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The National Association of Securities Professionals

"A Review of Diversity and Inclusion Performance at America's Large Investment Firms"

Before the U.S. House of Representatives Financial Services
Subcommittee on Diversity and Inclusion
Chairwoman Rep. Joyce Beatty
Ranking Member Rep. Ann Wagner

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2128 Rayburn House Office Building

First, I would like to thank the US House of Representatives Financial Services Subcommittee, and particularly, Chairwoman Joyce Beatty and Ranking Member Ann Wagner, for having me testify today.

My name is Ronald C. Parker and I serve as the President and CEO of the National Association of Securities Professionals – a trade association that advocates for and supports the development of ethnic minorities within the financial services industry. We work on behalf of five hundred members across the country. Our members hail from firms large and small, and from all asset classes.

I am here today to share some information about the current state of the industry when it comes to ethnic minority representation, share some facts about the realities of minorities in the industry and some solutions that the NASP organization supports to bolster inclusion and equality in financial services.

Indeed, the numbers tell a stark story about the need for greater inclusion in the asset management industry. There are substantial resources – over $100 trillion – that are under the control of governments, endowments, companies, and other institutions that are managed by third party investment professionals. While minority and women owned asset management firms make up 8.6% of this sector, they only manage about <u>one percent of all assets under management.</u>

While much of the disparity exists as a legacy of American racial and economic discrimination, our organization has identified some ways to address this issue via targeted legislation, clarification of rules around fiduciary duty, and supporting strong disclosure processes that make the industry more transparent and fairer.

One of the more egregious, and yet, easily remedied, issues is that of fiduciary duty. We all understand that consultants, asset owners and others owe a duty of fiduciary care when selecting asset managers and must pick top performing, trustworthy managers.

However, we know that minority owned firms produce some of the best results in the industry, often with fewer resources. Yet, according to the magazine Institutional Investor, research done by the Knight Foundation and Bella Research in 2019 found that "these firms are stuck managing a penny on the dollar, despite being overrepresented in the top quartile of performance." One of the study's authors, Josh Lerner, said, "When it came to performance, diverse-owned firms were overrepresented in the top quartile. Private equity performance was particularly notable. Minority-owned private equity firms represented 34 percent of the top quartile of performers, while firms owned by women were 29 percent of the top quartile of performers." A 2015 McKinsey report – "Why Diversity Matters" – underscores this point: companies in the top quartile of racial/ethnic and gender diversity were 35% more likely to have above median financial returns! Therefore, why aren't minority firms getting the same opportunities when they reach and even exceed performance targets?

We also find that RFPs require outsized levels of assts under management to even consider minority owned, smaller firms for investment opportunities. According to GAO, the minimum size requirements for assets under management could potentially exclude smaller minority and women owned firms. It is reasonable to have a minimum level of assets under management of $5 billion, however, many firms ask for AUM three or four times this amount. Similarly, there needs to be greater clarity on the definition of “diverse” so that large institutions and government entities have a consistent, working understanding of which firms they should consider. While there can be some variance across entities as to what constitutes sufficient minority ownership levels for these firms, NASP believes that 51% ownership should be the recognized standard by decision makers. Also, there should be opportunities for diverse financial services professionals to manage all asset classes, including actively managed funds. These rules often serve as a shorthand to denote a well-managed firm and do not consider the full performance and capability of a firm. They serve as an inaccurate shortcut that puts well managed, highly performing asset managers at a disadvantage.

While the first two patterns noted above chiefly affect the finance industry, we also believe that overall support of business supplier diversity will be key to minority asset managers’ success as well. it is imperative that public, private, and non-profit enterprises embrace ‘business diversity’ by increasing their utilization of diverse owned professional services companies in addition to working with diverse businesses in traditional procurement. While there may be a need to ensure that financing is available to diverse owned businesses, securing and retaining customers and clients with large enterprises is as essential and often overlooked.

Despite this context, we at NASP want to focus on SOLUTIONS. We have collaborated closely with members of this committee on legislation and remain committed to our advocacy work on these matters. To that end, I want to briefly discuss some of the legislation and agency rulemaking that we want to move forward to address some of the issues delineated above.

NASP supports passage of the Diverse Investment Advisors Act, spearheaded by Rep. Beatty, and championed by our Legislative Committee in 2019. By establishing a type of “Rooney Rule,” smaller firms will be guaranteed the opportunity to make their case alongside other firms in a process that is less about longstanding connections, but more about bringing new investment philosophies and strategies to the table. This legislation would specifically address the issue of fiduciary care by ensuring that top performing minority and women owned firms – regardless of ownership – have access to the same RFP and competition processes as other firms.

It would be beneficial to track and publish information detailing how much large federal contractors spend on diverse owned professional services firms, including asset managers. Tracking the use of professional services firms, as a way to monitor the utilization of these types of companies has been a best practice adopted in other arenas by companies including Exelon and some higher education institutions like University of Chicago. This effort brings transparency to monitor progress (or lack thereof) in the number of diverse professional services firms across the commercial side of these anchor institutions and the federal government should do so as a way to create more opportunities.

NASP also stands behind legislation put forward to amend the Dodd-Frank Act, section 342 by requiring that diversity and inclusion tracking be added to the Uniform Financial Institutions Rating System. The legislation would require firms to track diversity and inclusion efforts and appoint a Diversity and Inclusion Officer that reports directly to the CEO. This would give the industry robust and accurate data on diversity and inclusion, thus allowing finance entities and advocacy organization to identify issues and support changes. We will be able to track the use of minority owned firms in investment management platforms, as well as determine whether current diversity efforts produce desired results.

Federal and state regulators must have more diverse leaders and diversify their advisory panels. The Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the Commodities Futures Trading Commission have little to no people of color in top leadership roles. Moreover, these agencies also do not have diverse individuals on their formal advisory committees that provide recommendations on regulatory priorities for these agencies. These advisory committees not only perform important roles for the regulators, but they afford their members unique insight into the workings of these agencies and perhaps more notably, give select thought leaders a seat at the table. These advisory committees are woefully lacking with few people of color on them and need to intentionally recruit more diverse participants.

Lastly, I would like to discuss what we have been able to do with the US Securities and Exchange Commission, in conjunction with their Office of Minority and Women Inclusion on these matters. Earlier this year, the Asset Management Advisory Committee put forth a number of recommendations that would support diversity and inclusion goals. They include:

- Disclosure and Transparency
- Increased Guidance Around Fiduciary Duty and Due Diligence Thresholds
- Study and Investigation of “Pay to Play" and Political Contributions
- Clear and Effective Procedure for Reporting Discrimination and Unfair Treatment

Many thanks to NASP member, Gilbert Garcia of Garcia Hamilton, for his service on the Asset Management Advisory Committee.

Our hope is that via legislation, rulemaking, as well as data collection and analysis, we can frame and execute creative and effective solutions that address the issues touched upon here. The National Association of Securities Professionals and other likeminded organizations stand ready to support this committee in your goals of increasing opportunity, transparency, and fairness for everyone in the financial services industry.

Thank you, Chairwoman Beatty, and others on this committee for the opportunity to speak today.

We look forward to working closely with you in the future.

Ron Parker

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