

# Introduction to Racial Inequity as a Systemic Risk:

Why Investors Should Care and How They  
Can Take Action

**SUMMARY**

The Investment Integration Project  
June 2023



## **Disclosures**

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## June 2023

Not only is racial inequity morally and ethically abhorrent, but it also threatens the U.S. economy, the global financial system, and long-term investment returns across all asset classes. The good news is that the opposite is also true, racial equity yields benefits throughout society and the economy. While the drivers of racial inequity are many and complex, one thing is clear: the U.S. financial industry is part of the problem – it can therefore also work alongside government and civil society to be part of the solution.

*Introduction To Racial Inequity As A Systemic Risk: Why Investors Should Care And How They Can Take Action* helps investors (asset owners with long-term interests and the managers, consultants, and others that support their work) understand the *systemic* nature of racial inequity. It explains why investors should care about the issue – not only because it is bad for society, but because it also harms the economy and their bottom lines – and introduces them to how they can work within and outside of their portfolios to create meaningful, structural change and fortify long-term investment returns. The summary version of the report serves as a primer for those of you who are newly exploring the intersection between racial inequity and investing practices, while the full version guides those of you that are ready to act or to push existing efforts to the next level.

As representatives of institutions working to support system-level change and to foster sustainable communities, the undersigned know that thriving cultures, inclusive economies, and sustainable environments are not possible without directly addressing the root causes of racial inequity in the U.S., structural racism, and discrimination.

Beyond improving prospects for long-term economic growth and financial stability, eliminating racial and ethnic disparities, and promoting racial equity is also a pre-condition of the goal of racial justice. It is an integral step toward righting past wrongs and developing an inclusive economy and society free of racial hierarchies where all individuals can reach their full potential.

Signed,



**Don Chen**  
President  
Surdna Foundation



**Adam Connaker**  
Director, Impact Investing,  
Surdna Foundation



**Renaye Manley**  
Deputy Director,  
Strategic Initiatives, SEIU



**Rodney Foxworth**  
Founder,  
Worthmore



**Monique Aiken**  
Managing Director,  
The Investment  
Integration Project (TIIP)



**William Burkart**  
CEO,  
The Investment  
Integration Project (TIIP)



**Jessica Ziegler**  
Director of Research,  
The Investment  
Integration Project (TIIP)

This report is the first installment of what The Investment Integration Project (TIIP) plans to be a larger body of work focused on providing investors with practical and detailed guidance on how to address racial inequity.

The report primarily discusses the social and financial experiences of Asian, Black/African American, and Indigenous American (including people indigenous to the continental U.S., Alaska, and the Pacific Islands [including Hawaii]), people who are two or more races, and Latine/o/a/x people. Discussions of Asian people in this report primarily refer to East Asian people, for whom more data is available than for South Asian people, and discussions of Arab and Middle Eastern people are very limited given lack of data. Erasure and the gap in disaggregated data for all people of color is part of the problem.

The report focuses on racial inequity in the United States (U.S.), but it is a systemic risk across the world and across global financial markets. Lessons contained within might be applicable in other contexts when adapted to consider local history, differences between groups involved, local power dynamics, and the regulatory environment.

While discussed together as “people of color” throughout the report, Asian, Black/African American, and Indigenous American (including people indigenous to the continental U.S., Alaska, and the Pacific Islands [including Hawaii]), people who are two or more races, and Latine/o/a/x people are not homogenous nor are their experiences. Also, while commonly classified as a racial group (e.g., Indigenous to the continental U.S.), membership in a federally recognized Indian tribe in the U.S. is based on the rules of each tribe and not necessarily on “blood quantum” ancestry. Belonging to a tribal nation or community differs from racial identity.

This report does not include a discussion of tribal sovereignty, an important component of racial equity as it relates to people Indigenous to the continental U.S.

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# Summary

**Racial inequity is a major threat to the U.S. economy and financial system.**

**Racial inequity – the “unequal distribution of resources, power, and economic opportunity across race [and ethnicity] in a society”<sup>1</sup> – is a systemic social challenge that causes tremendous harm and poses considerable risks to the global economy and financial system.** In the United States (U.S.), racial inequity manifests as persistent unequal participation in and outcomes related to society and the financial system for Black/African American, Indigenous, Latine/o/a/x, East and South Asian, and Arab and Middle Eastern people relative to their White peers. This includes but is not limited to unequal participation in and outcomes related to democracy, education, income and wealth accumulation, health, the carceral system, and U.S. corporations and financial institutions.

**Racial inequity is embedded in American capitalism and the U.S. financial system.**

Wall Street was a slave market before it became the center of U.S. financial markets. Some of the financial accounting systems, business management and organization practices, and financial products used today were developed as part of the U.S. slave system and cotton industry. Slavery and the cotton trade built the wealth not only of Southern slaveholders, but also that of Northern and European businessmen and institutions that lent money to, traded with, or otherwise invested in plantations. These practices were the beginning of the financialization and globalization that are central to the U.S. financial system today.<sup>2</sup>

**Racial inequity threatens economic growth, social stability, and, ultimately, long-term investment returns.**




Not only is racial inequity morally and ethically abhorrent, but it also comes at a cost. The marginalization of Black/African-Americans alone cost the U.S. economy an estimated \$16 trillion in Gross Domestic Product (GDP) between 2000 and 2020.<sup>3</sup> The U.S. cannot reach its full economic and growth potential, and effectively compete in the global economy, if it continues to exclude people of color from fully participating in its economy – especially given that people of color will make up the majority of the U.S.’ population (approximately 52%) by 2050.<sup>4</sup> Major disparities in income, wealth, opportunity, and power – like those between people of color and White people in the U.S. – also lead to social discontent, tension, and unrest. Such social instability increases market volatility and uncertainty and creates a general sense of economic instability, impacting investment opportunities across all asset classes.<sup>5</sup> Racial inequity is not merely a negative “externality” or byproduct of the U.S. economic system. It is a systemic risk – that, like climate change, investors cannot “diversify away.”

Closing the racial wealth gap between White people and Black/African Americans, for example, could increase consumption and investment by hundreds of billions of dollars by 2050 (including by an estimated \$109 billion spent on food, \$30 billion on apparel,

and \$44 billion on entertainment); facilitating access to higher education for Black/African American students could increase lifetime earnings by \$90 to \$113 billion over five years; and eliminating racial and ethnic disparities could reduce spending on healthcare by more than \$230 billion per year.<sup>6</sup> Closing these gaps and doing so for all people of color would result in even more substantial gains.

**Racially diverse teams make better decisions and can help companies make more money.** Evidence increasingly shows that racially, ethnically, and gender diverse teams across industries make better, more efficient business decisions than homogenous teams – and they can help companies make more money. In the financial services industry, for example, “for every 10 percent more racially or ethnically diverse a company’s senior team is, earnings before interest and taxes (EBIT) is nearly one percent higher.”<sup>7</sup> A study of more than 360 public companies across the U.S., Canada, the United Kingdom (U.K.), and Latin America found that companies in the top quartile of racial and ethnic diversity are 30% more likely to have financial returns above their national industry medians.<sup>8</sup>

**Racial inequity is the result of centuries of policies and practices designed to ensure White dominance in a racialized hierarchy and to justify the marginalization and dehumanization of people of color.** Many of these policies and practices date back to before the U.S. was even founded and center around the “appropriation of the physical, financial, labor, and other resources” by White people from people of color.<sup>9</sup> This includes the genocide of and theft of land from Indigenous people, the enslavement of African people, Anti-Chinese and Japanese sentiment, and discrimination against Latine/o/a/x people – the list goes on. The negative economic and social impacts and legacies of these and other de jure and de facto policies and practices in the U.S. persist today (see Figure 1):

 <p><b>DEMOCRACY</b></p>	<p>State voting laws disproportionately discriminate against and disempower people of color (of the 3.1 million adults in the U.S. that are prohibited from voting, 2.2 million of them are Black/African American);<sup>10</sup></p>
 <p><b>HEALTH</b></p>	<p>People of color have higher rates of chronic illnesses like diabetes, hypertension, obesity, asthma, and heart disease than White people;<sup>11</sup></p>
 <p><b>CARCERAL SYSTEM</b></p>	<p>Black/African Americans are incarcerated in state prisons at nearly five times the rate of White people.<sup>12</sup></p>



### INCOME & WEALTH

Workers of color earn on average \$0.84 for every \$1.00 earned by White workers;<sup>13</sup>

People of color are substantially more likely than White people to live in poverty;<sup>14</sup>



### CORPORATIONS & FINANCIAL INSTITUTIONS

Less than a quarter of senior managers at U.S. financial services firms (24%), and just 19% of vice presidents, 12% of senior vice presidents, and only 10% of C-suite executives at these firms are people of color;<sup>15</sup>

White men manage nearly 98% of financial assets in the U.S.;<sup>16</sup>



### EDUCATION

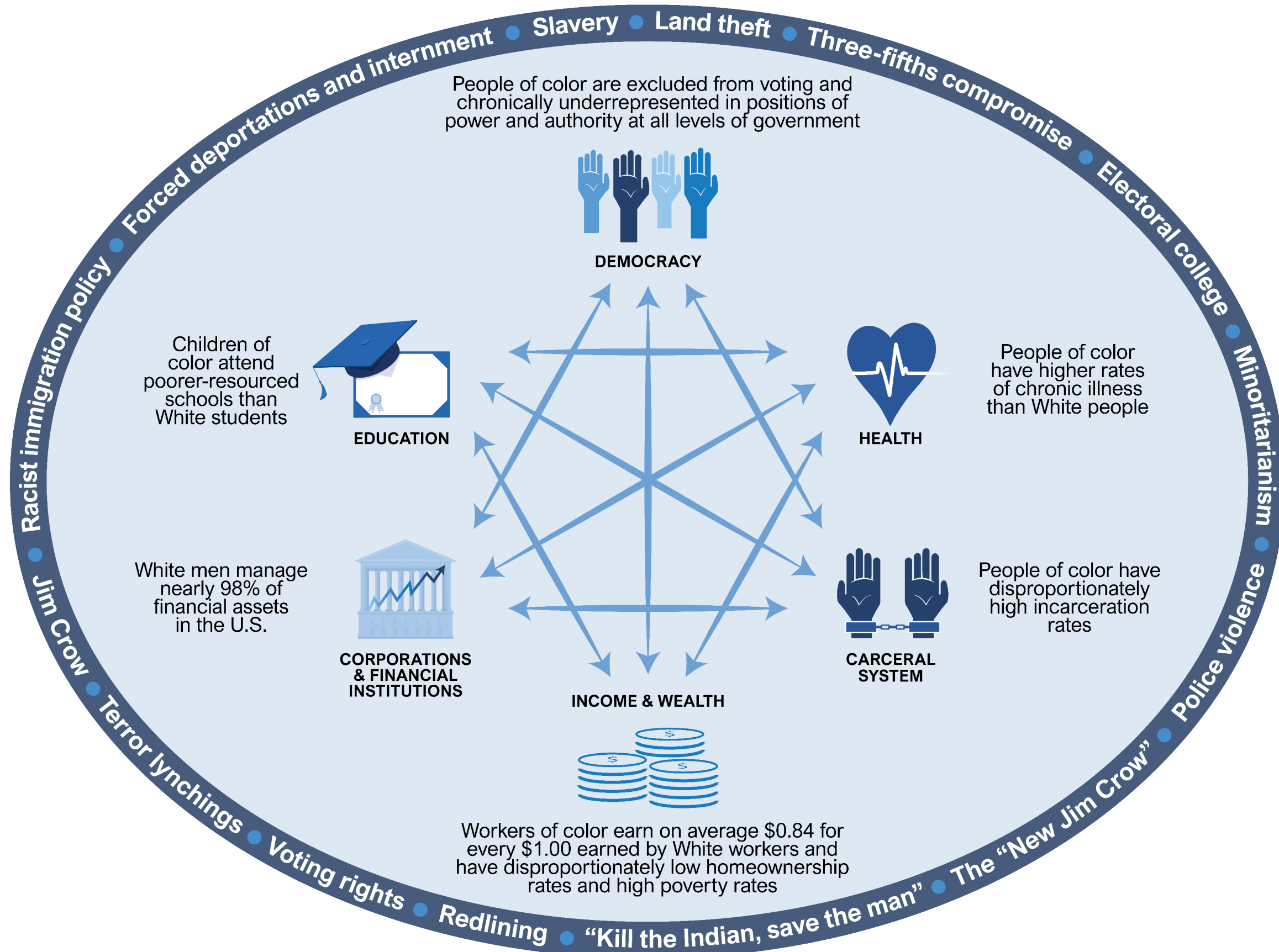
Most children of color attend poorer-resourced schools with larger class sizes, lower quality curriculum, and less qualified teachers than White students – all of which negatively influences academic performance.<sup>17</sup>

### **Investors must identify, confront, and address their contributions to the problem.**

While today's investment professionals did not create the systemic risk of racial inequity (it has been central to life and economic activity in the U.S. for centuries), they are perpetuating the problem whether they acknowledge it or not. This includes everything from not recognizing their direct and indirect contributions to the systemic risk of racial inequity (e.g., excluding people of color from full participation in the financial industry and investing in products/services, companies, and industries that underwrite racial inequity) to knowingly disregarding racial inequity and its long-term consequences in pursuit of short-term economic gain (see Figure 2). Allowing racially inequitable practices to persist is tantamount to co-signing them.



**Figure 1. The interconnected structures that perpetuate racial inequity in the U.S.:  
Summary of discriminatory policies and practices and select examples of their lasting legacies**



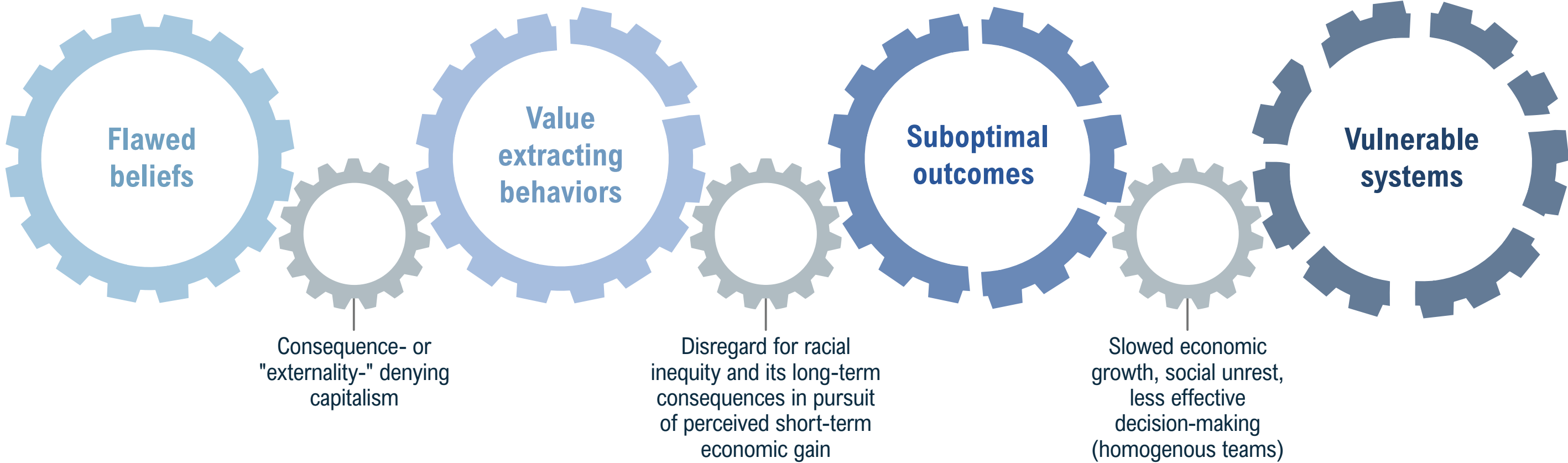
**Figure 2. Racial inequity: Flawed beliefs, value extracting behaviors, suboptimal outcomes, and vulnerable systems**

Belief that abusive practices in service to short-term investment returns and/or White dominance—including the marginalization and dehumanization of Black people, Indigenous people and other people of color—are acceptable

Investment in products, services, companies, and industries that underwrite racial inequity; financial industry dominated by White men that largely excludes people of color

Unequal participation in and outcomes related to democracy, education, income and wealth accumulation, health, the carceral system, and U.S. corporations and financial institutions for people of color

Weakened social and financial systems that harm the well-being and limit the economic gains of people of color and negatively impact growth and long-term investment returns



**There are key actions that the U.S. financial industry, with its more than \$100 trillion in assets under management (AUM), can take to promote the equal distribution of resources, power, and economic opportunity across all races and ethnicities in the U.S.** That is, there are two primary ways that investment professionals can leverage their power and work alongside government and civil society to effectively influence racial inequity – not just to improve well-being throughout society, but to support economic growth, improve business outcomes, and fortify long-term investment returns. These actions – or “leverage points” – include:

- **Investor action #1: Ensure racial equity at U.S. corporations and financial institutions**

Work to ensure parity, such that the racial and ethnic composition of the leadership and personnel of U.S. financial institutions, investee companies, and their supply chains mirrors the demographics of society, and that personnel earn equal compensation for equal work. Do so to ensure equitable inclusion of people of color in U.S. corporations and financial institutions, and to promote their equitable participation in decisions about where and how capital is deployed.

Only 17.5% of Fortune 500 board seats were held by people of color. White men manage nearly 98% of financial assets in the U.S.<sup>18</sup> This is not surprising given that existing leadership and personnel recruitment, hiring, compensation, and retention norms, policies, and practices across many industries – and the U.S. financial industry in particular – reflect in-group bias toward the employ, promotion, and retention of White people (and White men in particular), perpetuating (and exacerbating) racial inequity. This includes everything from asset owners requiring that prospective asset managers provide at least a 20-year track record (the oldest Black-owned asset management firms, for example, are only 30 years old) to conscious and unconscious bias against the hiring and promotion of financial professionals of color – barriers that have been acknowledged by the U.S. Securities and Exchange Commission (SEC).<sup>19</sup> Removing these barriers and diversifying teams across the financial industry and U.S. corporations is not just the right thing for investors to do, it will improve team decision-making and help them make more money.

- **Investor action #2: Contribute to the development of racially equitable social structures**

Work to ensure that underlying social structures in the U.S. – structures related to democracy, education, income and wealth accumulation, health, and the carceral system – do not continue to propagate racial inequity and, instead, support and promote the full, equitable participation of people of color in society and the financial system.

The underlying social structures in the U.S. – structures related to democracy, education, income and wealth accumulation, health, and the carceral system (and, increasingly, technology) – do not support and promote the full, equitable participation of people of color in society and the financial system. These structures are the foundation upon which the U.S. economy and financial system are built and underpin all investment activity – weak and inequitable structures contribute to poor economic outcomes; strong and equitable structures promote economic growth and support long-term investment returns.

Given that racial inequity permeates all aspects of life and economic activity in the U.S., there is no shortage of ways that investors from across asset classes, both as individuals as well as institutions, can act to support the replacement of discriminatory and biased social structures with those that promote racial equity and advance racial justice. They can do so not only to improve societal well-being, but also to promote economic growth and strengthen the financial system.

**There are a number of specific ways that investors of all types and using all asset classes (and approaches) can take toward generating effective, positive influence on the systemic issue of racial inequity related to (1) ensuring racial equity at U.S. corporations and financial institutions and (2) contributing to the development of racially equitable social structures.** This includes improving corporate governance and utilizing [portfolio-level actions](#) within the confines of their routine investment selection and management practices (i.e., adapting conventional investment techniques):

- **Statements of investment beliefs:** Develop a Statement of Investment Beliefs – a statement that articulates the fundamental perceptions of trustees and their institutions on the nature of financial markets and the role they play in these markets – that transparently conveys beliefs about the significance of racial inequity to investments across all asset classes.
- **Security selection and portfolio construction:** Assess racial inequity and its impacts on industries and/or stakeholders across all portfolios, in addition to conventional investment analysis.
- **Manager due diligence:** Assess managers' skills at managing the systemic social risk of racial inequity. Support them in improving these skills and hold them accountable for progress over time.
- **Engagement:** Engage with entire industries – not just individual corporations or firms – on the financial implications of racial inequity. Hold them accountable for their racial equity promises.

It also includes actions above and beyond corporate governance and everyday portfolio management and that involve collaborating with peers, building shared knowledge bases, setting new industry standards, and wielding political influence (i.e., [system-level actions](#)):

- **Collaborate:** Join or establish organizations that build the financial system’s capacity to address racial inequity; disseminate information about racial inequity to peers, clients, and the public – to build trust and increase the alignment necessary to establish shared goals and pursue effective collaborative action; and/or participate in and otherwise amplify public policy debates about governmental rules and regulations that impact exposure to the risks of racial inequity.
- **Enhance:** Help to establish standards and norms that provide the basis for engagement or investment in/divestment from industries related to racial inequity; pursue investments and promote business models that help to resolve racial inequity, rather than profit from it; and/or utilize a diverse range of investment approaches to maximize overall positive impact on racial equity.
- **Target:** Use financial products explicitly designed to and focused on addressing racial inequity; design new products when necessary; evaluate the inherent worth of the systemic intangibles of social and human capital; focus investments within a specific geographic region to increase its resilience to racial inequity; and/or maximize the societal uses for which specific asset classes were explicitly created to address racial inequity.

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**Beyond improving prospects for long-term economic growth and financial stability in the U.S., eliminating racial and ethnic disparities and promoting racial equity is also a pre-condition of the ultimate goal of racial justice. That is, a step toward righting past wrongs and developing a society free of racial hierarchies where people of color have “the dignity, resources, power, and self-determination to fully thrive.”<sup>20</sup>**

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# About the Authors



**Jessica Ziegler**  
Director of Research,  
The Investment  
Integration Project (TIIP)

Jessica Ziegler is the Director of Research at TIIP and oversees all of TIIP's research projects. She has extensive experience in research design, data collection and rigorous qualitative data analysis. She comes to TIIP from Mathematica Policy Research—an industry-leading policy research firm—where she spent nearly a decade conducting social policy evaluations. Ms. Ziegler has authored numerous reports on the implementation, costs and effectiveness of federally funded employment, family support and education programs; her reports are used by programs and policymakers to guide reforms and improvements. She holds a Master of Public Policy from Johns Hopkins University and a Bachelor of Arts in Policy Studies from Dickinson College.



**Monique Aiken**  
Managing Director,  
The Investment  
Integration Project (TIIP)

Monique Aiken is Managing Director at TIIP. She is a co-founder of Make Justice Normal, a growing collective seeking to open space for people working to move capital towards justice and the ReStarter Fund, an economic and climate justice initiative aiming to be a small business lifeline in these unique times. Monique is also a Contributing Editor at ImpactAlpha. Monique is a member of the Steering Committee for the Intentional Endowments Network, the Investment Committee for the NYU Impact Investment Fund and the Advisory Board for the Global Bio Fund, focused on gendersmart biotech and wellness. Monique is a proud Toigo, SEO, and INROADS alum and holds an MBA from NYU Stern School of Business, where she specialized in Financial Instruments and Markets and a B.Sc. in Foreign Service from Georgetown University.



**William Burkart**  
CEO,  
The Investment  
Integration Project (TIIP)

William Burkart is the CEO at TIIP. He is a co-founder of Colorful Capital, which is bringing capital support and scaffolding to enterprises founded and led by members of the broad LGBTQ+ community; he co-authors a regular column for Nasdaq.com on the intersection between LGBTQ+ advancement and investment. William is Adjunct Professor of International and Public Affairs and The Brandmeyer Fellow for Impact and Sustainable Investing at the School of International and Public Affairs (SIPA), Columbia University. He is a fellow of the High Meadows Institute and co-author of the book *21st Century Investing: Redirecting Financial Strategies to Drive Systems Change* (Berrett-Koehler, 2021). He holds a Master of Public Policy from Johns Hopkins University and a Bachelor of International Affairs from The George Washington University.

# Acknowledgements

## Racial Equity Working Group

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# Racial Equity Working Group



**Monique Aiken**  
Managing Director,  
TIIP



**Tynesia Boyea-Robinson**  
President & CEO,  
CapEQ



**Noel Pacarro Brown**  
First Vice President, The  
Conscious Wealth Management  
Group at Morgan Stanley



**William "Bill" Burkart**  
CEO,  
TIIP



**Jim Casselberry**  
Co-Founder & CEO,  
Known Holdings



**John Cochrane**  
Senior Manager,  
Policy and Programs  
U.S. Impacting Investing Alliance



**Adam Connaker**  
Director,  
Impact Investing,  
Surdna Foundation



**Erika Seth Davies**  
CEO,  
Rhia Ventures



**Mekaelia Davis**  
Director, Black Family  
Economic Mobility,  
Ballmer Group



**Dianne Dillon-Ridgley**  
Board Chair,  
Intentional Endowments  
Network



**Raudline Etienne**  
Founder & CEO,  
Daraja Capital



**Rodney Foxworth**  
Founder,  
Worthmore



**Mahlet Getachew**  
Managing Director of  
Corporate Racial Equity,  
PolicyLink



**Lissa Glasgo**  
Director of IRIS/Impact  
Measurement  
& Management, GIIN



**Tamar Honig**  
Associate  
Align Impact



**Renaye Manley**  
Deputy Director,  
Strategic Initiatives, SEIU



**Bhakti Mirchandani**  
Managing Director,  
Responsible Investing,  
Trinity Church Wall Street



**Renee Morgan**  
Social Justice Director  
Adasina Social Capital



**Shannon O'Leary**  
CIO, St. Paul & Minnesota  
Foundation



**Marvin Owens**  
Chief Engagement Officer,  
Impact Shares



**Paris Prince**  
Director of Justice  
Equity Diversity and Inclusion  
Intentional Endowments Network



**Santhosh Ramdoss**  
Interim President & CEO,  
Gary Community Ventures



**Vanessa Roanhorse**  
CEO Portfolio Lead,  
Roanhorse Consulting



**Rachel Robasciotti**  
Founder & CEO,  
Adasina Social Capital



**David Wood**  
Director, Initiative for  
Responsible Investment (IRI),  
Harvard University



**Jessica Ziegler**  
Director of Research,  
TIIP



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<sup>20</sup> Race Forward (2023). “What is Racial Equity? Understanding Key Concepts Related to Race.” *Racial equity is a process of eliminating racial disparities and improving outcomes for everyone. It is the intentional and continual practice of changing policies, practices, systems, and structures by prioritizing measurable change in the lives of people of color.* “*Racial Justice is a vision and transformation of society to eliminate racial hierarchies and advance collective liberation, where Black, Indigenous, Latinx, Asian Americans, Native Hawaiians, and Pacific Islanders, in particular, have the dignity, resources, power, and self-determination to fully thrive.*”