for strategies that aim to improve gender diversity and use engagement as a tool for helping to facilitate that positive change.

We further expect investment managers to have robust voting policies that address areas such as diversity, not only at the individual strategy level, but more broadly at the firm level, to demonstrate support and commitment. Over time, we would expect to see more reporting on the impact of these initiatives.

For private markets, managers are providing more detailed data on the diversity of their firms. This includes diversity statistics across levels (i.e., senior leaders, junior levels, etc.) and groups (i.e., investment team, operations team, etc.). Such statistics are typically released annually or during the fundraising of a new fund.

| Investment strategy level questions on diversity |
|---|
| • % of portfolio companies' board of directors that are female? |
| • % of portfolio companies' executive level management (C-Suite) that are female? |
| • Firm-wide voting policy on diversity? |
| • Firm-wide engagement on diversity? |

⁸ Proxypreview.org Proxy Preview 2021 [ProxyPreview2021_FINv14_20210608.pdf](#)

Case studies:

How the data in MercerInsight is used

1. Sourcing new ideas

While sourcing diverse managers is certainly a part of our normal selection process, in May 2021, we set aside specific time to invite approximately 50 firms that are either WMO and/or led by diverse key decision-makers across asset classes (equities, fixed income and diversifying alternatives) to present their investment philosophy and process to our management research team. Our objective was to increase Mercer's exposure to more firms and strategies, and to identify a potential shortlist of managers on which to pursue further due diligence.

We have since communicated to MercerInsight subscribers along with our client-facing investment consultants our initial views on each firm we met. We are undertaking additional due diligence on the most promising strategies and intend to host other due diligence days with investment managers that were not included in the initial review. Therefore, we encourage investment managers who are interested in participating in this future event to review and update their information in MercerInsight, and reach out to a member of our management research team.

Within private markets, clients are requesting an increased number of diverse managers be included in their pipelines and portfolio plans. Similar to above, we are encouraging private markets managers to review and update their diversity information on MercerInsight to ensure we are capturing all qualified funds in these requests.

2. Benchmarking DEI metrics

Investors are asking Mercer to help monitor future progress by benchmarking investment managers. This undertaking is typically done in conjunction with a review of an investment manager's corporate policy on DEI. The goal of this benchmarking exercise is to align the investor's mission, beliefs and objectives with its investment program.

The table below shows an example of how investors have begun to measure this goal and determine their overall investment program's diversity profile by looking at a subset of metrics and benchmarking managers on diversity through a variety of lenses. This includes gender makeup at firm ownership level, overall firm employee level and key decision-makers at the investment strategy or product level, as well as highlighting year-on-year progress (or lack thereof).

| | Ownership | | | | Firm Level | | | | Product Level | | | | Involvement in DEI Initiatives |
|------------------|-----------|------------|------------|------------|------------|------------|------------|------------|---------------|------------|------------|------------|--------------------------------|
| | Women | | Minorities | | Women | | Minorities | | Women | | Minorities | | |
| | 2019 | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 | 2020 | |
| Manager A | 10% | 10% | 8% | 8% | 35% | 33% | 21% | 31% | 45% | 45% | 20% | 27% | ✓ |
| Manager B | 49% | 54% | 56% | 30% | 59% | 60% | 29% | 29% | 59% | 50% | 29% | 38% | ✓ |
| Manager C | N/A | N/A | N/A | N/A | 36% | 36% | 53% | 53% | N/A | N/A | N/A | N/A | ✓ |
| Manager D | N/A | N/A | N/A | N/A | N/A | 52% | N/A | 58% | N/A | 24% | N/A | 18% | ✓ |

In other instances, we have noticed that investors use this same data to help shortlist and, in some instances, inform the selection of an investment strategy as part of the search process in public markets or, in the case of private markets, build client pipelines and portfolio plans. While an incomplete dataset may not necessarily exclude an investment manager from being selected as part of a search, our research suggests that additional time and energy may be required to get the investor comfortable with the investment manager’s diversity policies to ensure they align with the investor’s beliefs, goals and objectives.

3. Addressing diversity in portfolios

Many investment managers are starting to provide diversity details of their portfolios. For example, one investor noted that of its investment manager lineup, 75% engaged with underlying companies on DEI topics during 2020. This was a key initiative completed to improve transparency on gender diversity within the investor’s program, where they are now disclosing the number of companies that have at least 30% of women on boards they are monitoring. The investor acknowledges that this is a first step toward bringing about change and aims to make further commitments by instructing their investment managers to vote on all shareholder proposals over the year that will improve board diversity. Furthermore, the investor will continue to assess the availability of other diversity metrics over time, as gender is currently the only diversity metric available with good transparency.

Conclusions

Cognitive diversity remains a bedrock principle that manifests itself in many ways as part of our evaluation process of investment managers and their strategies. However, in recent years we recognize that additional forms of diversity have acquired increased importance as investors search for ways to tangibly demonstrate that they are aligning their mission and beliefs within their investment programs. To this end, we would encourage investment managers to review and populate your firm's information in the databases with the information your organization has collected to date. We would also ask that you consider revisiting your corporate policies as it pertains to sharing company data. It will be extremely helpful to establish and promote broad industry best practices, as we all look to partner together to bring about real industry change.

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