Inquiry into the Use of Diverse Asset Managers by College and University Endowments, and Related Diversity and Inclusion Practices

FALL 2020
INQUIRY BACKGROUND

On July 10, 2020, Congressman Emanuel Cleaver, II (D-MO) and Congressman Joseph Kennedy, III (D-MA) sent inquiries to 25 colleges and universities asking for information regarding the participation of women- and minority-owned asset management firms in the administration of endowment assets. Colleges and Universities associated with the largest higher-education endowments received an inquiry; 24 of 25 institutions submitted response letters to the Congressmen aiding Congress in its understanding of institutional policies, practices and efforts.

Thank you to the following colleges and universities: Harvard University, The University of Texas System, Yale University, Stanford University, Princeton University, Massachusetts Institute of Technology, University of Pennsylvania, The Texas A&M University System, University of Michigan, University of California, Northwestern University, Columbia University in the City of New York, Duke University, The University of Chicago, Washington University in St. Louis, Emory University, Cornell University, University of Virginia, Rice University, Johns Hopkins University, Vanderbilt University, University of Southern California, Dartmouth College, and The Ohio State University.

The University of Notre Dame did not return a response letter. Notre Dame was the only institution to choose not to do so. At a time when African-American alumni are petitioning the university to do more to address systemic racism, it is our hope that Notre Dame leadership provides a more adequate response to the needs of their students, faculty, alumni and trustees than they have provided to the Congress of the United States.

KEY FINDINGS

- 1 responding university made information about assets under management with diverse-owned firms publicly available prior to the inquiry.

- 20 out of 24 responding universities provided an analysis or estimate of total assets under management with diverse-owned or diverse-led firms.

- Explanations given for not providing an analysis or estimate centered on difficulties obtaining and identifying firm ownership information.

- Reports of assets under management with diverse-owned firms ranged from 5.1 percent to 35 percent.

- 3 responding universities detailed specific targets or projections for future allocations to diverse firms.

- No university reported interpreting the Uniform Prudent Management of Institutional Funds Act to prohibit expansion of diversity and inclusion policies and practices.
REASON FOR THE INQUIRY

The recorded killing of George Floyd shocked the moral conscience of America. This tragedy compelled Americans to examine the factors that led to such a horrific event. The incident was not isolated in history and many correctly came to understand the death of George Floyd as a manifestation of a national failure to address centuries of systemic discrimination and inequality. The knee on the neck of Mr. Floyd was a metaphor for the broader experience of so many black Americans in a country that has insufficiently affirmed the equal value of black life.

Acknowledging systemic inequality, activists have emphasized the need not only for justice to be done in the Floyd case but for individual and collective action responsive to broader social ills. Institutions have been called upon with urgency to examine their relationship to racism in America. It was important that chief investment officers, who in some cases invest tens of billions of dollars on behalf of their colleges and universities, were also included in higher education discussions about combating racial and economic injustice. The inquiry challenged institutions to consider how business officers responsible for management of endowments may make positive contributions during this national call to action.

The inquiry is also a matter of Congressional oversight. College and university endowments are subsidized by the federal government by way of tax exemption in accordance with Internal Revenue Code section 501(c)3. In return, those institutions spend endowment funds in accordance with the public interest and comply with numerous laws prohibiting discrimination in university operations. An inquiry was necessary to gather information on non-discrimination policies and practices regarding management of university assets. Non-discrimination laws are an extension of the federal government’s interest in closing social and socioeconomic opportunity gaps.

DISCRIMINATION IN ASSET MANAGEMENT

A 2019 study commissioned by the Knight Foundation found that asset management firms owned by women and minorities manage just 1.3 percent of assets in the $69 trillion asset management industry despite performance not statistically different from the broader industry. [1] Further, the study found that diverse-owned firms were overrepresented in the top-performing quartile of mutual funds, hedge funds and private equity. The lack of utilization of diverse-owned firms by institutional investors was not explainable based on availability or evidence of performance.

The Knight Foundation data point is troubling but not surprising. The state of diversity in the asset management industry is the foreseeable outcome of decades of discrimination against women and minorities in financial services. Historically, discrimination was a ploy to preserve the social and economic power of a dominant group regardless of the broader interest of the country. Diverse professionals were taken out of competition for financial services jobs and diverse communities struggled to access capital or attract investment. Today, the legacy of that exclusion is evident through the entire chain of capital.

University stakeholders, as diverse communities, often understand and experience the bitter taste of inequality in finance. Even the most talented diverse alumni face bias, discrimination and other challenges accessing capital. Much of the research testifying to the magnitude of this problem is produced by universities themselves. The

Knight Foundation study was co-led by a Harvard University professor. A team from Stanford University co-led a recent study highlighting evidence of racial bias in the allocation decisions of institutional investors. [2] University research nation-wide has long spoken to the challenges diverse entrepreneurs face in accessing capital in a system where roughly 2 percent of venture capital is allocated to women founders. [3] Universities recognize the problems, but some have not recognized their full influence as a solution.

DIVERSITY AND SOCIAL IMPACT

The Stanford-affiliated study entitled “Race Influences Professional Investors’ Financial Judgements” emphasizes that the implications of stark racial and gender disparities among asset allocators are concerning given the critical role allocators have in setting priorities for how capital is distributed. As noted in the study, investments begin with asset allocators and flow through professional money managers before taking root in companies and projects; any incorrect or biased incentives of asset allocators is reflected and reinforced in the entire capitalist system. There is reason to believe that biases of non-diverse asset allocators, and the low utilization of diverse asset allocators, are having a negative effect on the equitable distribution of capital. One report on the Small Business Administration’s Small Business Investment Company (SBIC) program done by the Library of Congress found that granting licenses to diverse funds increased the rate of investment into other women- and minority-owned companies while also producing returns comparable to their non-diverse counterparts. [4]

The Library of Congress report indicated that diverse populations, and low- and moderate-income communities, are better served through diverse teams of fund managers. However, a university that invests endowment assets with qualified diverse-owned firms may generate additional positive social impact as well. Stakeholders have argued that firms owned by minorities and women often hire and train other women and people of color thus creating better pipelines for future diverse talent. [5] Asset management firms also wield tremendous influence over governance policies in the private sector and investments in diverse-owned firms serve to amplify the voice of women and minorities in the capitalist system. Even marginal investments with diverse-owned firms can be leveraged for additional investments thereby further amplifying positive social ripple effects.

DIVERSITY AND FIDUCIARY DUTY

Opponents to investing with diverse-owned firms often argue that investing with such firms is a violation of fiduciary duty. Fortunately, none of the respondents reported that they believed this misunderstanding to be true. The unfounded proposition that investing with diverse-owned firms occurs at the expense of returns is both insulting and contrary to academic research and empirical findings. In fact, expanding the pool of talent under consideration and seeking differentiated investment strategies is a hallmark of prudent investing. Universities that miss opportunities to allocate to high-performing diverse managers due to bias in sourcing or firm assessment may be violating fiduciary obligations by failing to generate those returns for their endowment.

Additionally, all risk is not captured through use of quantitative analysis. Asset owners regularly consider qualitative and quantitative factors when evaluating potential partners. Those factors should include the material short- and long-term risk associated with investing with non-diverse teams.

REPORT DISCUSSION

The inquiry of college and university endowments uncovered broad variation in the way that teams managing university endowments define ownership and track investments with diverse managers. We summarize those differences below and include select examples in the discussion on recommendations.

DIFFERENT OPINIONS ON TRACKING OWNERSHIP

Institutional tracking of diverse ownership varied based on the philosophical and practical differences of responding schools. At least two institutions opposed consideration of diverse ownership opting instead for exclusive consideration of diversity in firm leadership or elsewhere. Other institutions acknowledged the importance of diverse ownership and included diverse leadership merely as an additional data point. We agree with the latter and consider diverse ownership a necessary but insufficient factor in a holistic view of diversity and inclusion. However, we also acknowledge that although ownership is important, it may not fully explain how the economic profits of a firm are distributed or give a full picture of firm governance and decision making.

Variation in ownership tracking was also attributed to the fact that firm ownership can be more difficult to identify than other diversity and inclusion characteristics such as firm leadership. One respondent described the sometimes-obscure nature of firm ownership structures as a barrier to identifying participation of women and minorities. Schools that develop methods for proactively soliciting ownership information from partner firms as part of initial and ongoing due diligence decrease the difficulty of obtaining ownership information. For purposes of this inquiry, women- and minority-ownership was defined as a percentage greater than 50 percent. Some institutions reported tracking partial ownership at a percentage lower than 50 percent as well.

VARIATION IN USE OF DIVERSE MANAGERS

Due to the difficulty in obtaining ownership data, particularly within the timeframe of the inquiry, some institutions reported the need to “estimate” the diversity of their partners. As mentioned, some institutions also reported the need to define ownership in a way that was easier to determine. Differences in approach likely led to wildly different reports of assets under management with diverse-owned firms. Further, some institutions did not clearly differentiate data on investments with domestic firms from data on investments with international firms. Additional standards for data reporting will be necessary to improve both validity and the ability to compare institutional investments with diverse-owned firms. In general, the schools that submitted the most detailed reports of assets under management with diverse-owned firms also reported lower numbers on average; this is a discrepancy worthy of further analysis and may be attributed to “estimation” biases.

As discussed later, Congress and industry associations can take additional steps to create standards for collection of diversity information. It is questionable whether associations receiving sponsorship funding from non-diverse firms will engage at the level required to move the industry. However, some industry associations including the Diverse Asset Managers Initiative, the NYU Stern Center for Business and Human Rights, and the Intentional Endowments Network are progressing the discussion in substantive ways. Centralized efforts to collect, share and standardize information will help answer important questions and enable further research.
KEY FINDINGS

Importantly, this inquiry was extremely helpful in gathering feedback on various approaches to tracking assets under management with diverse firms and gathering information on successes and challenges that will inform future Congressional work. The questions posed to colleges and universities primarily focused on engagement with diverse-owned asset management firms but also collected significant information on other diversity and inclusion efforts. In addition to practices for investing with diverse-owned firms we detail a wide-range of investment office diversity and inclusion practices in the section on recommendations. Findings include:

- 1 responding university made information about assets under management with diverse-owned firms publicly available prior to the inquiry.
- 20 out of 24 responding universities provided an analysis or estimate of total assets under management with diverse-owned or diverse-led firms.
- Explanations given for not providing an analysis or estimate centered on difficulties obtaining and identifying firm ownership information.
- Reports of assets under management with diverse-owned firms ranged from 5.1 percent to 35 percent.
- 3 responding universities detailed specific targets or projections for future allocations to diverse firms.
- No university reported interpreting the Uniform Prudent Management of Institutional Funds Act to prohibit expansion of diversity and inclusion policies and practices.

RECOMMENDATIONS

The recommendations below are general principles that should be adopted and scaled industry wide. The associated examples are practices revealed during the inquiry that should be discussed further and may be industry best practice. The list of practices below is not an exhaustive list nor does it indicate whether an included university has taken a holistic view of diversity and inclusion practices. It is our hope that the inclusion of this list will spur additional conversation among institutions and outside stakeholders.

Example practices and recommendations include:

1. **Commit to asset management diversity at the highest levels of your institution.** University leadership should commit to increasing opportunities for diverse asset managers and reinforce such commitments through regular discussion and in subsequent written policy and practice. Examples:

   - In 2008 the Office of Business Diversity, Office of Investments, and key supporters from the Board of Trustees at the University of Chicago launched an effort to increase the racial and gender diversity of external investment managers. The university reported that by June 2020 it had allocated $1.4 billion of its endowment across 25 diverse managers.
As part of HopkinsLocal, an economic inclusion effort of Johns Hopkins University designed to redress systemic inequalities, Johns Hopkins committed to assigning at least $75 million of additional capital from the endowment to be managed by a minority-owned firm.

Credible diversity and inclusion initiatives include top university leaders who both empower diversity and inclusion and hold professionals accountable to goals.

2. **Hire, promote and retain diverse professionals on the university investment team.** Investment teams managing university assets in-house should reflect a diversity of perspectives, experiences and backgrounds.

Example:

- In 2019 University of California Investments Office piloted the limited use of a requirement that a pool of candidates must be diverse before its hiring process may advance. Following a successful demonstration, the university reported that it will use the approach across all open positions in the investment office going forward.

Research continues to demonstrate that diversity improves team performance. Diverse persons expand team perspective, and studies have shown that teams composed of diverse people do a better job analyzing and processing information.

3. **Actively promote an inclusive environment in the university investment office.** In-house investment teams should empower persons with different perspectives, experiences and backgrounds to make contributions.

Example:

- MITIMCO, the investment arm of the Massachusetts Institute of Technology, established an internal diversity and inclusion working group that meets monthly to discuss current diversity and inclusion issues and recommendations. The group has catalyzed several diversity and inclusion efforts.

Harnessing the benefits of diversity requires the full and equal participation of diverse persons. Investment teams should leverage the perspective of diverse persons in all decision making – including investment decisions.

4. **Use the university investment office to further develop the next generation of talent.** University investment offices should mentor, train and assist diverse groups of future industry leaders.

Example:

- Johns Hopkins University reported that more that 75 percent of interns in the Johns Hopkins Investment Office internship program are of diverse backgrounds. The university also has staff that actively participates as mentors for diverse talent through the Johns Hopkins University Finance Diversity Mentoring Program.

Tomorrow's future industry leaders are training on investment teams today. College and university investment offices have an opportunity to further develop the diverse pipeline of talent and to assist diverse persons with career advancement and placement.
5. **Strengthen relationships with diverse asset management firms.** Universities should network with diverse asset management firms, and associations of such firms, and maintain relationships with promising managers. Examples:

- Since 2009 the University of Chicago has hosted an annual two-day Business Diversity Professional Services Symposium that connects university administrators with diverse-owned professional services firms. The Investment Office coordinates with the University’s Office of Business Diversity to cultivate relationships that lead to invitations to participate in the event.

- The Harvard Management Company (HMC), which oversees investments of the Harvard University endowment, engaged a third-party service provider to introduce HMC to more women- and minority-owned asset managers. HMC also reported that it will proactively contact diverse industry organizations in order to encourage their membership to review investment partnership information and to contact HMC.

Effectively monitoring industry developments requires broad industry engagement. Schools that diversify their investment network are better able to capitalize on overlooked opportunities. Organizations, such as the Diverse Asset Managers Initiative, can serve as a bridge between institutions and diverse-owned firms.

6. **Evaluate your institution’s process for sourcing asset managers to partner with.** Investment teams should critically examine whether existing sourcing methods are leading to a diverse application pool. Examples:

- The University of Virginia Investment Management Company (UVIMCO) is currently engaged in an initiative to help ensure that its sourcing process captures the entire breadth of the asset management space. In addition to this project, the university plans to identify and evaluate a number of women- and minority-owned firms that were not otherwise in the pipeline.

- The Northwestern University Investment Office has adopted a Rooney Rule for their research process in order to include women and minority-owned firms on their list of managers that they meet with and review. The university is in the early phases of adoption and is monitoring the impact of this approach.

Sourcing methods such as waiting for proposals to come through a website likely do not reach or attract the widest range of high performing firms.

7. **Discuss diversity and inclusion values with external asset management firms.** Universities should convey the importance of diversity and inclusion in due diligence meetings and periodically afterward. Example:

- Rice University reported that the Rice Management Company, as part of due diligence meetings with all third-party asset managers, asks about team diversity at the manager level and shares best practices. Rice referenced research that shows that diverse teams leads to better overall decision making.
Schools should convey their priorities to asset management firms competing for their business. Even firms without diverse ownership should be able to provide a diverse team of decision makers to work on university investment matters.

8. **Track university allocations to diverse asset management firms.** Universities that invest resources with external asset managers should collect data on the diversity of the firms receiving allocations. Examples:

- The Cornell University Office of University Investments is in the process of surveying Cornell’s investment managers to construct a multi-pronged approach to measuring diversity in their portfolio. Cornell is engaging managers on five metrics including: diversity policies, ownership, leadership, next generation pipeline development, and investments in diverse-led portfolio companies.

- Cornell University and Ohio State University both reported considering women- and minority-owned underwriting firms in bond offerings.

Collecting data enables schools to analyze investment practices and determine if practices align with investment assumptions and goals. Data should be granular enough to determine how demographic subgroups, such as Black and Latino/a asset managers, are represented.

9. **Use your institution's voice to positively influence the financial services industry on this and other importance governance issues.** Investment offices should engage with other industry stakeholders on matters of diversity and inclusion and contribute to healthy industry development. Examples:

- Harvard University reported multiple engagements on matters of diversity and inclusion by the Harvard Management Company’s Managing Director for Sustainable Investing since at least 2018. That engagement includes working with outside organizations including, but not limited to, the NYU Stern Center for Business and Human Rights, the Managed Funds Association, the Institutional Limited Partners Association, and the Diverse Asset Managers Initiative.

- PRINCO, the Princeton University office responsible for investing the institution's endowment, notes that it serves on advisory boards for almost every firm with which it invests. PRINCO reported that it works with asset managers to encourage and assist with improvements on issues of diversity.

Institutions committed to diversity and inclusion can progress the broader industry by driving industry discussion and action.

10. **Publicly disclose information about your institution's efforts.** Universities should include information about diversity and inclusion efforts, including assets allocated to diverse managers, in addition to other regularly disclosed endowment information. Example:
In accordance with California law, the University of California now submits an Office of the Chief Investment Officer Diversity Report to the California State Legislature. UC Investments’ first ever annual report on diversity and inclusion details the UC Investments diversity strategy and is publicly available on the Investment Office website.

Transparency invites accountability, may help decrease barriers to adoption at other institutions, and contributes to industry data and/or research beneficial to all participants.

RECOMMENDATIONS SUMMARY

College and university endowments varied in the number and substance of diversity and inclusion initiatives. Some institutions demonstrated a deeper engagement on the above recommendations than others. Concerningly, some multibillion-dollar endowments were found to not be tracking investments with women- and minority-owned asset managers and have not adopted key diversity and inclusion recommendations. All responding institutions acknowledged the importance of diversity and inclusion work broadly.

NEXT STEPS

College and university leadership should discuss if there are additional steps their institutions might take to expand opportunities for women and minority asset managers. We hope that institutional decision makers will consider and adopt the approaches detailed in this report and take further initiative to engage peer institutions and key industry stakeholders. Associations that represent college and university leadership should also receive feedback from members about how associations might best engage or be helpful to the related efforts of members schools. Associations can be particularly helpful with centralizing information sharing and contributing associated data for member research and insights.

Government also has a role to play in assisting healthy industry development. Multiple survey participants pointed to a lack of readily available industry data concerning the diversity of asset management firms. Most asset management providers do not track diversity in a systematic way and some have refused to voluntarily publish or report that information. Perhaps most shockingly, the U.S. Securities and Exchange Commission has struggled to obtain voluntary self-assessment responses from regulated entities in the industry. Government actors will need to continue to work toward greater transparency and standardized diversity and inclusion reporting in the asset management industry.

As demonstrated in California, state legislatures can also take action to require state universities to adopt and report on equitable investment practices. The results of this inquiry beg state officials to engage respective public-school endowment stakeholders on utilization of diverse-owned asset managers.

Moving forward we hope that all stakeholders may work together in developing greater consensus about important diversity and inclusion metrics and standardizing methods for collecting such information. The most immediate progress will come from schools that are transparent and schools that require the firms they work with to be transparent as well.
CONCLUSION

Although diverse managers have historically faced extreme levels of overt bias and discrimination – continuing to impact the allocation of capital today – institutional investors have an opportunity to correct the legacy of systemic exclusion and expand opportunities for high performing diverse asset managers. Colleges and universities who consider investments with these underutilized and often overlooked diverse managers stand to improve returns on investment and drive social impact. While some institutions have already made headway, there is much room for improvement among institutions and in the broader asset management industry. Amid great national challenge and social unrest, it is with urgency that institutional investors challenge the lack of participation of diverse Americans in all levels of the economy - including in the management of college and university endowment assets.