

Investments

Diversity in the Asset Management Industry





‘Teams with more diversity typically produce better long-term outcomes.’ This belief is supported by leading research¹ and explains why our research process considers diversity in such detail.

In this paper we cover:

- Our beliefs around the importance of diversity as a key ingredient of success for asset managers
- The importance of looking beyond asset management ownership to understand diversity and what really drives performance
- Our approach to measuring diversity and asset management culture and how we are engaging with the asset management industry
- The initial findings of our assessment of diversity and the positive link to performance outcomes
- The tools we have developed to assess and assist asset managers and asset owners to help bring about change in the area of diversity

Our approach builds on a template developed by our Thinking Ahead Institute (TAI). TAI has spent many years assessing the impact of greater cognitive diversity on a team’s effectiveness². This culminated in the development and formal inclusion of a “culture review” as part of our manager research process of our high conviction asset managers. Since 2018, we have completed over 100 culture reviews, of which inclusion and diversity (I&D) is a key component³.

I&D is an area where progress remains disappointingly slow for the whole investment industry; not just asset management but also other segments, including investment consulting (and hence our own organization) too. We need to and are committed to improve, and recognize the part we must play in accelerating progress given our role as advisor or co-fiduciary to our clients. Here we examine how we could better effect change by adopting:

- a data-driven approach to measuring diversity, and
- an engagement model in manager research that not only focuses on identifying diverse-led teams, but also aims to get the 90%+ of the industry that isn’t diverse-led to evolve.

Reflecting our belief that better diversity means better outcomes for our clients, we must challenge the status quo, while at the same time playing our role in helping to address the deep-rooted inequality in society more earnestly. We highlight some of our own initiatives, as well as ideas for asset managers and asset owners so that we may all collectively increase the pace of change.

Introduction

In our view, an ideal asset manager has optimal cognitive diversity, where we define cognitive diversity as the inclusion of people who have different ways of thinking, different viewpoints and different skill sets in a team. Cognitive diversity is hard to measure, but it is heavily influenced by quantitative metrics of diversity that we can collect. We therefore assess diversity across gender and ethnicity, and endeavour to assess the deeper and more nuanced aspects in our manager research process, including considering neurodiversity and differences in prior social, educational and working experience.

¹See The other diversity dividend, The Tipping Point Woman on Boards, How and where diversity drives financial performance

²See A cognitive take on diversity, also visit TAI’s Culture, Leadership and Diversity Hub

³See Measuring Culture in Asset Managers

How to measure diversity better – the fallacy of a single metric

Investors frequently rely on minority and female ownership as a screening metric to improve the diversity mix of asset managers in their total portfolio. However, we believe an asset manager having minority and female ownership doesn't necessarily mean diversity is reflected across different functions within the organization.

In the context of assessing an asset manager's competitive advantage, we focus on the diversity of the investment teams and leadership, in addition to looking at ownership metrics. The people that comprise the investment teams and leadership are the primary source of alpha generation and responsible for the organizational culture that can sustain competitive advantages. We believe it is important to combine a variety of metrics.

Focusing on a single metric can also create additional limitations. Take minority and female ownership as an example. At first glance, it seems to be a good metric because it combines diversity with alignment, an important consideration in the sustainability of an asset manager's competitive advantage. However, when we examine the data reported to a third-party database provider which comprises over 6,000 firms, only about a quarter of them provided ownership details, making screening by diverse ownership extremely limiting. Of the quarter of those

who voluntarily reported ownership information, the minority/female equity stakeholders is still fairly low and not representative of society.

So what could be done?

There is no single avenue for sourcing diverse-led firms or investments teams, necessitating proprietary data collection, scouring of external databases and engagement. We engage with asset managers around three "areas of edge" to help accelerate change. Diversity is one of the three key pillars. We systematically ask asset managers a series of over 25 questions related to I&D. We collect information both at the firm and product level, including investment team demographic information that provides insights into diversity in terms of endowed traits (e.g. gender, ethnicity) and acquired traits (e.g. work experience). We roll this up into our new Willis Towers Watson Diversity Score to provide a base-level assessment of an asset manager's diversity. While we are mindful that quantitative metrics are

subject to potential flaws and input manipulation, they can help to:

1. Raise awareness and engage asset managers on implementing I&D initiatives systematically,
2. Make more robust and consistent comparisons between managers and across asset classes, and
3. Track progress over time.

Other questions to ask

- How does the firm measure and monitor diversity?
- Does the firm I&D strategy include measurable objectives?
- Is the firm signatories or members of any I&D charters or industry initiatives?
- What is the level of diversity of the investment team as measured by gender/ethnicity/language spoken?



When we examine the data reported to a third-party database provider which comprises over 6,000 firms, only about a quarter of them provided ownership details, making quantitative analysis by diverse ownership extremely limiting.



Our findings support a positive link between diversity and performance outcomes

Our belief is that diversity leads to better decision making, and there is strong supportive evidence from the corporate world and executive decision-making bodies. We have sought to understand what data can tell us about the relative merits of diverse teams within the context of investing. The natural indicator to consider is investment returns, although there are limitations such as low signal-to-noise ratio and various other biases. In addition, we also expect diverse teams to account for a small proportion of the overall sample size. Put simply, it is hard to draw a clear link from diversity to investment returns.

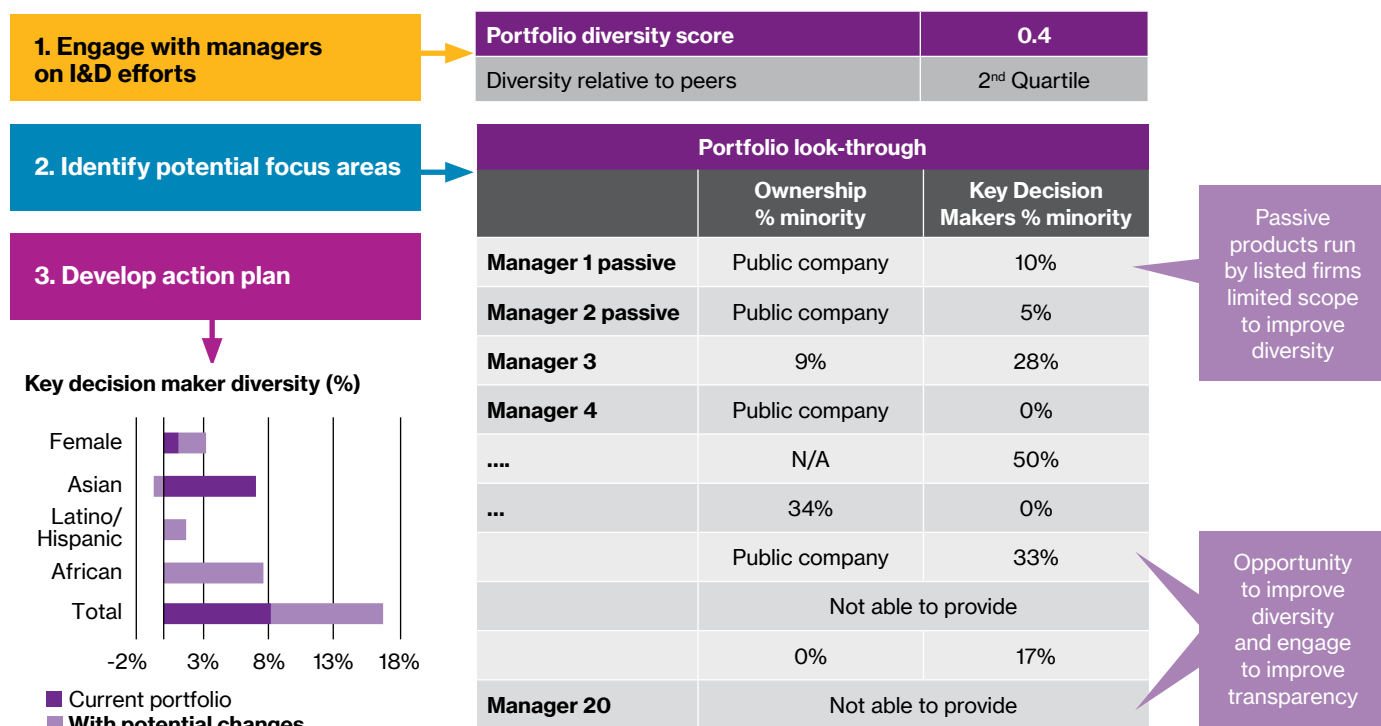
Using proprietary data and employing a data-driven approach, we analyzed

information on a cohort of around 400 products across a number of asset classes over several years, including benchmark-relative returns, tracking error and diversity.

Does diversity lead to better returns? At a minimum, diversity does not hurt returns. But more than this, Willis Towers Watson's assessment of diversity and performance outcomes shows that investment teams with diversity, in particular ethnic diversity, tend to generate better excess returns.⁴ Our research continues as we collect more data, expand our database of manager diversity information, and engage with the investment management community to evaluate how improvements in diversity support investment outcomes.

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Pleasingly, the analysis supports our beliefs; investment teams with diversity tend to generate better excess returns.
 Chris Redmond, Head of Manager Research

Figure 1: Our new Willis Towers Watson Diversity Score



Note: Figures above are for illustrative purposes only. This is a sample representation of our work with an investment manager. Outcomes will vary and there is no guarantee that we can achieve any particular results with any particular manager.

⁴Performance presented herein is gross of underlying investment manager fees and other relevant trading costs. Past Performance is not indicative of future results.

Affecting wider spread change via an engagement model

Greater focus on the capabilities of minority and female owned firms is an important step in improving the investment industry for the benefit for savers. However, we should also recognize that it is unrealistic for many asset managers to transform their ownership and teams in the near term. Furthermore, due to many biases against minorities in the industry, leading to less opportunities for many throughout their careers, there is an unbalanced talent pool. To address this systemic issue more holistically, we need to go beyond targeting what is currently a very small subset of minority and female-owned firms by also engaging with firms that are weak in diversity.

Our manager research process starts with the proprietary data collection to establish an asset manager's current state. Beyond that, we want to have direct conversations with senior leadership of these asset managers to:

1. Enhance our understanding of the firm's policies and plans around diversity, and
2. Engage, sharing best practice and encouraging them to accelerate change.

We do not seek to impose targets on the asset managers ourselves, given the varying states and challenges each firm may be facing. However, we do seek to challenge them to establish plans or targets and hold them accountable if they do not demonstrate progress in the timeframe noted.

The diversity characteristics of the asset managers in our industry are a long way from being representative of broader society. This implies we

must be missing out on talent and failing to deliver optimal cognitive diversity, which is bad for savers. By developing metrics and a common language for measuring diversity we can help to highlight the gaps. In turn, this can allow us to better direct capital to diverse asset management teams and those making progress. An engagement model also provides us with the

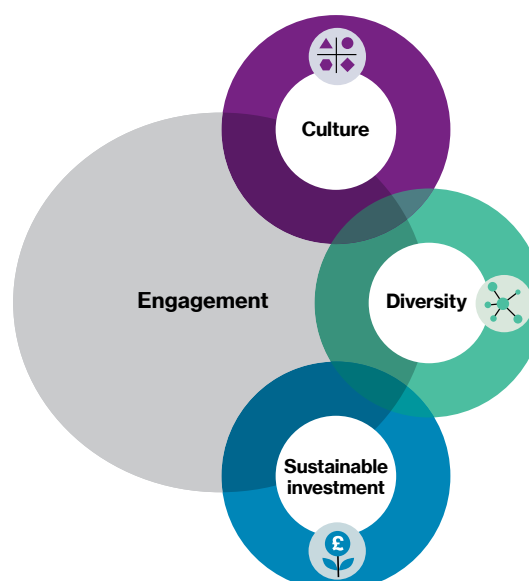
opportunity to exchange ideas with asset managers as we look for ways to make improvements and evolve internally.

In *Figure 2*, we highlight some of our observations from having engaged with asset managers on this topic, including demonstrating how there can be material differences depending on the size of the asset manager.

Figure 2: Willis Towers Watson observations on asset manager progress on I&D

	Challenges	Positive developments
Smaller firms	<ul style="list-style-type: none"> ■ Limited opportunity to diversify key decision makers ■ Less budget for resources ■ Risk of losing talent to larger firms ■ Limited formal I&D policies 	<ul style="list-style-type: none"> + Greater transparency + More nimbleness to develop, change policies and adapt
Larger/public firms	<ul style="list-style-type: none"> ■ Very few evidence-based policies ■ Limited dissemination of actual progress 	<ul style="list-style-type: none"> + More budget for dedicated resources, e.g. Chief Diversity Officer + More hiring opportunities + Growth in college recruiting, network expansion and more training

Figure 3: Willis Towers Watson Engagement Model



Call to action

We all need to play a role in helping to collectively bring about change and improve the system. Below are examples of our own initiatives, as well as ideas for asset managers and asset owners.

1. Asset managers

Our engagement with asset managers on I&D includes some of the following examples:

1. Transparency and disclosure: high-level statistics to understand how diversity is reflected across different functions, including the Board, executive leadership, key decision makers, investment teams and product teams
2. Recruitment: ways to change the composition of the talent pool, such as graduate programs for junior hires, returner programs to senior hires, adjusting job requirements/descriptions
3. Compensation structure and policies around flexible working arrangements
4. Shift of decision-making structure from star models to a team-based approach that introduces more diversity
5. Internal policies and focus: internal training and networks on the topic of racism, inclusion, unconscious biases, targeted resources, i.e. Chief Diversity Officers, evidence-based policies, better policies around parental leave.

Case study:

Improving diversity at asset managers

In 2019, we engaged with an asset manager on their culture. After a constructive feedback session, they have since strengthened multiple diversity initiatives, while targets and reporting remain opportunities for further improvement.

Pre-engagement

- ✗ Measurable goals
- ✗ Practices to attract and retain a diverse workforce
- ✗ Internal and external networks
- ✗ Investment team leadership diversity

Post-engagement

Internal policies and practices	✓	Tracking of diversity
	✓	Training on communication
	✓	Mentoring/reverse mentoring and sponsorship programs
	✓	Work flexibility (job-sharing, part-time)
	✓	Internal network
External	✓	Coordination with diversity networks and firms in related sectors
	✓	Recruiting: Coordination with external talent pools

This is a sample representation of our work with an investment manager. Outcomes will vary and there is no guarantee that we can achieve any particular results with any particular manager.

2. Investment consultants and discretionary investment solution providers

Our manager research team has set explicit goals aligned with our beliefs and desire to accelerate improvement in the diversity characteristics of asset managers from its current levels. This includes a bid over the near term to:

1. Increase sourcing of diverse talent: to challenge our own unconscious biases and push ourselves to achieve a more balanced opportunity set.
2. Deliver against stretching targets to significantly increase the diversity and improve expected performance within client portfolios. We have made progress through identifying new diverse teams and engaging with existing teams.
3. Continue to ensure our decision-making teams remain diverse.

We are also continuing to improve the quality and depth of the data we are collecting on diversity.



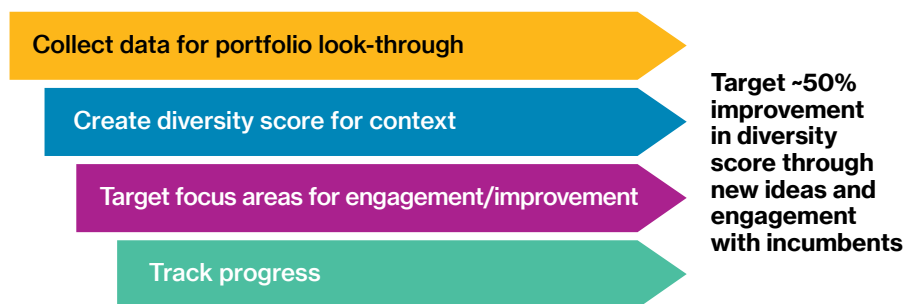
3. Asset owners

We also encourage asset owners to devote more time and attention to diversity, both in terms of how they go about manager selection, but also the constructions of their internal teams and decision-making groups. Our collaboration with asset owners on this topic involves creating an action plan that may include the following:

1. Examine committee diversity in order to make better decisions⁵.

2. Measure diversity in asset manager line-up beyond ownership, e.g. examine key decision makers mix for team-based structure and/or broader investment team composition.
3. Mitigate potential unconscious biases by removing requirements that may unwittingly exclude diverse funds/firms. For example, imposing strict rules around length of track record creates a higher bar for minorities, who often face a longer wait before rising to the position of portfolio manager.

Figure 4: Asset owner approach



Progress is possible

In one representative best ideas mandates (holding 76 funds), in one year we upgraded the portfolio to have better return expectations through process enhancements and manager engagement, including improving the diversity in key decision makers from 21% to 31%.

Portfolio	% Diverse ownership	% Diverse key decision makers
Manager A	8%	12%
Manager B	Does not disclose	
Manager C	0%	14%
Manager D	N/A	34%
Manager E	33%	33%
Diversity score		0.18

Engage to improve transparency

Note: Portfolio above for illustrative purposes only but represent a typical model to engage with clients on improving diversity in their portfolios.

⁵See Why diversity matters

An internal reflection on our diversity and approach



Inclusion and diversity beliefs

Our mission in manager research is to deliver strong, sustainable investment outcomes for savers and other stakeholders over the long term.

1. Diverse teams lead to better long-term outcomes
2. Diversity should be examined across multiple dimensions
3. A strong and inclusive culture is necessary for the sustainability of an organization's success
4. Increasing diversity in the industry requires active engagement with all stakeholders
5. We commit to doing more internally and focus on culture, I&D hiring, career opportunities, mentoring.

Global manager research team



90+
researchers globally



43% Female



~50% speak >1 language
~45% have lived in >1 country



Diversity measured across age, education, work experience, upbringing, political/religious views and more.

Data as of 30 June 2019

Thinking Ahead Institute

Culture, leadership and diversity

Our research has been focused on:

- Stronger theory: we need deeper thinking on diversity
- Diversity means embracing whole identity
- Creating safe zones for team decisions
- Leadership under challenge
- The evolving role of culture
- The impact of culture on institutional investors
- The power of culture study

For more insights and research from the Thinking Ahead Institute, visit the Culture and Diversity hub for podcasts, videos and more.



Marissa Hall and Tim Hodgson
Co-heads of the Thinking Ahead Group

Manager research leadership



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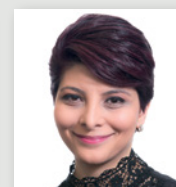
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Our commitment



We are diverse in our Manager Research leadership and wider team, though we recognize there is more to do



We believe cognitive diversity is a key element to the success of manager research, both in finding the best opportunities and making better decisions. We will robustly measure diversity on a number of levels to help track progress and highlight gaps.



We commit to doing more and focus on culture, I&D hiring, career opportunities, mentoring



We will challenge our biases, with a focus on team education and improving our decision making processes to help reduce bias

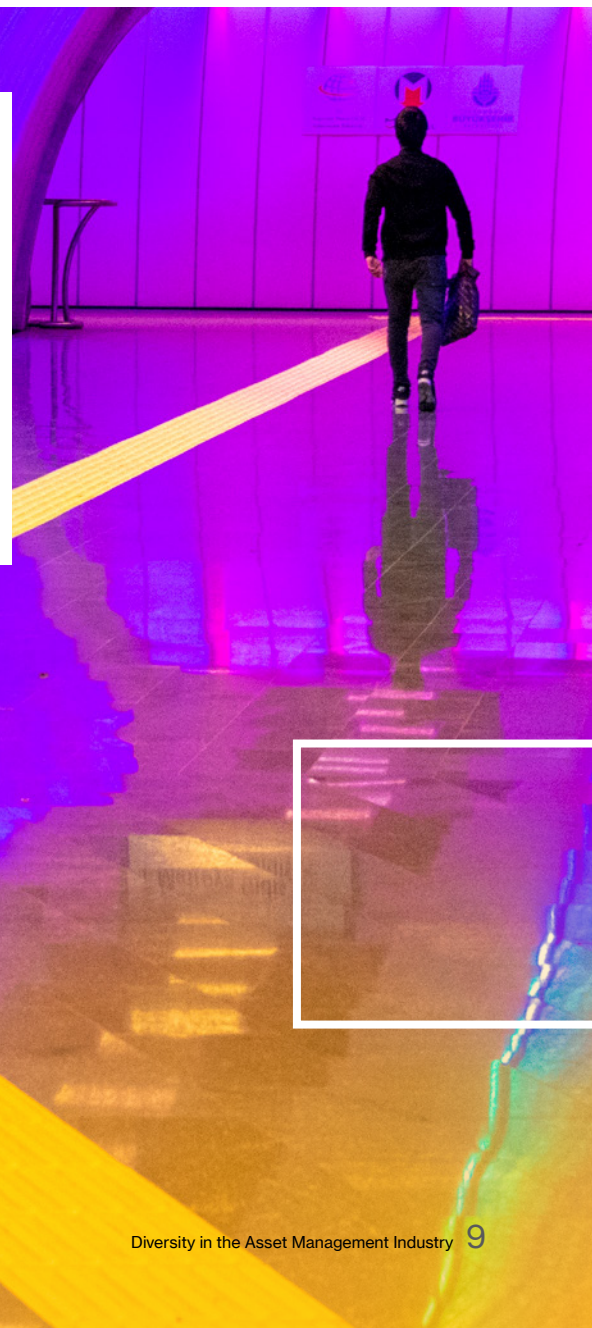


We will keep striving to deliver exceptional outcomes, bring the best of diverse thinking to the table and being an advocate for change.

Looking forward

Addressing the systemic issue of poor diversity in the asset management industry requires a collective effort, and in many cases a fundamental change in mindset and culture. Although we expect obstacles will remain and some of these efforts will take time to bear fruit, we need to be challenging ourselves to do more now.

The above is just a starting point and we are committed to doing more, pushing ourselves and asset managers to improve diversity and better reflect the societies they are operating in, and ultimately to provide the best outcomes for savers that we can as an industry.





For more information

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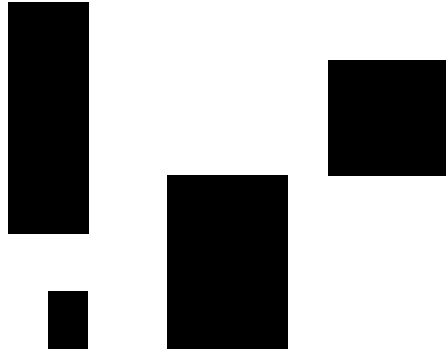
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