Aon Institutional Investor Survey

Diverse Investment Initiatives

2021

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EXECUTIVE SUMMARY

The events of 2020 have impacted how institutional investors think about diversity (gender, race, LGBTQ, etc.) in their investment portfolios.

Against this backdrop, Aon conducted a survey of institutional investors, including public and corporate pensions, endowments, foundations, defined contribution plans, healthcare organizations, and other asset owners that revealed increased pressure from boards and beneficiaries to address diversity in their portfolio.

Whether through increased interactions with women- and minority-owned/run firms, engagement with majority-owned (non-diverse) asset managers about diversity, or the creation of policies and programs that promote diversity, our survey reveals growing momentum to address the issue of diversity in investment management head-on.

Unfortunately, the path forward may not be simple. Our survey results also show that the motivations for embracing diverse asset managers, differing definitions of diversity, and questions about resourcing, scale, risk/reward, and compatibility with the U.S. regulations may prove problematic for investors who wish to pursue diverse investing initiatives. While certainly not insurmountable, these challenges must be addressed if the investment and asset management industries are to become more inclusive.

This paper examines the potential challenges associated with diverse investing initiatives, as well as the following topics:

- **Reasons why investors pursue diverse investing initiatives**
- **Current trends in institutional investor diversity policies/ programs**
- **Potential components of diverse investment programs**
- **How diversity is defined and the pros and cons of those definitions**
- **The ongoing impediments to launching diverse manager programs**

INTRODUCTION

As we reflect on 2020, it has become increasingly clear that some of our lowest moments have the potential to become positive catalysts for change.

COVID-19 brought essential workers, workforce safety, and a variety of environmental, social and governance (ESG) issues to the forefront of our collective consciousness.

The murders of George Floyd and Breonna Taylor and the subsequent Black Lives Matter movement further focused national and international attention on social and economic justice issues. Together, all of these events have driven global discourse on inclusion and diversity in criminal justice, corporate boardrooms, financial markets, and society.

More and more, the endowments, foundations, public and corporate pensions, and defined contribution plans with whom Aon works are turning their attention toward diversity (or the lack thereof) in investing. We have seen the number of diverse manager initiatives grow, albeit slowly, and we are increasingly being asked how institutional investors can support diversity in investing while simultaneously fulfilling their fiduciary duty.

Aon is committed to doing our part to foster a more inclusive asset management ecosystem but has also come to realize that there is really no one-size-fits-all approach to integrating diverse managers into an investment program. Allocation sizes, state and federal regulation, staff resources, active/passive mix, and a host of other factors can influence how a particular investor pursues (or not) investment with women and minority asset managers.

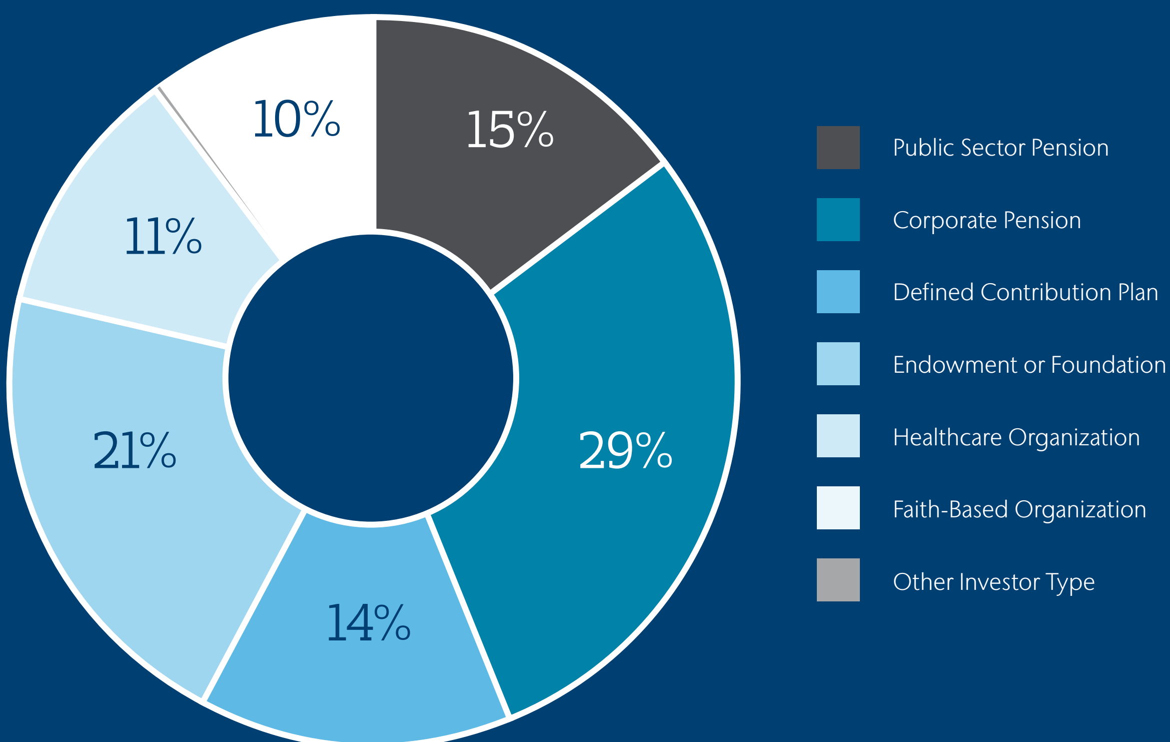
But even if the solution is ultimately complex, it is clear there is much that remains to be done when it comes to diversity in investment management. Despite more than 15 years of diverse investment initiatives in the United States, a 2019 study from the Knight Foundation found that, at the end of 2018, only USD 1.3 trillion of the USD 69 trillion in global assets under management were invested by women or minority-owned firms.[1]

To get a sense of how investors pursue or plan to pursue diversity, equity, and inclusion in their investment portfolios, we surveyed clients and prospects on this topic in December 2020 and January 2021. Our goal: to identify what is working well and what work remains to be done to make investing in women- and minority-owned or -managed investment funds easier and more common. We collected information from 100 public and corporate pensions, defined contribution plans, endowments, foundations, healthcare, and other organizations and found that the events of 2020 did, in fact, shine a light on the issue of diversity in institutional asset management, and that some investors are changing how they encourage and measure diversity in their investment portfolios as a result.

OUR GOAL

Identify what is working well and what work remains to be done to make investing in women– and minority–owned or –managed investment funds easier and more common.

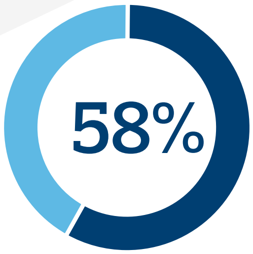
Figure 1: Survey Demographics



[1] *2018 Diverse Asset Management Firm Assessment Final Report - January 2019*

Changing Attitudes Toward Diversity in Investing

While 42% of our survey respondents stated that the events of 2020 had not changed their thinking or approach to diverse asset manager investing, the majority reported that the events of last year did make them more attuned to issues around diversity and inclusion in their portfolios.



indicated that the events of 2020 had influenced their thinking on diversity, equity and inclusion in investing

In addition to being more sensitized to diversity, equity, and inclusion (DE&I) issues, investors across the spectrum of respondents also indicated they felt more pressure to take concrete action to address the issue head-on. In addition, our survey found:

11% of those investors polled felt **more pressure from stakeholders to invest** with diverse managers

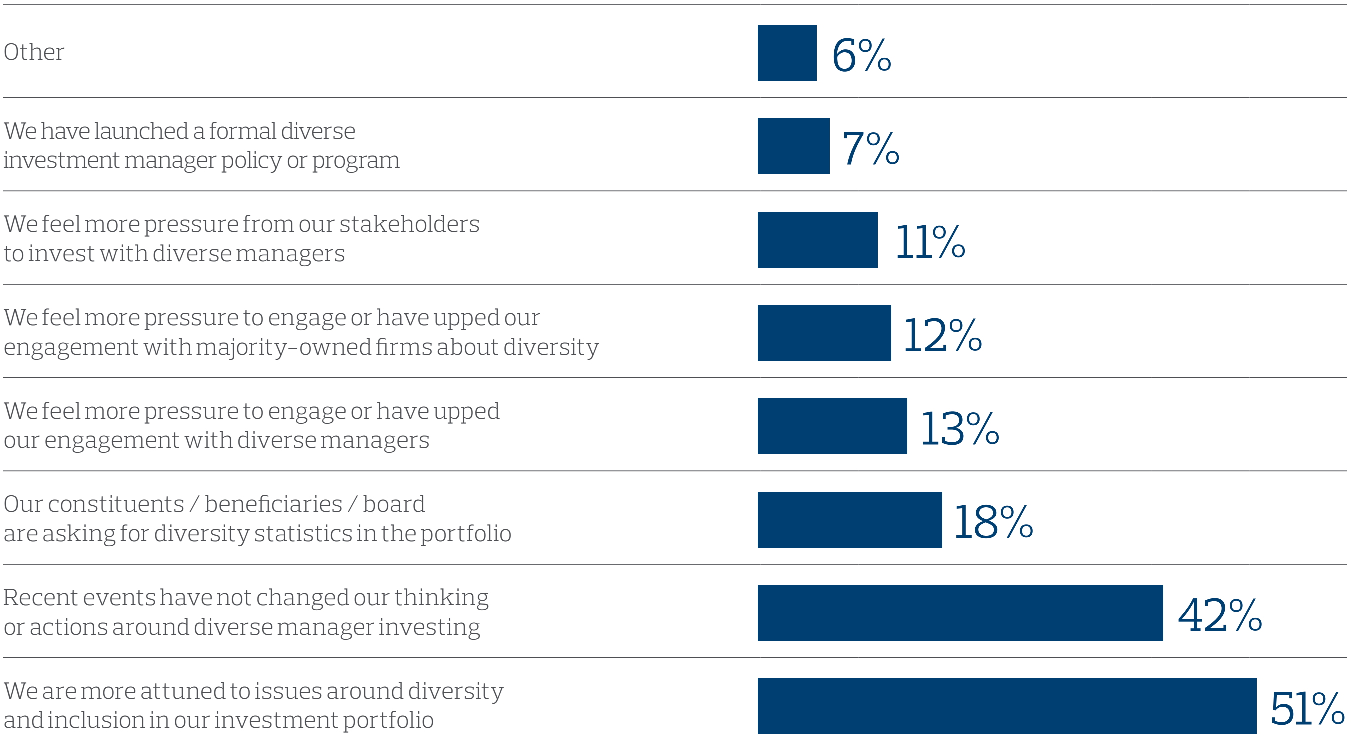
18% reported that constituents, boards, and beneficiaries are now **asking for statistics on diversity** within their portfolio

12% felt **more pressure to engage with majority-owned** (not owned by women or minorities) firms about diversity statistics, programs, and other DE&I issues

13% responded they felt **more pressure to engage or had increased engagement with diverse investment firms**

7% of those polled reported that they had **launched a formal diverse investment manager policy/program in response to the events of 2020**. Notably, those respondents came from a range of investor types, including corporate pensions and endowments/foundations (two each), and public sector pensions, healthcare firms, and other investor types (one each).

Figure 2: 2020's Impact on Diverse Manager Initiatives



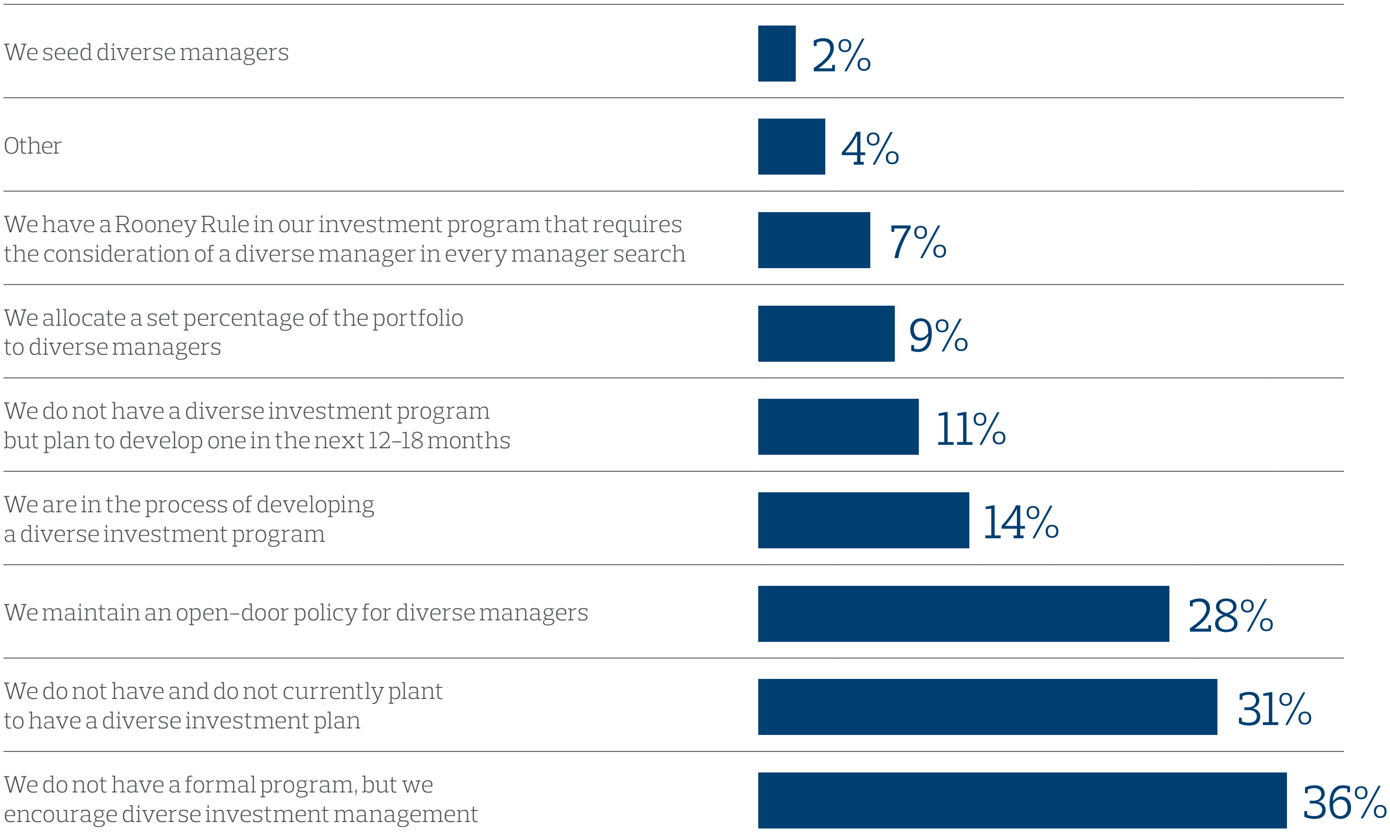
Many in our survey report they are taking at least some steps to bring diversity into their investment portfolio, although 31% continue to report that they do not have a policy or program and do not intend to have one in the future. Another 36% state that they do not have a formal diverse manager policy or program but that they do encourage diverse investment management.

For pre-launch women and minority asset managers, options remain limited. Only two of the one hundred survey respondents, both from public sector pensions, report that they will seed diverse managers. There appear to be more avenues for active intervention for diverse asset managers with a track record. Approximately 7% of survey respondents report that they have a Rooney Rule in place. The Rooney Rule, named after the former owner of the Pittsburg Steelers Dan Rooney, came about after a study showed that, despite winning a higher percentage of games, black coaches were less likely to be hired and more likely to be fired than white head coaches.[2] The rule requires that ethnic minorities be interviewed for head coaching jobs but does not mandate hiring outcomes. In investment management, the presence of a Rooney Rule usually indicates that at least one woman- or minority-owned or managed investment product must be included in any active fund searches.

Approximately 7% of survey respondents report that they have a Rooney Rule in place

[2] *https://www.si.com/nfl/2018/12/31/rooney-rule-explained-nfl-diversity-policy*

Figure 3: Diverse Manager Policies and Programs



The next most popular diverse manager intervention is the targeted allocation. Investors who use this technique carve out a specific portion of their portfolio for allocation to diverse managers. Although this inclusionary tactic does get assets into the hands of diverse asset managers, the percentage allocated to diverse funds may still be small. **Figure 4 shows that while 2% of those polled have allocated 25% or more of their portfolios to diverse asset managers, the majority of these targeted allocations total less than 15% of assets under management. And still, 87% of respondents have no dedicated allocation to diverse asset managers.**

For those investors who have not yet enacted official diverse manager investment policies and procedures, it seems that the increased pressure and scrutiny generated from the events of 2020 may result in more formalized efforts. Approximately 11% of those polled stated they do not have a diverse investment program but plan to develop one in the next 12 to 18 months, while another 14% responded that they are in the process of developing a diverse investment management program at present. A final 28% report having an open-door policy for women- and minority-owned or run funds. An open-door policy differs from a Rooney Rule in that there is no formal requirement for inclusion of diverse managers in search activity, but rather a requirement that diverse managers seeking a meeting can schedule one. Of course, the presence of various diverse manager interventions varied across investors, and Figure 5 summarizes the most common approach by investor type.

11% of those polled stated they do not have a diverse investment program but plan to develop one in the next 12 to 18 months

Figure 4: Dedicated Allocations to Diverse Investment Funds

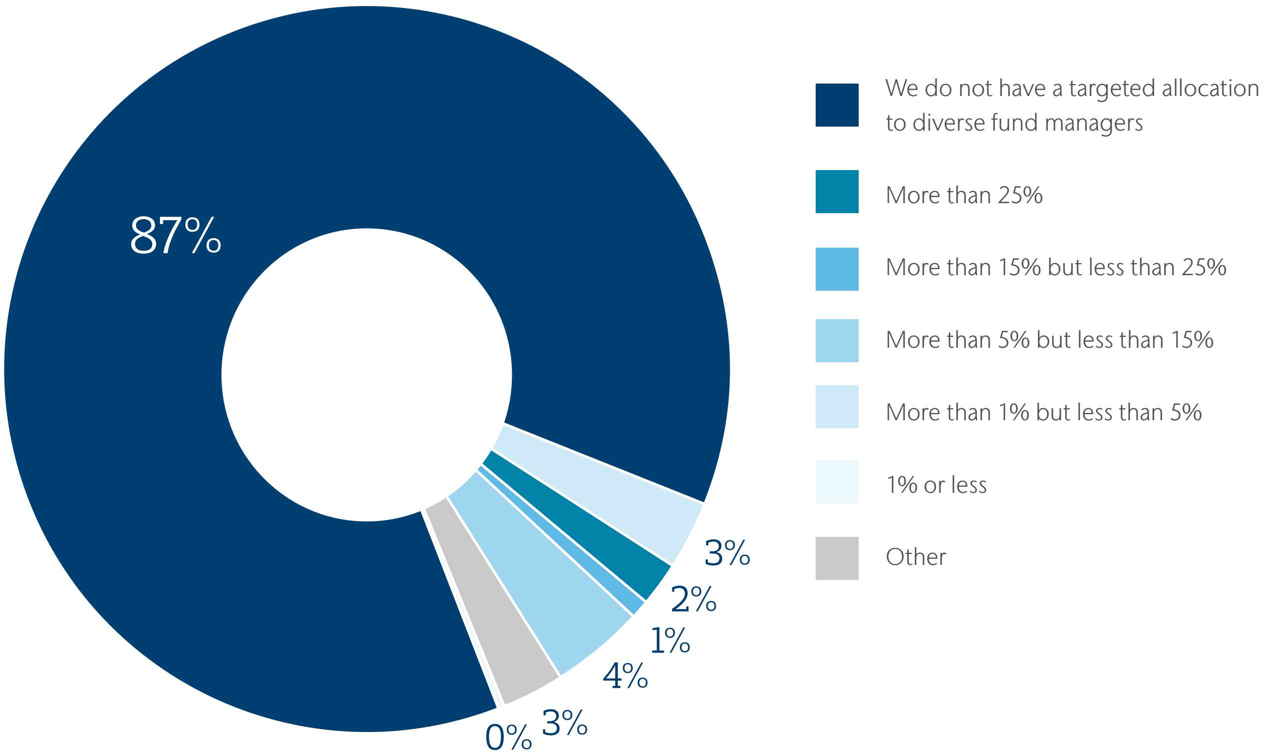


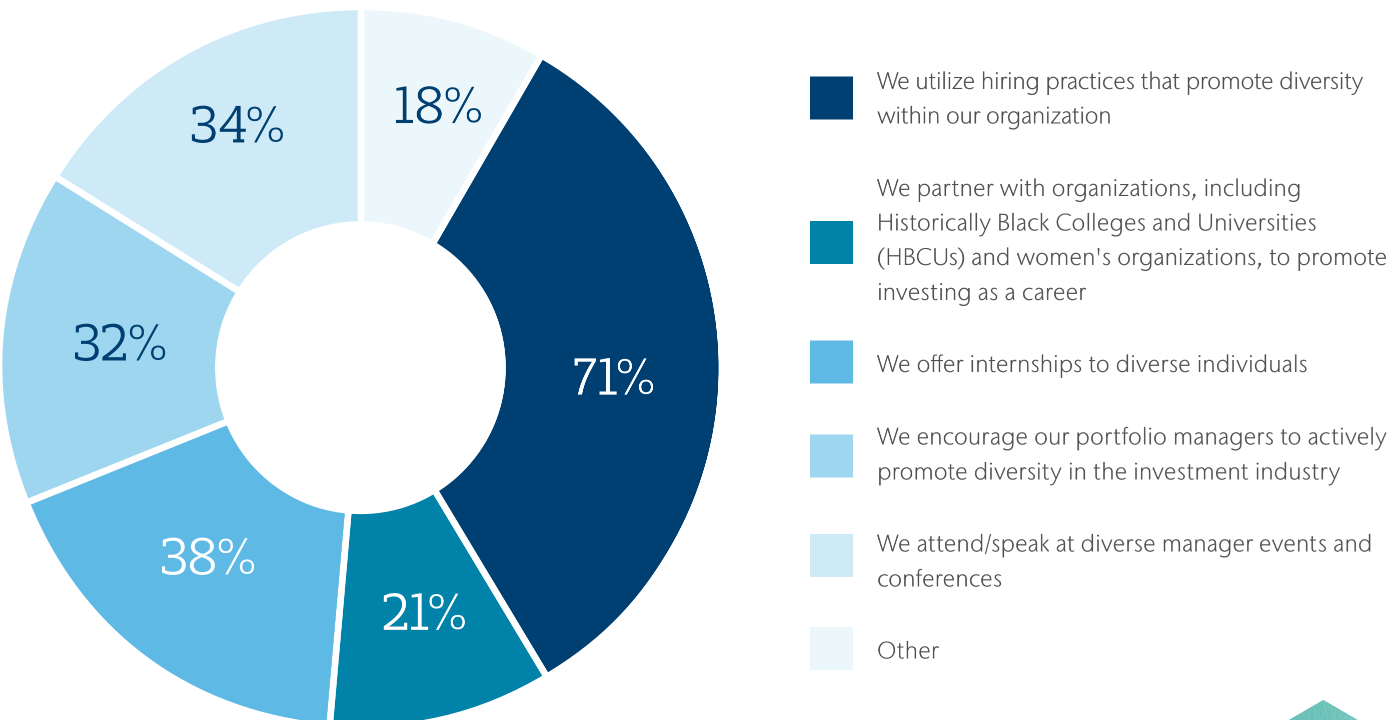
Figure 5: Common Diverse Manager Interventions by Investor Type

Response	Entity Most Likely to Provide This Response
We do not have and do not currently plan to have a diverse investment program	Healthcare
We maintain an open-door policy for diverse managers	Healthcare
We are in the process of developing a diverse investment program	Other
We do not have a diverse investment program but plan to develop one in the next 12–18 months	Defined Contribution
We allocate a set percentage of the portfolio to diverse managers	Public Sector Pension
We have a Rooney Rule in our investment program that requires the consideration of a diverse manager in every manager search	Healthcare
We seed diverse managers	Public Sector Pension

In addition to the formal diversity policies and programs that investors are more frequently initiating, more indirect methods of increasing diversity in investment management also appear to be on the rise. Approximately 71% of those investors polled indicate they use hiring practices within their own organization that are designed to boost diversity, while 38% offer internships to women and minorities. Being visible in the diverse investment manager community is also seen as valuable, with 34% of those polled speaking at diverse manager events and conferences. Another 32% encourage their portfolio managers to promote diversity in the industry, while 21% partner with Historically Black Colleges and Universities (HBCUs) and women's organizations as well.

Approximately 71% of those investors polled indicate they use hiring practices within their own organization that are designed to boost diversity

Figure 6: Informal Diversity Initiatives



Why and How Investors Embrace Diversity

Just like there is no one-size-fits-all approach to diverse manager investment policies, programs, and informal initiatives, there is likewise no single reason that investors choose to (or do not choose to) make specific efforts to invest with diverse fund managers.

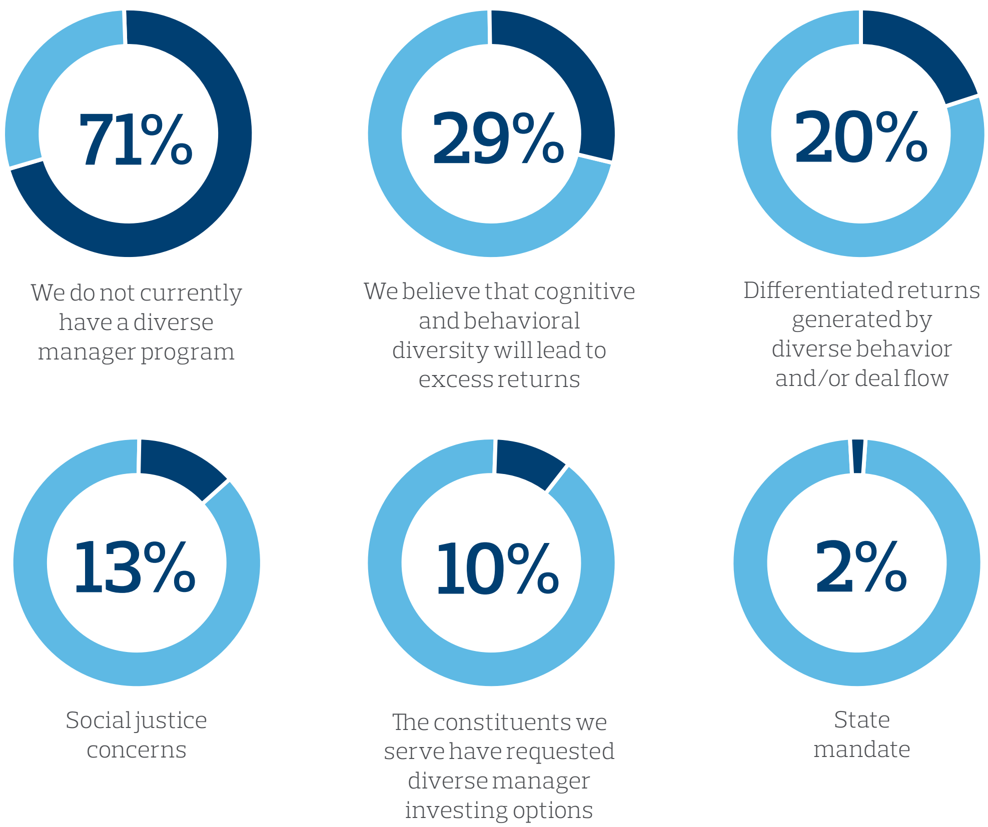
29% of those polled indicated they allocate to diverse managers because they believe that **cognitive and behavioral diversity** will lead to excess returns. That is, that a diverse background, which has historically been signaled by gender and ethnic minority status, may result in differentiated investment behavior and/or deal flow that will create excess returns or mitigate volatility

20% of those polled similarly indicate that their diverse investment initiatives are motivated by the **potential for differentiated, though not necessarily excess, returns**

13% of those polled report their diverse investment management initiatives are **driven by social justice concerns**

10% are **reacting to bottom-up pressure** from the constituents they serve

Figure 7: Reasons to Pursue Diverse Investing Initiatives



Roughly 15% of those polled state that to qualify as "diverse" in their program, 51% or more of the asset manager must be owned by a woman or minority

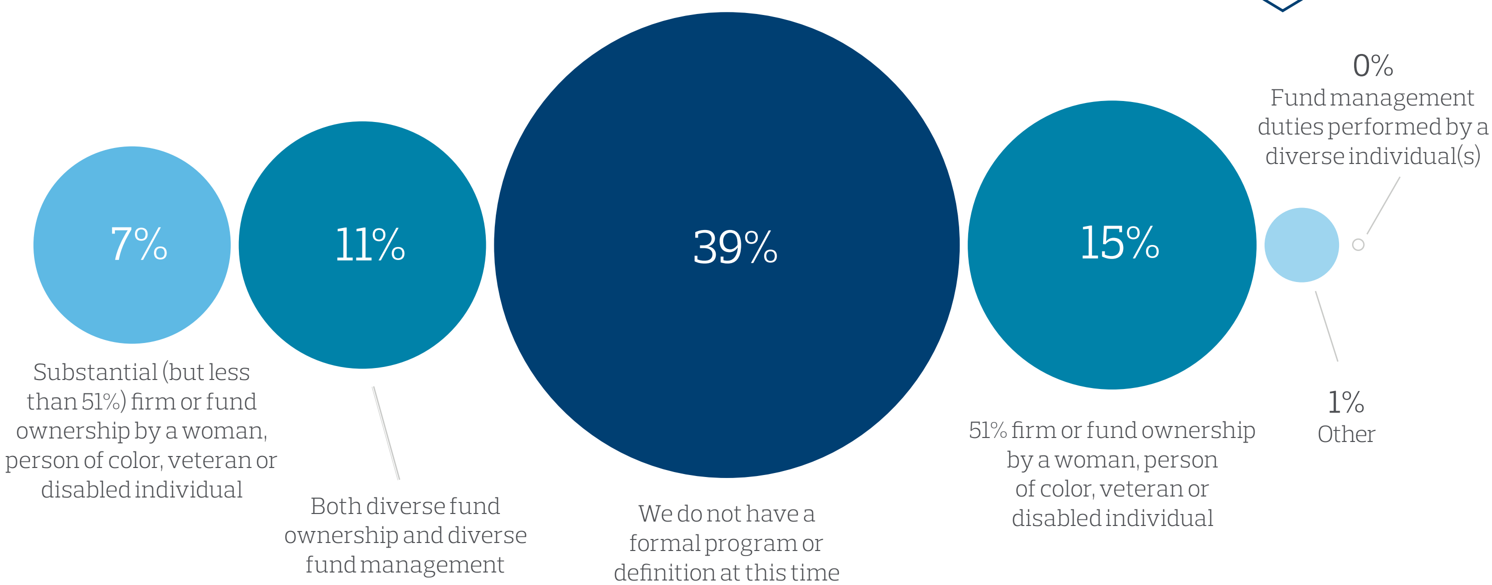
Ambiguity remains the name of the game, even as investors attempt to define diversity. Figure 8 shows that the vast majority of investors who have diverse investment policies or programs in place use woman or minority ownership as at least a partial indication of diverse status. Roughly 15% of those polled state that to qualify as "diverse" in their program, 51% or more of the asset manager must be owned by a woman or minority. Another 7% indicate that substantial ownership rather than majority ownership is required. No investors polled indicated that the presence of diverse investment management staff (regardless of ownership) would suffice to qualify a fund offering as diverse, while another 11% responded that diverse fund ownership and diverse investment management were required.

While an ownership requirement results in straightforward measurement and application, unfortunately, this approach has limits. Furthermore, it could potentially hinder the goal of increasing women and minority participation in investment management and sub-optimize efforts to achieve differentiated and/or excess returns, which are predicated on investment management diversity and not fund ownership. Also it is notable that investors seem less focused on the demographic composition of the investment management decision-makers, despite such a high percentage of respondents citing cognitive and behavioral diversity for excess returns or differentiated streams of returns.

Obviously, in a perfect world, we would prefer to see both diverse fund management and fund ownership coexist, reaping the benefit of diversity within the investment framework from a firm that also has majority ownership by women or minorities. Unfortunately, given historic socio-economic and diversity realities within investment management, that may not always be possible. As a result, we often point to ownership as a helpful indicator and something to strive for, but perhaps a metric that is insufficient on its own.

We often point to fund ownership as a helpful indicator and something to strive for, but perhaps a metric that is insufficient on its own

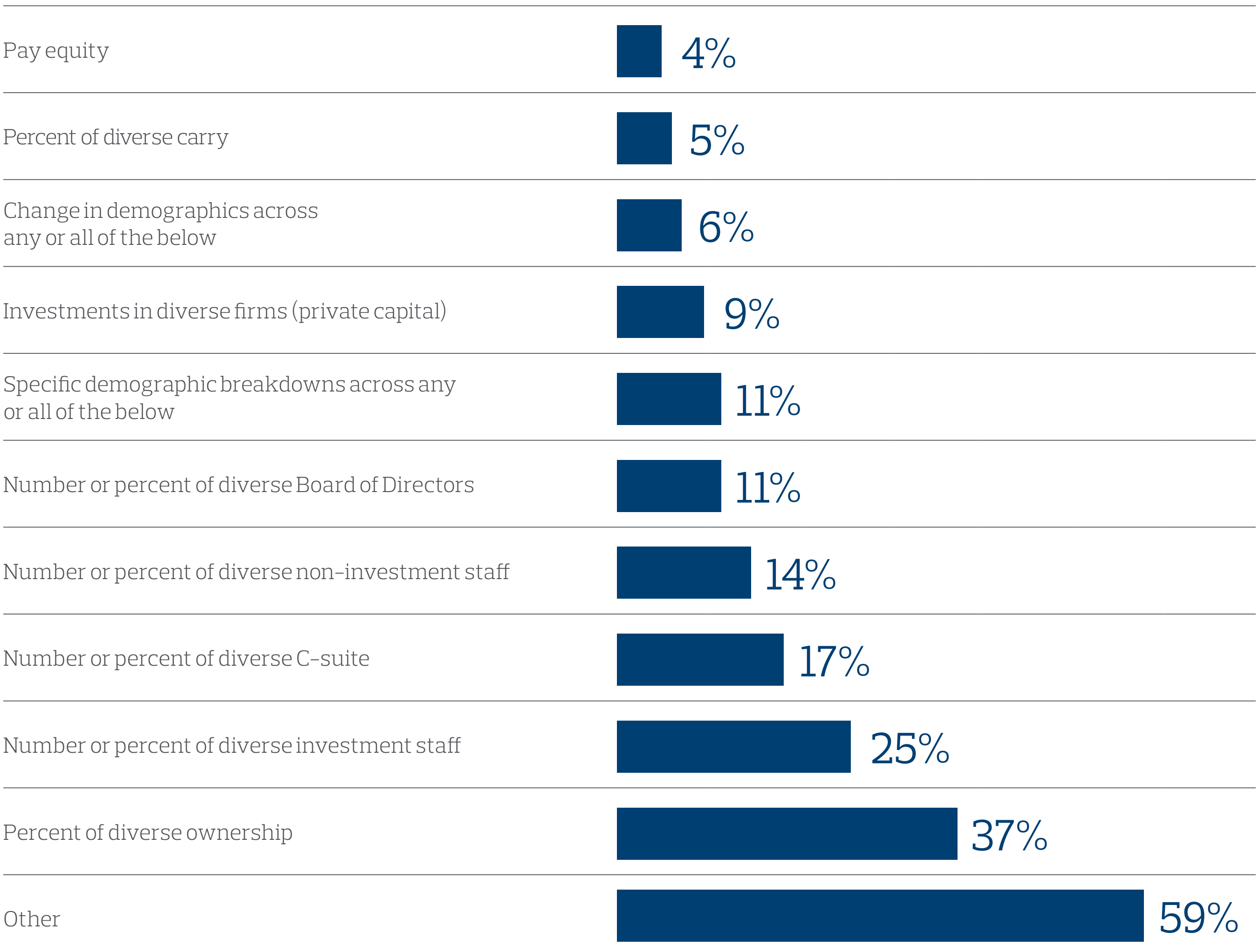
Figure 8: How Investors Define Diverse



Given the array of definitions of, motivations for, and programs addressing diverse manager investing, it is likely unsurprising that there are also a number of ways that diversity is monitored. While roughly 37% do monitor diverse asset manager ownership, consistent with the most common definition of diversity above, there are a host of ways that investors also keep tabs on diversity. Despite it not being a key indicator of diversity on its own, approximately 25% of those polled do monitor the number or percent of diverse fund management staff, and others monitor diverse staff across the organization (C-Suite, Board, non-investment staff). Roughly 6% of the respondents look at increases (or decreases in these statistics), while 4% look at pay equity within an organization, and 5% pay attention to the carried interest maintained by diverse staffers. The majority of the nearly 60% who selected "other" for monitoring diversity indicated they do not monitor any of these issues or that the question was not applicable due to the absence of a formal program.

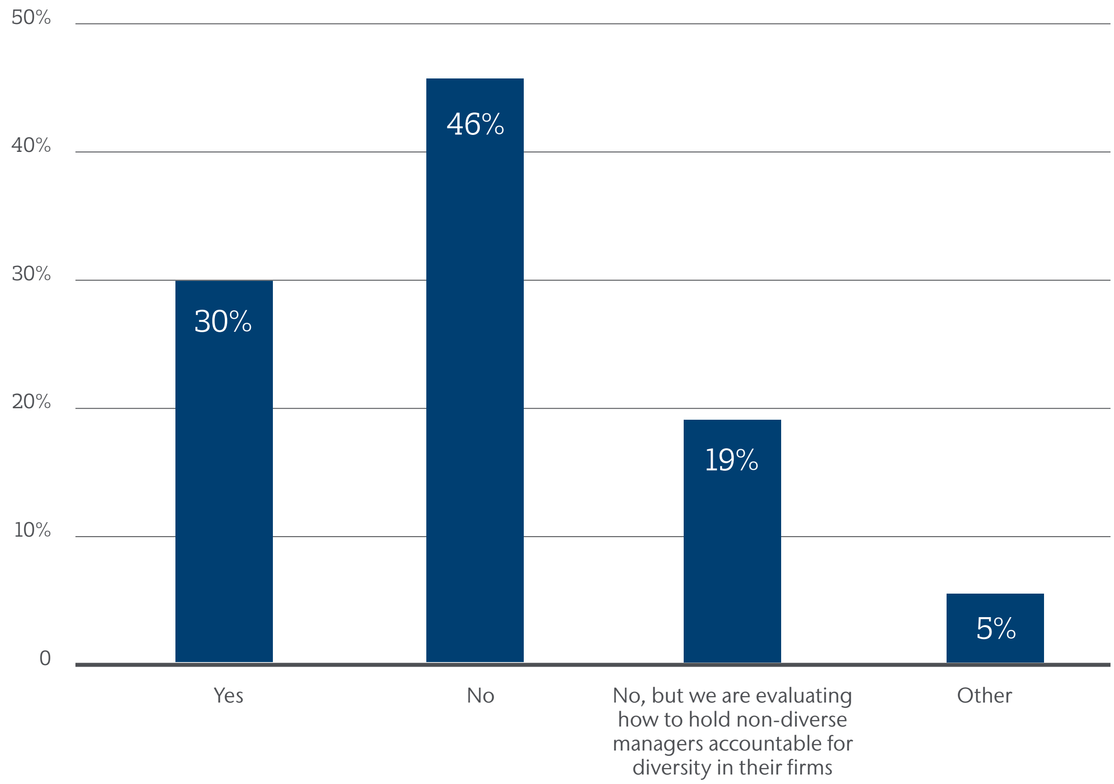
25% of those polled do monitor the number or percent of diverse fund management staff, and others monitor diverse staff across the organization (C-Suite, Board, non-investment staff).

Figure 9: How Diversity Is Monitored



Perhaps a sign that traditional measurements of diversity may be changing, a meaningful number of investors in our survey indicated that they either currently measure or plan to start measuring diversity at non-diverse owned "majority firms." While a plurality (46%) indicate they do not track diversity within majority firm asset managers, 30% responded that they do, with another 19% looking to adopt this practice in the future. Given that majority firms are often the launching ground for diverse talent, and given the focus on cognitive and behavioral diversity (which can exist regardless of firm ownership), it seems like this practice could be conducive to diverse manager gains in the future.

Figure 10: Tracking Diversity at “Majority” (Non-Diverse) Firms



Taking a Holistic Approach to Diversity

Aon has increasingly been working with clients to design customized diverse manager programs that address an investor's specific organizational objectives. Although no two programs are likely to look the same, a way to create a holistic framework that builds diversity can be designed focusing on four broad areas:

- **Purpose:** what does diversity mean to the organization
- **Pipelines**: how do women and minorities find (or not find) their way into finance and investing
- **Pedigree:** building a portable track record conducive to fund or firm launch
- **Portfolio Managers:** allocating to women- and minority-owned or managed firms

When we review the available diverse investment activities discussed in this paper thus far, most of them slot into one of these areas and all combine to create an ecosystem that will be more conducive to fostering diversity in investment management. For those

Purpose

Align D&I with values/goals:

- Assess current status
- Agreement on objectives and benefits
- Formalize process/beliefs

Education, Research, Discussion

Pipeline

Build investment industry talent pipeline for BIPOC and women:

- Increase interest and access
- Support mentor
- Recruiting/hiring/promoting

Outreach, Partnership, Portfolio Managers

Figure 11:

A Holistic Diverse Investment Framework

Pedigree

Increase the number of BIPOC and women with portfolio track records and non-diverse companies:

- DE&I at "majority" firms
- Employee development, opportunity and path
- Infrastructure support, culture

Ongoing surveying and engagement

Portfolio Managers

Allocate assets to diverse investment managers:

- Rooney Rule for manager selection
- Broaden network/outreach
- Encourage/seed entrepreneurs
- Foster behavioral and cognitive alpha

Evaluation, representative allocation

BIPOC – Black, Indigenous, and People of Color

Without a focus on **Pipeline** and **Pedigree** and organization/industry is unlikely to achieve the defined **Purpose** and the number of diverse **Portfolio Managers** will not materially increase over time, depriving the investor of the benefits of cognitive and behavioral alpha.

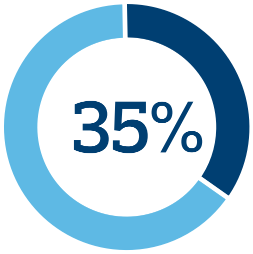
Impediments to Diverse Investing Initiatives

Despite the progress being made at some investor organizations, there remains a large contingent of institutional investors who do not have formal diverse investment programs and policies.

And even though a dedicated allocation to diverse managers is not a requirement, as evidenced by our holistic framework above, generally, **diversity thrives when there is intentionality behind the effort**. Roughly 35% of those polled stated they do not have a formal policy due to equal consideration given to diverse and non-diverse funds, but 15% also stated that they still need more research on diverse manager risk/return profiles, and another 15% remain concerned that diverse investment initiatives may conflict with fiduciary duty.

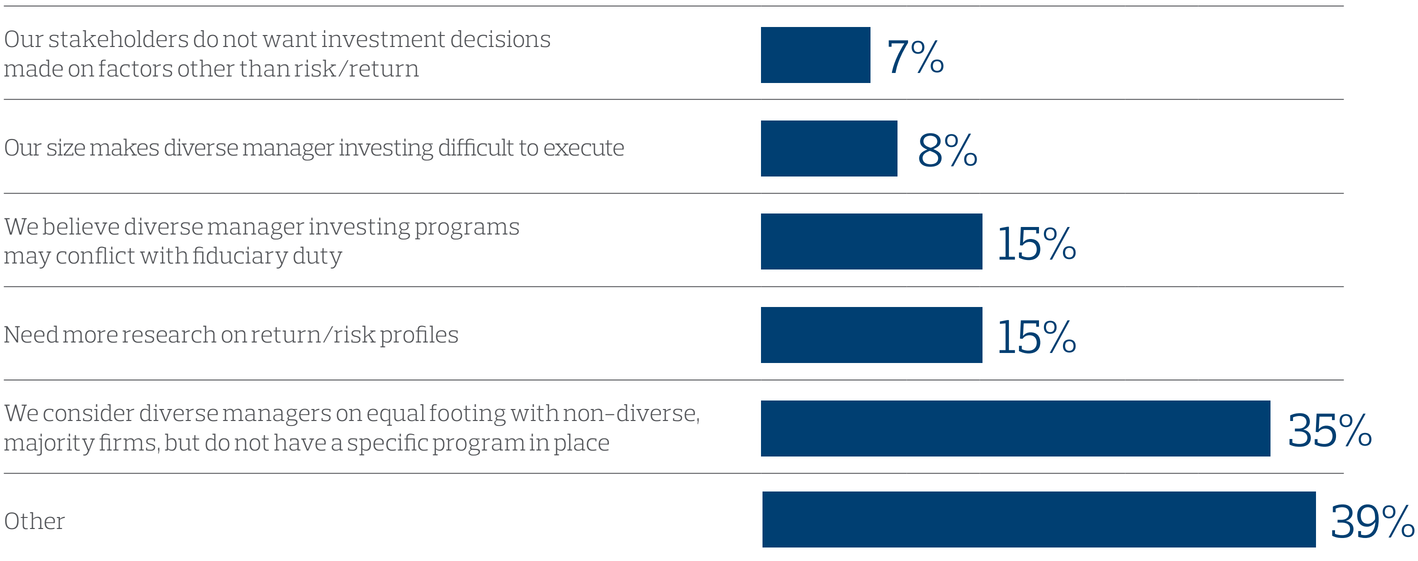
And while none of the public pensions polled believed their size was an impediment to allocating to women and minority-owned or managed funds (which are, on average, smaller than majority firms), approximately 14% of defined contribution plans and 19% of endowments and foundations felt structural impediments created by relative size were difficult to overcome.

But perhaps the most encouraging answers to this question were found in the "other" responses provided by survey respondents, which were primarily grouped into "we do have a program," "we are assessing a program," and/or "we are evaluating this," although some felt that compliance with ERISA regulation precluded activity.



of those polled state they do not have a formal policy due to equal consideration given to diverse and non-diverse funds

Figure 12: Why We Don't Have Diverse Investment Policies/Programs

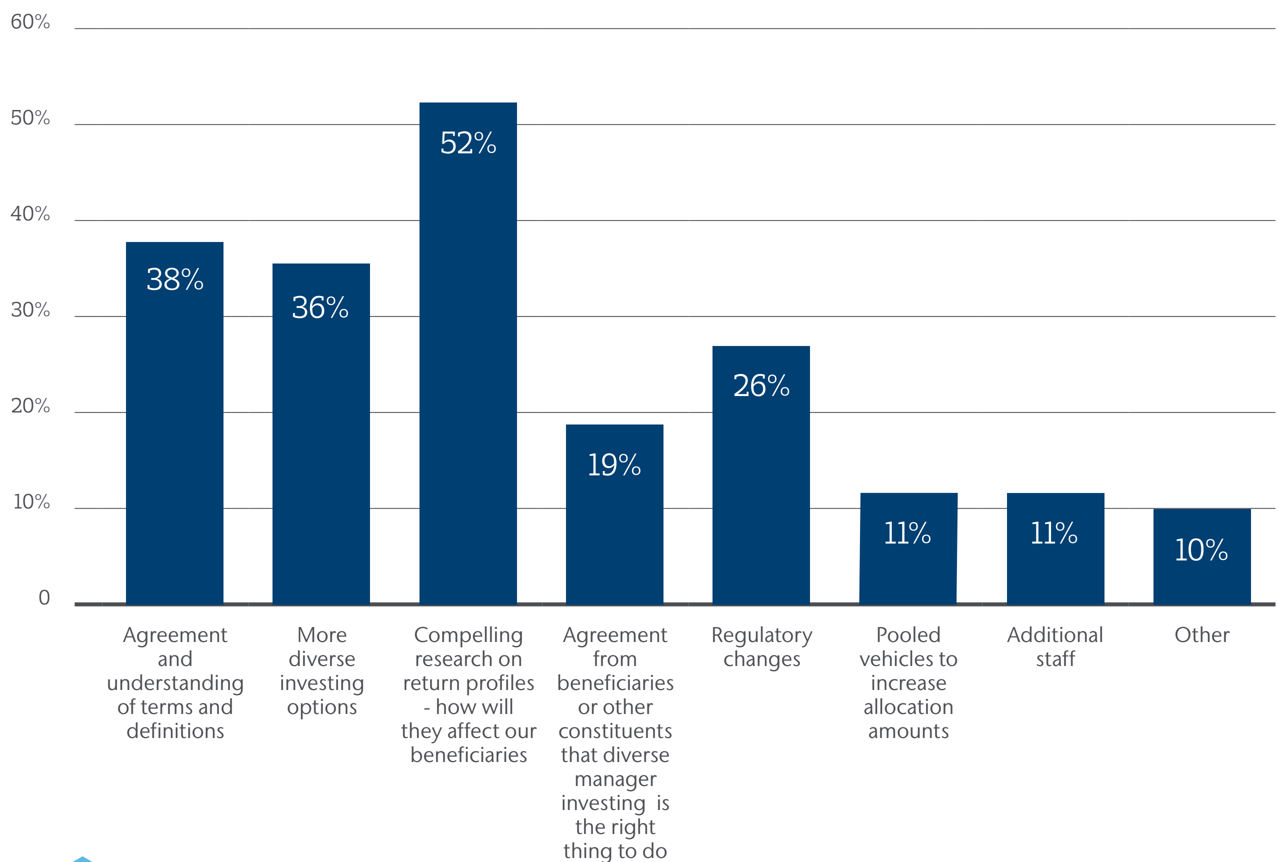


There are a host of ways the industry could continue to encourage diversity in investment management. Based on our survey, it seems investors still feel like additional research is needed on the return profiles of women- and minority-owned/managed funds (52% in our survey). In fact, firms like Bella Research and the Knight Foundation have completed studies that show diverse funds are disproportionately represented in top quartile performance figures, and a 2020 study by Aon and the National Association of Investment Companies (NAIC) likewise shows that diverse private equity firms outperformed median performers in 78.6% of the years studied. And still other studies have shown that diverse investment funds on average perform on par with majority firms. Based on this data, it appears there is little risk from pursuing diversity in a portfolio, and potentially some reward.

A study by Aon and the NAIC found that diverse private equity firms outperformed median performers in 78.6% of the years studied

Not surprisingly, institutional investors remain stymied by the lack of agreement on terms and definitions when it comes to diversity. If the industry coalesced around standard terms and definitions, it would make diverse manager investing easier for 38% of the organizations in our survey. Another 26% would be more likely to undertake diverse investment initiatives if there were regulatory changes, while 19% stated agreement from beneficiaries or constituents that diverse investing is the right thing to do would spur them along. A final 11% reported that structural issues (staffing, pooled vehicles) remain an impediment to diverse investing activity.

Figure 13: What Would Make Diverse Investing Easier for Us



CONCLUSION

While the events of 2020 have been trying for all of us, and with 2021 off to a somewhat difficult start between civil unrest and emerging COVID–19 variants, it may be helpful to focus on what good may yet come out of an objectively difficult year.

Conversations about diversity, equity, and inclusion have dramatically accelerated over the last 12 months and, based on our survey results, seem to have the investment industry rethinking how to address DE&I within their portfolios.

Our survey also shows that a wide array of interventions are possible. Investors are taking steps to monitor and address diversity through direct investment, increased monitoring, open-door policies, and additional interaction with diverse managers. Even if an organization feels that ERISA frameworks preclude some diverse manager activities, the holistic framework Aon has designed for investors means that some action should still be possible. And that is great news since an ever-growing body of compelling research shows that diversity will not only benefit society, but it could mean differentiated returns and deal flow, and potentially higher returns, too.

METHODOLOGY

To create the 2021 report "Diverse Investment Initiatives in Institutional Portfolios," Aon relied on the following information:

- Aon surveyed clients and institutional investor contacts from late December 2020 through mid-January 2021. 100 investors ultimately responded to the survey questions.
- The survey captured the sentiments of 100 investment professionals (primarily US-based).
- Responses from the survey were analyzed and aggregated to create summary results.
- Responses were also parsed based on a number of key groups identified by Aon. Investor types whose responses were considered separately include:
  - Public Sector Pension Plans
  - Defined Contribution Plans
  - Corporate Pension Plans
  - Endowments and Foundations
  - Healthcare Organizations
  - Other Organizations
- Survey participants were asked to provide additional commentary throughout the survey process. These comments have been considered in the creation of the report.
- We also reviewed research on key trends and developments in diverse manager investing, including academic research, articles, and white papers.

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