TIIP THE INVESTMENT INTEGRATION PROJECT

Introduction to Racial Inequity as a Systemic Risk:

Why Investors Should Care and How They Can Take Action

The Investment Integration Project

June 2023

Disclosures

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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.

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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.

Table of contents

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" [1] – 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.[2]

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.[3] 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.[4] 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.[5] 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.[6] 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."[7] 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.[8]

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.[9] 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):

DEMOCRACY

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);[10]

HEALTH

People of color have higher rates of chronic illnesses like diabetes, hypertension, obesity, asthma, and heart disease than White people;[11]

CARCERAL SYSTEM

Black/African Americans are incarcerated in state prisons at nearly five times the rate of White people.[12]

INCOME & WEALTH	Workers of color earn on average $0.84 for every $1.00 earned by White workers;[13] People of color are substantially more likely than White people to live in poverty;[14]
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;[15] White men manage nearly 98% of financial assets in the U.S.;[16]
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.[17]

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

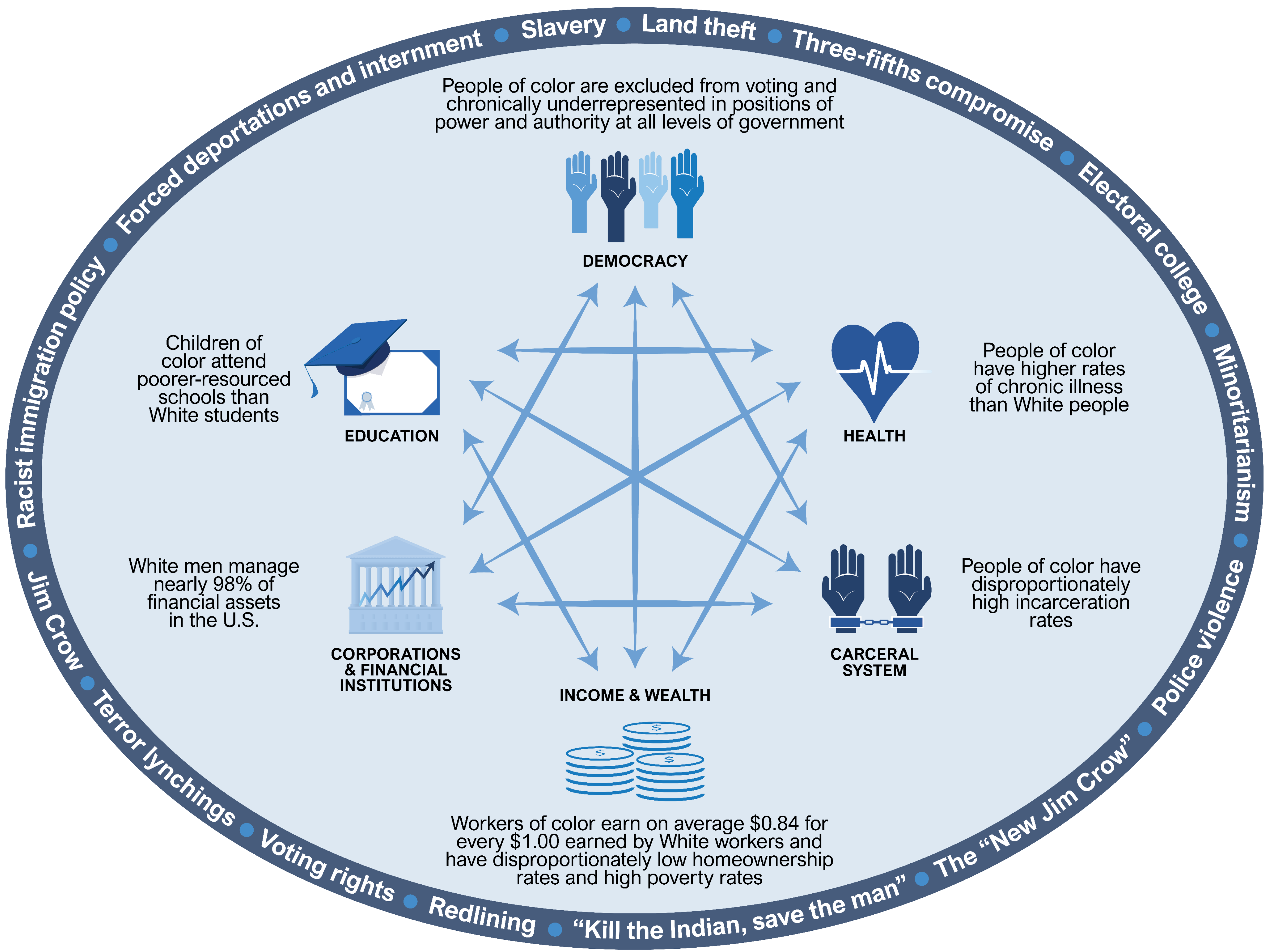


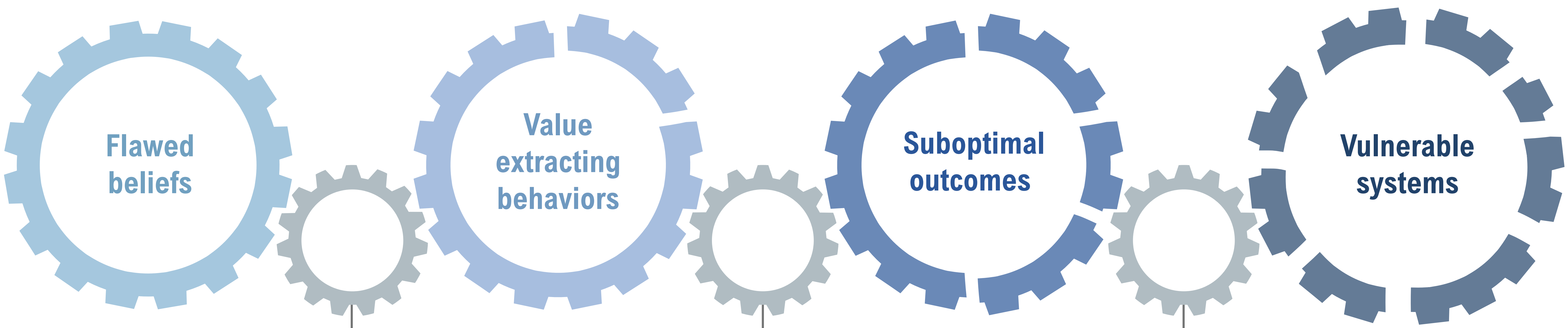
Figure 2. Racial inequity: Flawed beliefs, value extracting behaviors, suboptimal outcomes, and vulnerable systems

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



Consequence- or "externality-" denying capitalism

Disregard for racial inequity and its long-term consequences in pursuit of perceived short-term economic gain

Slowed economic growth, social unrest, less effective decision-making (homogenous teams)

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.[18] 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).[19] 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.

The remainder of this report introduces the investment community (asset owners [AOs], and associated asset managers [AMs], consultants, and advisors) to the why, the what, and the how of investing to address racial inequity in the U.S.

WHY should investors care about racial inequity?	**WHAT** is racial inequity? (history, context, legacy, scope and scale)	**HOW** can investors address racial inequity?

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."[20]

Why Investors Should Care About Racial Inequity

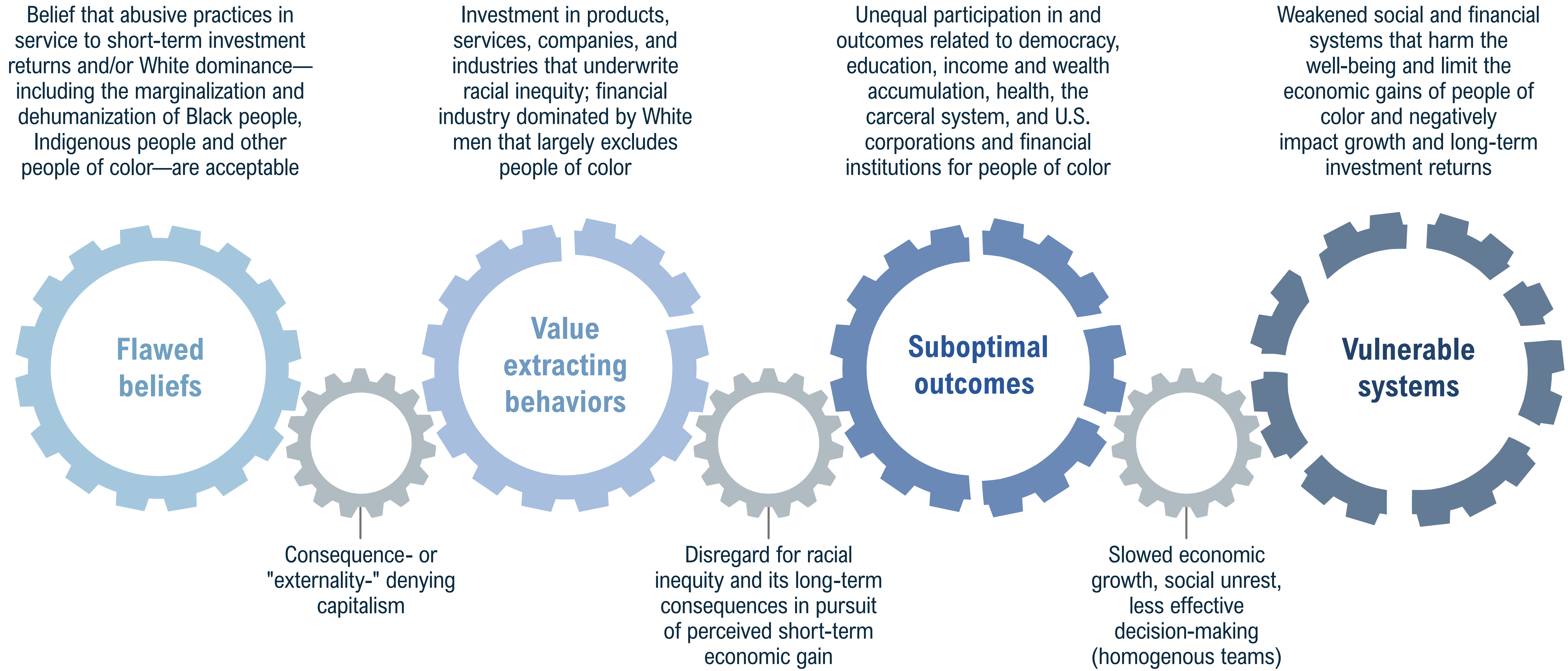
Not only is racial inequity morally and ethically abhorrent, it also threatens the U.S. economy, the global financial system, and long-term investment returns across all asset classes.

Racial inequity is the "unequal distribution of resources, power, and economic opportunity across race [and ethnicity] in a society."[21] In the U.S., racial inequity underpins the broader system of racial injustice and manifests as substantial and 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, health, the carceral system, and U.S. corporations and financial institutions. Racial inequity is a structural, systemic challenge that is affected by and that affects all aspects of life in the U.S. and threatens the health of American social and financial systems (see Figure 2 [repeated] and Box 1).

Fully acknowledging the moral and ethical abhorrence of racial inequity, racial inequity has caused incalculable harm to people from historically excluded groups and specifically threatens economic growth, social stability, and, in turn, long-term investment returns. Racial inequity is but one manifestation of the consequence-denying or "externality-denying" capitalism that has come to characterize financial markets. Put simply, "externality-denying" capitalism is the process of how investors internalize the gains and benefits of their investments but externalize or shift the costs of these investments on to the environment and society. This cost-shifting has created an incomplete accounting of what drives markets, investment opportunities, and returns – revealing only the benefits accrued by the "invisible hand" of the market but obscuring or otherwise hiding the "unmentionable foot" of the market (the "accumulation of social and ecological problems").[22]

There is increasing consensus as to the relevance of racial inequity to investors across asset classes. It is both doubly material (i.e., both financially and socially and environmentally material) and dynamically material (i.e., could become increasingly material in sudden, unpredictable, and preventable ways). Simply diversifying investment portfolios will not insulate investors from related uncertainty and the negative economic consequences of racial inequity over the long term. In short, there is nowhere for investors to hide.[23]

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



Box 1. Racial inequity is systemic… it's "in the groundwater"

The *Groundwater Approach*, developed and introduced by the Racial Equity Institute, provides a useful framework for understanding the systemic nature of racial inequity in the U.S. and the role that systemic interconnection plays in perpetuating the problem.

> *If you have a lake in front of your house and one fish is floating belly-up dead, it makes sense to analyze the fish. What is wrong with it? Imagine the fish is one student failing in the education system. We'd ask: Did it study hard enough? Is it getting the support it needs at home?*
>
> *But if you come out to that same lake and half the fish are floating belly-up dead, what should you do? This time you've got to analyze the lake. Imagine the lake is the education system and half the students are failing. This time we'd ask: Might the system itself be causing such consistent, unacceptable outcomes for students? If so, how?*
>
> *Now… picture five lakes around your house, and in each and every lake half the fish are floating belly-up dead! What is it time to do? We say it's time to analyze the groundwater. How did the water in all these lakes end up with the same contamination? On the surface the lakes don't appear to be connected, but it's possible—even likely—that they are. In fact, over 95% of the freshwater on the planet is not above ground where we can see it; it is below the surface in the groundwater.*

Considering this analogy and internalizing the *Groundwater Approach* can help investors and others to understand that people of color in America have worse outcomes across the board than their White peers (e.g., related to democracy income, wealth, health, education, and the carceral system) because of *underlying and interconnected systemic (or structural) inequities*. The U.S. cannot realize racial equity through piecemeal interventions targeted at individuals or at individual institutions (e.g., the American education system), it can only do so through wholistically acknowledging, understanding, and addressing *interconnected* systems. "In other words, [the U.S. has] a 'groundwater' problem, and [it] need[s] 'groundwater' solutions."

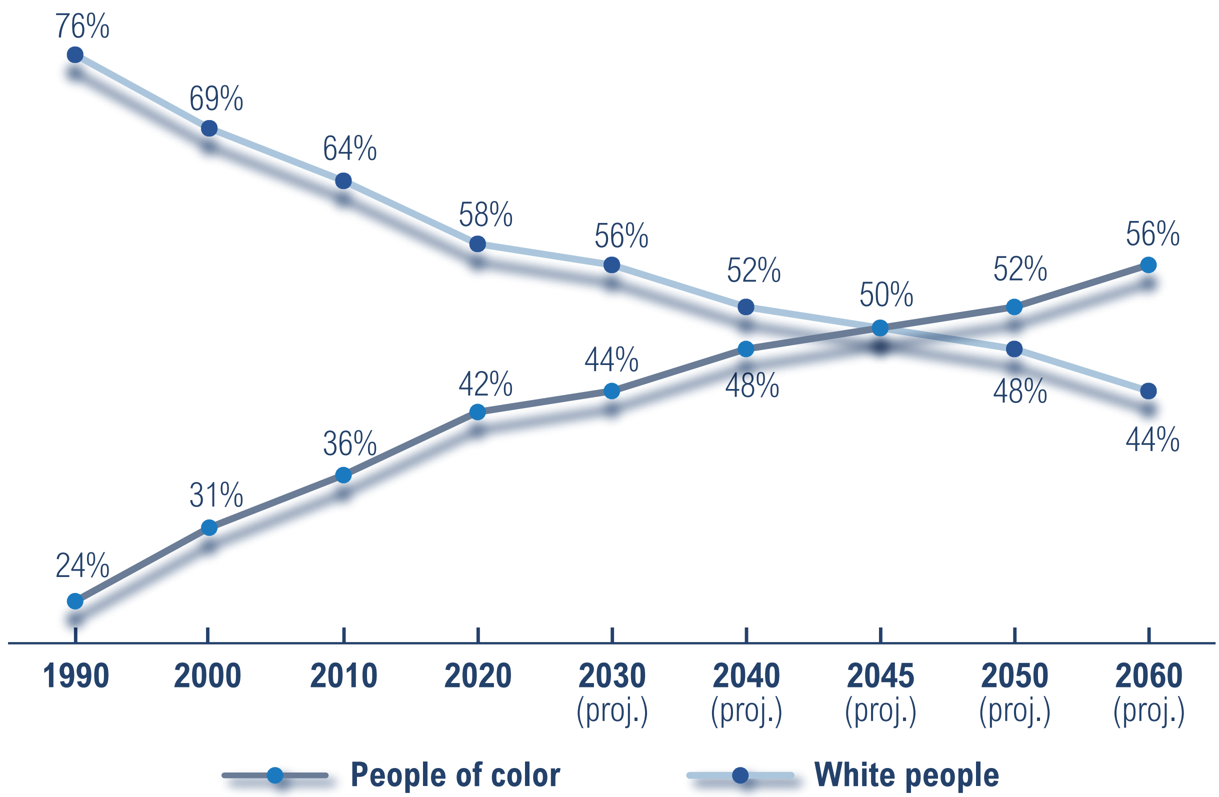
Source: Love, Bayard and Denna Hayes-Greene (2022). *The Groundwater Approach: Building a Practical Understanding of Structural Racism.* The Racial Equity Institute. 2022.

Racial inequity threatens economic growth

Future economic growth depends on the full, equitable participation of people of color in the American society, in the U.S. financial system, and in its economy.[24] The U.S. economy cannot reach its full economic and growth potential, and effectively compete in the global economy if it excludes people of color from fully participating in it.[25] People of color will make up most of the U.S.' population (approximately 52%) – and its workforce, consumers, and taxpayers (the core engines of economic growth) – by 2050 (see Figure 3).[26]

Research suggests that racial inequity – and inequity between Black/African American people and White people specifically – cost the U.S. an estimated $16 trillion in Gross Domestic Product (GDP) between 2000 and 2020. The U.S. economy could have grown by an estimated $218 billion, for example, between 2000 and 2020, if it had added 770,000 Black/African American homeowners. If there was fair and equitable lending to entrepreneurs of color, the U.S. economy could have created more than an estimated $13 trillion in business revenue and 6.1 million jobs between 2000 and 2020.[27]

Figure 3. Percent of U.S. population by race and ethnicity (1990-2060)



Sources: U.S. Census Bureau, Population Division (2018). Projected Race and Hispanic Origin: Main Projections Series for the United States, 2017-2060. Washington, DC. Revised estimates released September 2018.

Furthermore, groups like Citi GPS and the W.K. Kellogg Foundation calculate that improving equity between White Americans and Black/African Americans could grow the economy by $8 trillion by 2050, or even by as much as 0.35 percentage points per year (totaling approximately $5 trillion over five years).[28] Substantial increases in consumer spending, coupled with increased tax revenues and decreases in social services and health spending, would be the cornerstone of this growth. Researchers estimate, for example, that:

- Closing the racial wage gap would 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) and increase annual federal, state, and local tax revenues by a total of $550 billion;[29]

- Facilitating access to higher education for people of color would increase the lifetime earnings of Black/African American students, for example, by an estimated $90 to $113 billion over five years;[30] and

- Eliminating health disparities could reduce spending on healthcare by more than $230 billion per year.[31]

Closing these gaps and doing so for all people of color would result in even more substantial gains.

Racial inequity leads to social unrest

Major disparities in income, wealth, opportunity, and power – like those between people of color and White people in the U.S. – lead to social discontent, tension, and unrest. People of color and their White allies have demonstrated against and protested racial inequity in the U.S. since the 19th century, but as racial inequity persists, related social unrest is growing. In 2020, more than 15 million (and by some estimates as many as 26 million) Americans protested racial inequity across 2,000 U.S. cities – the most and largest demonstrations to take place in U.S. history.[32] The protests were launched in response to the more than 150 police murders of Black/African Americans and Latine/o/a/x people in 2020 [a] and centered around dismantling the system of White dominance outlined in the pages above, eliminating associated economic disparities, and "advocating for wholesale radical change" (e.g., "defund the police").[33]

Such social instability can increase market volatility and uncertainty, create a general sense of economic instability, and negatively impact both individual stocks and investment opportunities across all asset classes.[34] Given the rise in social unrest both in the U.S. and around the world in recent years, academics, global economic

[a] Including Manuel Ellis (age 47; Tacoma, WA; was walking home from the grocery store), Rayshard Brooks (age 27; Atlanta, GA; fell asleep in his car in a Wendy's drive through), Daniel Prude (age 41; Rochester, NY; ran into the street naked during a mental health episode), George Floyd (age 46; Minneapolis, MN; allegedly tried to use a counterfeit twenty dollar bill), and Breonna Taylor (age 26; Louisville, KY; was asleep in her home).

organizations, and risk analysis consultants have begun to develop indices to examine the economic and business disruptions associated with social unrest and to predict the likelihood of social unrest in a country or local area.

- Macroeconomic analyses conducted using the International Monetary Fund's (IMF's) Social Unrest Index, for example, have found that: (a) "unrest has an adverse effect on economic activity" with a one-standard deviation increase in the index associated with a 0.2 percentage point decline in GDP six quarters after the event; (b) "unrest lowers confidence and raises uncertainty"; and, (c) large increases in the index – triggered by an "unrest event" – are associated with a one percentage point decline in GDP six quarters after the event.

- First Peoples Worldwide analyzed the impact that protests and other social pressure exerted by the Standing Rock Sioux Tribe had on the stock price of Energy Transfer Partners (ETP), the company leading the development of the Dakota Access Pipeline through indigenous land. The analysis found that "ETP's stock price significantly underperformed relative to market expectations during the event study period, and that it experienced a long-term decline in value that persisted after the project was completed. In fact, from August 2016 to September 2018, ETP's stock declined in value by almost 20% whereas the S&P 500 increased in value by nearly 35%."[35]

- Recent analyses conducted using Verisk Maplecroft's Civil Unrest Index put the U.S. in the "high-risk" category following the record-breaking protests of 2020, ranking it as the 34th "riskiest" jurisdiction globally.

Racially diverse teams make better decisions and can help companies make more money

Furthermore, evidence increasingly suggests that racially and ethnically diverse business teams make better decisions than homogenous teams and, turn, increase companies' profitability.[36] Such teams are less susceptible to group think, better able to identify and confront thought biases that could cloud decision making, more likely to focus on facts and examine evidence more carefully, and are more innovative and efficient.[37]

In the financial services industry, for example, research indicates that diverse asset managers in private equity outperform when compared to industry benchmarks, with one study noting that "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."[38]

Research has also found that overall racially diverse companies across various industries are more profitable than racially homogenous companies ("top-quartile companies outperformed those in the fourth [quartile] by 36 percent in profitability"), and that “unequal performance of companies in the same industry and the same country implies that diversity is a competitive differentiator shifting market share toward more diverse companies.”[39]

A 2016 study of 366 public companies across the U.S., Canada, the U.K., and Latin American, for example, 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 and companies in the bottom quartile are statistically less likely to achieve above average returns.[40]

Racial Inequity: History and Context

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.[41] Understanding how we got here is essential to assessing what it will take to course correct, given the scale and ubiquity of the risk.

Throughout the 1600s, 1700s, and 1800s, for example, White colonists seized more than a billion and a half acres of land from Indigenous people and forcibly relocated them from their homelands and onto reservations, places where diseases spread and former nomadic and coastal peoples struggled to create livelihoods on these interior, bounded land tracts.[42] In response to Bacon's Rebellion in 1676, a cross-racial uprising, patriarchal colonists codified chattel slavery to specifically pertain to African people, leading to the capture and selling into slavery millions of Africans and the forced reproduction of enslaved women to further increase the amount of enslaved laborers. During the same period, the colonists nearly eradicated the entire Indigenous population of the continental U.S. through genocidal violence.[43] That stolen land (valued at $23 trillion as of 2009) and forced labor "provided 250 years of free labor [and land] for the profit of the White landholders and business owners" (and White men in particular).[44]

The slave system and cotton industry were the foundation of American capitalism and the U.S. financial system. Wall Street was a slave market before it became the center of U.S. financial markets. Many 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 (e.g., enslaved people were commonly used as collateral for mortgages and other loans).[45] It built the wealth not only of Southern slaveholders, but also that of Northern and European businessmen that lent money to, traded with, or otherwise invested in plantations. It was the beginning of the financialization and globalization that are central to the U.S. financial system today.[46]

Together, the slave system and simultaneous land theft comprise the roots of the structural oppression and marginalization of people of color that persisted in the U.S. for more than three hundred years. This included, but was certainly not limited to:

- **The Civilization Fund Act, the Indian Removal Act, and "kill the Indian, save the man."** Throughout the 1800s, a collection of federal policies focused on both forcibly stealing fertile land from people Indigenous to the continental U.S. and on erasing their culture and ways of life. The Indian Removal Act of 1830, for example, authorized the forced relocation of nearly 50,000 Indigenous people from their homes to "Indian Territory" (known today at the "Trail of Tears").[47] The Dawes Act of 1887 subsequently parceled tribal land from this territory to Indigenous individuals from certain tribes to "assimilate" them to the White American agricultural way of life, sometimes in exchange for tribes abolishing their tribal governments and agreeing to recognize U.S. laws. Allotted land was rarely suitable for farming, "the techniques of self-sufficient farming were much different from their tribal way of life," and few people could afford the tools, seeds, and other supplies required to successfully farm.[48] Other policies, such as the Civilization Fund Act of 1819, sanctioned the kidnapping of Indigenous children from their families and their enrollment in boarding schools operated by Christian missionaries. The explicit purpose of these schools – some of which operated through the 1980s and which physically punished students for speaking their native languages or exercising their spiritual beliefs – was to erase their Indigenous culture, convert them to Christianity, and otherwise force their "assimilation" into White culture.[49] Or, as U.S. Army Captain Richard Pratt put it, the goal was to "kill the Indian, save the man."[50]

- **The three-fifths compromise, Electoral College, and minority rule.** To appease White slaveholding men from less populous Southern states, the framers of the U.S. Constitution agreed to count three-fifths of states' enslaved, non-voting Black/African Americans when determining representation in the House of Representatives and federal taxation. The "three-fifths compromise" also gave Southern slaveholding states "bonus" electors when establishing the Electoral College. Beyond the dehumanization of counting human beings as three-fifths of a person, the three-fifths compromise ultimately established a system of minority rule under which the U.S. Constitution and its Electoral College rewarded White, Southern slaveholders for maintaining slaves and provided them with representation disproportionate to their voting population (i.e., made the vote of each White slaveholding man in the South more powerful than that of each White man in the North).[51]

- **"Jim Crow," terror lynchings, and voting rights.** After the Civil War and official abolishment of slavery in 1865, the subjugation of Black/African Americans continued through other mechanisms like sharecropping and peonage. "Jim Crow" laws (so named after a character portrayed by a White actor in "blackface") sanctioned racial segregation and denied Black/African Americans the right to vote, work, and go to school. So called "vagrancy" laws in some states, for example, allowed imprisonment of Black/African Americans for being unemployed, while laws in other states prohibited Black/African Americans from owning land, working in certain industries, or testifying in court.[52]

Some states required Black/African Americans to pass literacy tests, pay "poll taxes", and/or live in towns with a minimum number of inhabitants before registering to vote – none of which was required of White people.[53] During this time, White mobs subjected Black/African Americans to "terror lynchings" and marauded and pillaged Black/African American communities, often "in broad daylight" and with impunity – stealing whatever wealth they had been able to accumulate, terrorizing Black/African Americans, and deterring them from exercising their rights.[54]

People indigenous to the continental U.S. were similarly excluded from voting during this time. Despite being "granted" U.S. citizenship in 1924, individual states either fully prohibited indigenous people from voting or deterred them through familiar mechanisms like poll taxes, literacy tests, and intimidation up to and throughout the 1960s.[55]

- **Redlining, interstate highways, and community degradation.** In the early 1900s, the (now defunct) Federal Housing Administration advised mortgage lenders that it was risky to lend to neighborhoods with high concentrations of Black/African Americans and/or immigrants (referred to as "redlining"). This ensured that post-Depression housing subsidies were provided almost exclusively to White people, discouraging investment in communities of color, and excluding people of color (including Black/African American veterans) from the wealth accumulation that fueled the creation of the American middle class.[56]

  The consequences of redlining were compounded throughout the 1950s, 60s, and 70s in the aftermath of the Federal-Aid Highway Act of 1956. The more than 40,000 miles of multi-lane interstate highway built under the Act physically separated poor, urban communities of color from wealthier White suburbs. The U.S. Department of Transportation used eminent domain to displace more than 475,000 households and more than a million people – most of them Black/African Americans – to build the highways that "cut through neighborhoods, darkened and disrupted the pedestrian landscape, worsened air quality and torpedoed property values," destroying any wealth that these families of color had been able to amass.[57]

- **The "New Jim Crow" and police violence.** Launched by President Richard Nixon in the 1970s (and expanded by Presidents Ronald Reagan and Bill Clinton) the so called "War on Drugs" increased federal funding for drug enforcement, expanded government regulation of certain drugs and substances (e.g., marijuana), and established mandatory minimum prison sentences for drug crimes (including non-violent crimes).[58] The "war", increasingly referred to as "the new Jim Crow,"[59] disproportionately targeted Black/African Americans and led to mass incarceration and the associated militarization of police.[60]

According to one Nixon administration official, *"We knew we couldn't make it illegal to be either against the [Vietnam] war or [B]lack, but by getting the public to associate the hippies with marijuana and Blacks with heroin. And then criminalizing both heavily, we could disrupt those communities. We could arrest their leaders, raid their homes, break up their meetings, and vilify them night after night on the evening news. Did we know we were lying about the drugs? Of course we did."* [61] Together with the extension of qualified immunity in the 1960s – limiting the ability of victims of police violence to hold their attackers to account even if they acted unlawfully – the "War on Drugs" perpetuated the epidemic of police violence against Black/African American people and other people of color that persists to this day (discussed below).[62]

Certainly, such discrimination was/is not limited to Black/African Americans and Indigenous people; people of other races and ethnicities were and continue to be systematically marginalized in the U.S., including but not limited to East Asian people and Latine/o/a/x people:

- **Anti-Chinese and Japanese sentiment.** Lest Chinese immigrants displace White workers, the U.S. government barred nearly all Chinese immigration into the U.S. in the late 1800s. During that same time, the Supreme Court of California prohibited Chinese people from testifying in court against White people, based on repugnant and faulty assessments of their culture and intellectual capacity.[63] Anti-Asian sentiment during World Word II led to the forcible internment of more than one hundred thousand Japanese Americans without due process in the 1940s, nearly two-thirds of them American citizens.[64] Further, Asian people were also targets of the redlining practices discussed above and racist local housing policies (i.e., housing covenants) commonly forced them into overcrowded enclaves (e.g., Chinatowns and Koreatowns).[65]

- **Discrimination against Latine/o/a/x people.** Discrimination against Latine/o/a/x people has a similarly well-established history in the U.S. It includes withholding aid from Mexican Americans during the Great Depression and forcibly deporting them in the millions (including those who were U.S. citizens) and separating families and devastating communities, so that they could not "steal" scarce jobs and resources from White people.[66] Further, Latine/o/a/x children largely attended segregated schools throughout the late 1800s and early 1900s. In the mid-1900s, in some counties, as many as 80% of Latine/o/a/x (mostly Mexican) children attended separate, lower-quality schools. School officials claimed the separation was necessary because of retrograde views about the children's health and cleanliness.[67]

  The Undesirable Aliens Act of 1929 made it a misdemeanor to enter the U.S. from outside of an official point of entry and a felony to return to the U.S. after deportation.[68] The law applied to all immigrants but the vast majority of those imprisoned under the law (no fewer than 85% at a given time) were Mexican.[69]

Many of the fist agents of the U.S. Customs and Border Patrol (CBP), established in 1924, were members of the Ku Klux Klan. CBP has a well-documented history of violence against Mexican and other South and Central American migrants (and other migrants of color from the Caribbean and elsewhere), including violence against children, pregnant women, and asylum seekers, sexual assault, tear gassing families, and verbal abuse of people while detained in their custody.[70]

Racial Inequity: Legacy, Scope, and Scale

While much of the de jure and de facto system supporting White dominance discussed above has been repealed or dismantled, its legacy, racist sentiments, uneven enforcement of equal protections, and failure to invest in the people and communities harmed by all the above have led to the stark, severe racial inequities in life, liberty, and the pursuit of happiness that persists in the U.S. today (see Figure 1 [repeated]). The legacy of racist policies and practices permeates all aspects of life in the U.S., from its democratic institutions, to education, income and wealth, health, the carceral system, and U.S. corporations and financial institutions.

Democracy. Most states have laws requiring voters to present specific types of government-issued photo ID at the polls. Such laws disproportionately impact people of color who are less likely in most states than White people to possess the requisite ID, resulting in election outcomes that align with the preferences of White voters. Of the 3.1 million adults in the U.S. that are prohibited from voting due to these laws, an estimated 2.2 million of them are Black/African Americans.[71] Further, maps of U.S. Congressional districts are commonly drawn – or "gerrymandered" – in such a way that they discriminate against voters of color, and the American Electoral College system continues to disempower voters of color (especially in Southern states). [72]

As a result, people of color are chronically underrepresented in positions of power and authority at all levels of government in the U.S. As of 2020, people of color made up 42% of the U.S. population but constituted just 25% of U.S. Congresspeople (and only 12% of U.S. Senators), just 27% of active U.S. District Court and Court of Appeals judges, and only three of the country's fifty state governors (less than 1%).[73] Less than a quarter of the U.S.'s local mayors and less than 7% of local school district superintendents are people of color, and people of color are substantially underrepresented in local police departments relative to their makeup of the local population.[74] And, of course, the U.S. has only had one President of color and one Vice President of color.

Income and wealth accumulation. The legacy of America's racially inequitable policies and practices is particularly apparent when examining the income and wealth accumulation of people of color versus their White peers (including related to earnings, home ownership, business ownership, and retirement savings). For example:

- People of color are paid less than White people at all education levels. Workers of color earn on average $0.84 for every $1.00 earned by White workers –

– Latine/o/a/x workers earn $0.73 for every $1.00 earned by White workers, Black/African Americans $0.76, and workers indigenous to the continental U.S. $0.77.[75] Latinas and Black/African American women are particularly low earners, earning a median of $744 and $856 respectively per week in the fourth quarter of 2022, compared to a median of $991 per week for White women and $1,194 for White men.[76]

- Black/African American and Latine/o/a/x families hold 2.9% and 2.8% of U.S. wealth respectively, despite being 15.6% and 10.9% of the population.[77] Families indigenous to the continental U.S. have a median wealth of $5,700 compared to a median wealth of $65,000 for the general population.[78]

- People of color have higher poverty rates than White people, and the shares of Latine/o/a/x people, Black/African Americans, and indigenous people living in poverty are greater than their share of the population – in fact, indigenous people's share of the poverty population is twice as large as their share of the general population.[79]

- Just 45% of Indigenous Pacific Islander households, 46% of Black/African American households, 53% of Asian households, and 65% of Indigenous Alaskan households and households of people indigenous to the continental U.S. own their homes, versus 72% of White households.[80] 80 Latine/o/a/x homebuyers pay 43% more to close on a home purchase and 30% more in interest compared to White applicants.[81]

- Black/African American and Latine/o/a/x households represent 64% of households that do not have checking or savings accounts (i.e., unbanked) and 47% of underbanked households (despite being 32% of the population). Unbanked households "cannot generate the data that helps establish creditworthiness" precluding them from accessing credit "to fund wealth-creating activities such as investing in education or a business venture."[82]

Education. Despite efforts to desegregate American schools, most children in the U.S. attend school in racially concentrated school districts. Given that local property taxes fund America's public schools and, thanks in large part to the legacies of redlining and forced relocation of Indigenous people onto reservations, children of color are more likely to live in low-income communities than their White peers and attend poorer-resourced and performing schools than White children.[83] School districts with higher concentrations of White students spend approximately $2,000 more per pupil than school districts with mostly students of color. In total, the U.S. spends nearly $23 billion more on White students than students of color.[84] School districts with high concentrations of students of color also typically have larger schools with larger class sizes, lower quality curriculum, and less qualified teachers – all of which are shown to negatively influence academic achievement.[85]

More than 80% of Indigenous and Black/African American, and 80% of Latine/o/a/x 4th graders, for example, read below "proficient" in the U.S. (vs. 59% of White 4th graders), and approximately 90% of Indigenous, Black/African American, and Latine/o/a/x 8th graders are below "proficient" in math in the U.S. (vs. 66% of White 8th graders).[86]

Health. People of color have higher rates of chronic illnesses like diabetes, hypertension, obesity, asthma, and heart disease than White people, and the life expectancy for Black/African Americans is four years lower than for White people.[87] As of 2018, 29% of Indigenous Alaskans and people indigenous to the continental U.S., 21% of Latine/o/a/x people, 12% of Black/African Americans, and 10% of Indigenous Pacific Islanders lacked health insurance, compared to just 8% of White people.[88]

Although having health insurance and access to quality healthcare are critical indicators of health outcomes, the social determinants of health – "the conditions in which people are born, grow, live, work and age"– are much stronger predictors of overall health.[89] This includes things like income and education (discussed above) that are directly correlated with things like living in "an environment that poses barriers to health such as lack of safety, exposed garbage, and substandard housing," having limited access to things like parks, playgrounds, and libraries, food insecurity, and stress.[90] These things negatively impact people of colors' health and "may have multi-generational impacts."[91] There are more than 500 abandoned uranium mines on Navajo Nation (located in Arizona, New Mexico, and Utah), for example, that contaminate local land and water with radiation known to cause cancer and impair kidney function.[92] Furthermore, many of the communities devastated by redlining, the development of interstate highway system, and discriminatory zoning border industrial plants are often called "sacrifice zones" (named as such because the well-being of their residents is sacrificed for economic gain). Residents of sacrifice zones breathe "dirtier air than people in more affluent communities farther away from facilities" and are at higher risk for cancer.[93] More than half of Black/African American children and more than two-thirds of Asian and Indigenous Pacific Islander and Hispanic children live in counties with poor air quality (compared to 40% of White children).[94]

Carceral system. Due in large part to the "War on Drugs," Black/African Americans are incarcerated at more than five times the rate of White people due to aggressive over-policing in their communities and racial profiling. One in three Black/African American boys born in the U.S. today, and one in six Latine/o boys, are likely to be sentenced to prison (compared to one in seventeen White boys). Although just 12% of the U.S. population, Black/African American people represent nearly 25% of people killed by police.[95] Further, while just 5% of illicit drug users in the U.S. are Black/African Americans, Black/African Americans represent 29% of those arrested and 33% of those incarcerated for drug offences.[96] Today, Black/African Americans are incarcerated in state prisons at nearly five times the rate of White people, and Latine/o/a/x people at 1.3 times the rate of White Americans.[97] One in eighty-one Black American adults is currently incarcerated in a state prison.[98]

Thanks to a provision in the 13th Amendment (which abolished slavery in the U.S. in 1865 “except as a punishment for crime whereof the party shall have been duly convicted”), most prisoners are forced to work for the government – assisting in the running of the prisons, making license plates, farming, etc. – for little or no pay or face punishment.[99] The government appropriates an estimated $14 billion in wages from these prison laborers, or “prison slaves,” each year.[100] In addition, many companies directly utilize prison labor in their operations, and others benefit indirectly from its use throughout their supply chains.[101]

The negative long-term impacts of being convicted of a crime are devastating for formerly incarcerated people and their families: in most states, people on parole or probation cannot vote and in a fifth of states people who have been convicted of felonies are barred from voting for life; prior incarceration limits employment options and eligibility for some federal assistance; and children with parents entangled in the U.S. carceral system suffer from “psychological strain, antisocial behavior, suspension or expulsion from school, economic hardship, and are six times more likely to be involved in criminal activity.”[102]

U.S. corporations and financial institutions. Racial inequity is pervasive across corporate America and the U.S. financial industry, and particularly visible when it comes to representation in leadership. As of 2020, just over 1% of U.S. Fortune 500 CEOs were Black/African American – despite Black/African American people making up 12% of the U.S. population and Black/African-American women being the most educated segment of the U.S. population[103] – and only 17.5% of Fortune 500 board seats were held by people of color (including just 4% by people of Latine/o/a/x origin [despite their being 19% of the population]); and two out of five of Black board members, and nearly a quarter of Asian and Indigenous Pacific Islander board members, served on multiple boards.[104] There are currently only six women of color CEOs of Fortune 500 companies and no Indigenous CEOs of any gender of Fortune 500 companies.[105]

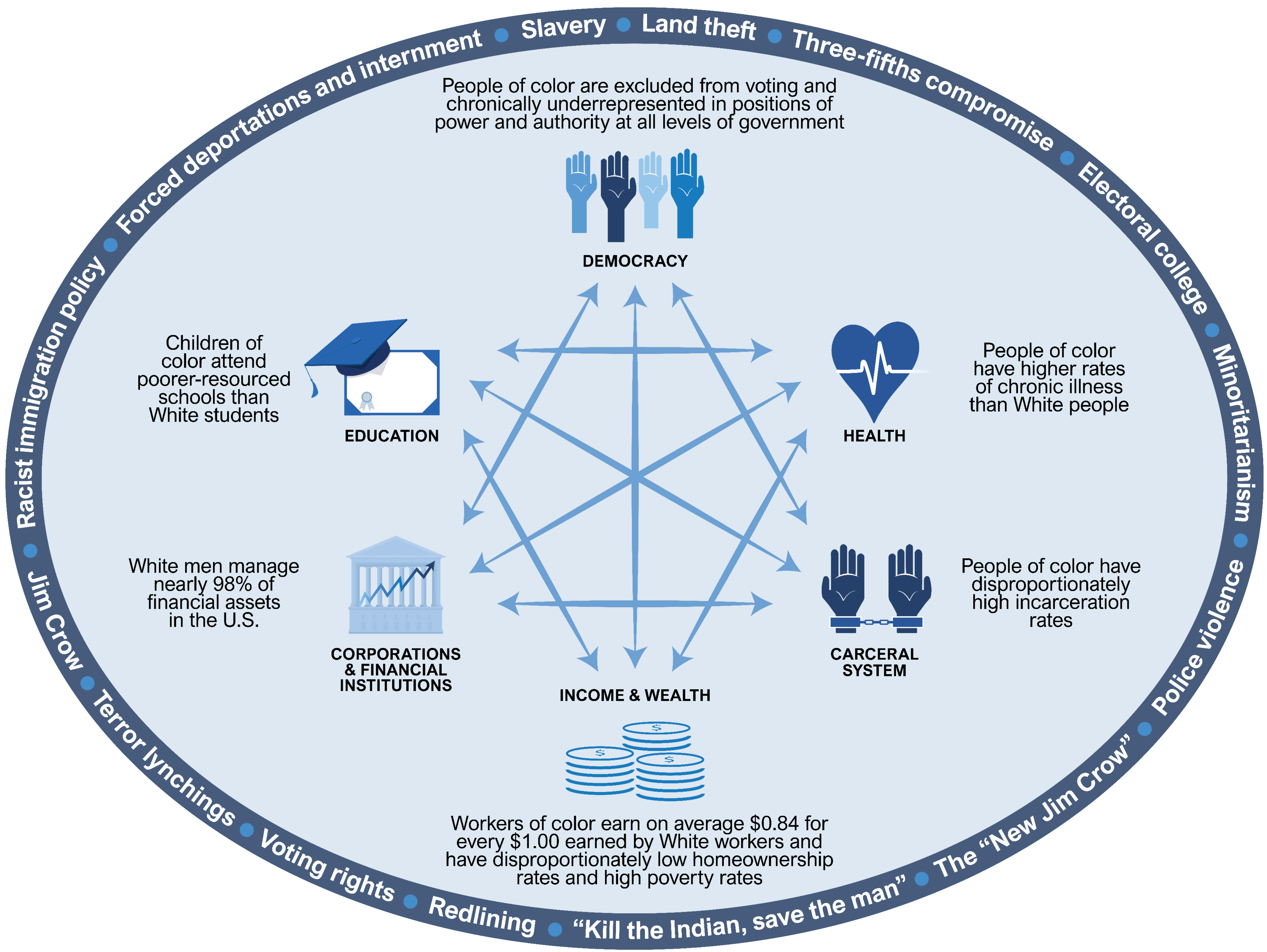
Additionally, less than a quarter of senior managers at U.S. financial services firms (24%), and just 19% of vice presidents, 12% of senior vice presidents, and only 10% of C-suite executives at these firms were people of color in 2020.[106] While at the entry-level the proportion of people of color in financial services nearly aligns with their share of the population (approximately 40%), their representation diminishes substantially in the management and senior levels of financial services firms. Attrition stemming from (a) the mental health strain caused by being the only person of a racial or ethnic group in the room and “othering” (including having to endure microaggressions [e.g., being dismissed, ignored, or addressed unprofessionally or having your judgement questioned unnecessarily]), (b) outright hostility, and (c) relatively low promotion rates for people of color (Black/African Americans for example are half as likely than their White peers to be promoted to management and beyond), are among the primary reasons that so few people of color lead financial services firms.[107]

As of 2021, less than 2% of the collective $82 trillion assets managed by U.S.-based asset management firms was managed by firms owned by people of color and/or women, including just 0.04% of hedge funds, 0.04% of real estate funds, 0.37% of private equity firms, and 0.99% of mutual funds.[108] This, despite the fact that research indicates that the performance of these firms is indistinguishable from that of those owned by White people.[109] Put another way, White men manage nearly 98% of financial assets in the U.S.[110]

Finally, ***technology.*** Recently, people of color have been confronted with a relatively new, technology-based form of discrimination – bias in artificial intelligence (AI). Racial and ethnic bias in AI – the science of teaching machines to think like humans – is an increasingly widespread problem.[111] AI "is built by humans [i.e., in the mostly White and male technology industry] and deployed in systems and institutions that have been marked by entrenched discrimination – from the [carceral] system, to housing, to the workplace, to our financial systems."[112] Simply put, AI in the U.S. reflects the systems of that support White dominance in the U.S. and related marginalization of people of color. Bias in AI ranges from inequitable and unjust – including using "data such as eviction and criminal histories, which reflect long standing racial disparities in housing and the [carceral system]" as part of tenant and mortgage evaluations – to egregiously dangerous – including AI-based oxygen censors failing to detect occult hypoxemia (i.e., a critically low oxygen level) in Black/African American patients nearly three times more often than in White patients.[113]

Understanding of the history, context, scope, and scale of the U.S. structures of racial inequity ensures that investors are better prepared to address this systemic risk and manage its impacts on social and financial systems.

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



How Investors Can Address Racial Inequity

There is a lot that investors can do – starting today – to manage the systemic risk of racial inequity.

If investors do not act now to address racial inequity and its risks, people of color will continue to suffer – and so too will investors' bottom lines. 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. Consciously or not, allowing racially inequitable practices to persist is tantamount to co-signing them.

Investors must identify, confront, and address their contributions to the problem. There are two key actions that U.S. financial industry, with its more than $100 trillion in AUM, can take to leverage its power and work alongside government and civil society to effectively influence racial inequity – not just to promote the equal distribution of resources, power, and economic opportunity across all races and ethnicities in the U.S., but also to support economic growth, improve business outcomes, fortify long-term investment returns, and help to set the U.S. on a path to racial justice.[114]

These actions – or "leverage points" – are:

- **Investor action #1: Ensure racial equity at U.S. corporations and financial institutions.** Only 17.5% of Fortune 500 board seats were held by people of color and White men manage nearly 98% of financial assets in the U.S.[115] 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).[116]

Investors can take steps 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 that of society, and that personnel from across all the above earn equal compensation for equal work.

Investors should do so not only ensure equitable inclusion of people of color in U.S. corporations and financial institutions, but also to promote their equitable participation in decisions about things like where and how capital is deployed.

Diversifying their teams 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.** As is detailed above, the underlying social structures in the U.S. – structures related to democracy, education, income and wealth accumulation, health, 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. They are the foundation upon which the U.S. economy and financial system are built and underpin all investment activity.

  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 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 any number of specific ways that investors of all types and from across asset classes can take toward generating effective, positive influence on the systemic issue of racial inequity related to each of these "leverage points." 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). It also includes utilizing actions above and beyond everyday portfolio management – system-level actions – that involve collaborating with peers, building shared knowledge bases, setting new industry standards, and wielding political influence (i.e., thinking and acting systemically).

Improving corporate governance and adapting conventional investment techniques *at the portfolio level.* Many investors have adopted ESG (Environmental, Social, and Governance) integration as a daily practice, incorporating it into valuations when they deem it material. This is a first step on the road to adapting other every day, conventional investment practices to manage systemic risks like racial inequity. This includes adapting four specific activities:

- **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.

Thinking and acting *at a system level.* Forward-looking investors are using a wide range of techniques specifically designed to help them manage systemic social issues, including techniques that focus on amplifying positive influence on racial equity through collaboration (collaborate), enhancing the way that they and other investors make investments (enhance), and creating and using investment opportunities designed to address racial inequity and strengthen the broader social system (target):

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.

- 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.

- 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 and 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.
- Maximize the societal uses for which specific asset classes were explicitly created to address racial inequity.

The remainder of this report introduces investors to how they might leverage their power and influence to promote racial equity and, ultimately racial justice, through activities related to (1) U.S. financial institutions and corporations, and (2) discriminatory and/or biased social structures.

Specifically, it:

- **Suggests basic questions that can guide investor action at each leverage point;**
- **Provides an initial checklist for portfolio-level action at each leverage point; and**
- **Recommends considerations for how investors might think and act systemically at each leverage point.**

Further, given the increasingly broad consensus that racial inequity poses a serious risk to long-term investment, financial industry organizations of various kinds have started to develop tools that align with or otherwise compliment these suggestions, checklists, and recommendations contained within this report. Box 2 on the final page of this section therefore also highlights select of such existing tools, frameworks, and organizations.

1. Ensure racial equity at U.S. financial institutions and corporations

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 that 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.

Questions that can guide action at this leverage point

- Does the racial and ethnic composition of the leadership of our organization (e.g., executives and board members) mirror that of U.S. society? What about of the leadership of our partners (e.g., asset managers and consultants), and our investee companies and the entities throughout their supply chains?
- What racial and ethnic biases exist in our recruitment and promotion policies and practices? In the recruitment and promotion practices of our partners (including asset managers), investee companies, and entities throughout their supply chains?
- Are our leaders and employees of color subjected to racially or ethnically based microaggressions that create an uncomfortable work environment and, ultimately, lead to the attrition of employees of color? What about in our partner organizations (including asset managers), investee companies, and entities throughout their supply chains?
- Do people in our organization receive equal compensation for equal work? In our partner organizations (including asset managers), investee companies, and entities throughout their supply chains?
- How can our organization partner with our peers from across the U.S. financial system to establish and promote standards – and related policies, procedures, and norms – for the racial and ethnic composition of personnel across finance and other industries?

Checklist for corporate governance and portfolio-level action at this leverage point

Statements of investment beliefs

- [ ] Formally and publicly (a) recognize racial inequity as a risk to investment, and (b) commit to becoming a racially equitable organization and ensuring that your investee companies and their supply chains are racially equitable too – including their leadership (executives, board) and all other personnel.

- [ ] Conduct an internal racial equity audit with input from stakeholders of leadership, personnel, hiring, promotion and compensation policies and practices, and of attrition rates for employees of color.[117]

- [ ] Revise policies – including investment belief statements and other governance materials – and practices accordingly.

Security selection and portfolio construction

- [ ] Audit and refine security selection and portfolio construction criteria related to racial equity in personnel, leadership, and compensation.

- [ ] Audit racial equity within investee companies and throughout supply chains.

- [ ] Develop and adopt racial equity security selection and portfolio construction criteria.

Manager due diligence

- [ ] Assess managers' skills at managing the systemic social risk of racial inequity.

- [ ] Audit procedures (policies and practices) for manager selection for racial and ethnic biases (e.g., meeting minimum thresholds for AUM to win allocations from large institutional and minimum track record [20 years]) and revise policies accordingly.[118]

- [ ] Require that managers provide data on the racial and ethnic composition and compensation of leadership teams and personnel. Hold them accountable for improvement over time.

Engagement

- [ ] Engage with managers, companies, and industries that do not meet your standards regarding racial equity in personnel, leadership, and compensation.

- [ ] Support shareholder proposals encouraging transparency and accountability related to the racial and ethnic composition and compensation of leadership teams and personnel.

Considerations for system-level action at this leverage point

Collaborate

- Identify opportunities to collaborate with other investors to amplify messaging and influence about racial and ethnic bias in governance, personnel, and compensation norms, policies, practices, and procedures across the financial industry, in investee companies, throughout their supply chains and within their investment practices.

Enhance

- Identify or develop and utilize standards for the disclosure of data on the disaggregated racial and ethnic composition and compensation of leadership teams and personnel at financial institutions, investee companies, and throughout their supply chains.

- Identify or develop and utilize standards for engaging with industries and your investee companies therewithin about the racial and ethnic composition and compensation of leadership teams and personnel.

Target

- Identify financial products across asset classes that are explicitly designed to and focused on addressing racial inequity within financial institutions and corporations, and design new products as needed.

- Consider whether specific asset classes can be effectively utilized to address racial inequity within financial institutions and corporations.

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.

Questions that can guide action at this leverage point

- Does our organization or our partner organizations (e.g., asset managers) invest in any services, products, companies, or industries that directly or indirectly underwrite racial inequity? Do we invest in any companies that engage in political spending, lobbying, or related activities that directly or indirectly underwrite racial inequity?

- Does our organization or our partner organizations (e.g., asset managers) invest in any services, products, companies, or industries that support racial equity? Do we invest in businesses owned and/or operated by people of color?

- Does our organization have the information that we need to make informed, thoughtful, proactive investment and other decisions related to racial equity (e.g., including an understanding of the historical context of the issues we aim to address)? Have we solicited input about the wants and needs of impacted communities from those communities?

- Does our organization support public policies focused on reducing racial inequities / increasing racial equity related to U.S. democracy, education, income and wealth accumulation, health, and the carceral system? And reject those that propagate racial inequity?

- How can our organization partner with our peers from across the U.S. financial system to establish and promote standards – and related policies, procedures, and norms – related to racial equity in the U.S.?

Checklist for portfolio-level action at this leverage point

Statements of investment beliefs

- [ ] Formally and publicly (a) recognize racial inequity as a risk to investment, and (b) commit to do everything your power to eliminate racial inequity and promote racial equity across U.S. society and the financial system.

- ☐ Update policies – including investment belief statements and other governance materials – and practices accordingly.

- ☐ Explicitly state that the inclusion of racial equity considerations in investment policies and practices aligns with fiduciary duty.

Security selection and portfolio construction

- ☐ Develop and adopt security selection and portfolio construction criteria to ensure that you do not invest in any services, products, companies, or industries that directly or indirectly underwrite racial inequity (this might include, for example, customer discrimination and abuse, algorithmic bias in artificial intelligence, private prisons, or for-profit colleges).

- ☐ Audit your portfolio against your new racial equity criteria.

- ☐ Develop plans to engage with (and remove from your portfolio if necessary) those investments in services, products, companies, or industries that do not meet your new racial equity criteria.

- ☐ Require investee companies to disclose their political spending, lobbying, and related activities.

Manager due diligence

- ☐ Assess managers' skills at managing the systemic social risk of racial inequity.

- ☐ Audit procedures (policies and practices) for manager selection to determine whether they examine managers' investments in services, products, companies, or industries that directly or indirectly underwrite racial inequity.

- ☐ Update manager selection and due diligence procedures to ensure that they include analyses of managers' investments in services, products, companies, or industries that directly or indirectly underwrite racial inequity. Hold managers accountable for improvement over time.

Engagement

- ☐ Engage with those managers and investments in services, products, companies, or industries that do not meet your new racial equity criteria.

- ☐ Support shareholder proposals encouraging transparency and accountability related to racial equity and related political spending, lobbying, and activities.

Considerations for system-level action at this leverage point

Collaborate

- Disseminate and otherwise amplify 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.

- Support public policies focused on eliminating racial inequity and promoting racial equity; including, for example, policies relate to democracy (voting rights, the Electoral College, gerrymandering), education (school funding, de facto school segregation), health equity, affordable housing and homeownership, and the carceral system (qualified immunity, prison slavery, bail reform, immigrant detention).

- Identify and join, or establish, organizations focused on (a) building the financial system's capacity to address racial inequity in U.S. society (e.g., encouraging clarification that addressing systemic risks like racial equity aligns with fiduciary duty), and (b) influencing positive public policy change related to racial inequity.

Enhance

- Identify or develop and utilize standards for the disclosure by companies and industries related to their services and products and racial inequity.

- Identify opportunities to invest in businesses and business models that promote racial equity and discourage racial inequity. This might include directly investing in businesses owned and/or operated by people of color (including small- and medium-sized enterprises).

- Identify opportunities to support access to credit and the affordability of credit for people of color (e.g., mortgages) and business owned by people of color.

Target

- Identify financial products across asset classes that are explicitly designed to and focused on addressing racial inequity (including cash with Minority Depository Institutions and other mechanisms to support Community Development Financial Institutions), and design new products as needed.

- Identify opportunities to focus investment within Indigenous sovereign nations, redlined communities, and sacrifice zones to promote equitable access to and outcomes related to education, health, income and wealth accumulation, and the carceral system.

Box 2. Select tools, frameworks, and organizations that can further guide investor action on racial inequity

Adasina Social Capital. The *Adasina Social Justice Investment Criteria*, "a data-driven set of standards" is available to the public via Adasina's website and outlines racial justice investment screens focused on supporting racial justice through advancing decarceration, land rights and self-determination, equity and inclusion, and fair dealing. Adasina's website also includes (a) a list of those companies that failed to meet these criteria, the specific dimension failed, and their status related to the dimension, and (b) BRIDGE, a "one-stop platform for social impact data."

Due Diligence 2.0. A collection of asset owners, consultants, and financial intermediaries have publicly committed to ensuring that their due diligence practices promote the inclusion of managers of color. Included in the nine components of the commitment are considering alternatives to existing minimum track record requirements, increasing transparency, and reassessing assets under management as a risk metric. Due Diligence 2.0 also provides asset owners with tools include a Due Diligence 2.0 Questionnaire Template.

First Peoples Worldwide. First Peoples Worldwide's Free, *Prior and Informed Consent Due Diligence Questionnaire* "provides a list of considerations for investors seeking to implement best practices as to operationalizing the free, prior and informed consent (FPIC) of indigenous peoples regarding development of resources on and near their lands and territories," including land and marine resources and intellectual property.

Institutional Allocators for Diversity, Equity, & Inclusion (IADEI). IADEI "is a consortium of asset owners -- endowments and foundations, along with pensions, family offices, and other institutional investors -- that seeks to drive diversity, equity, and inclusion (DEI) within institutional investment teams and portfolios and across the investment management industry." It maintains the Diverse Manager Database of diverse-owned and -led investment firms and facilitates connections to these firms for asset owners.

Majority Action. Majority Action "empowers shareholders to hold corporations accountable to high standards of corporate governance, social responsibility, and long-term value creation." Racial justice is among its core focus areas. Recent work in this area includes its 2021 *Equity in the Boardroom* report and the 2021 *racial justice proxy voting guidelines*, and participating in the development of shareholder letters focused on things like *corporate political spending* and voter suppression.

McKinsey Institute for Black Economic Mobility. Established as part of McKinsey's formal organizational commitment to racial justice and equity in 2020, the Institute provides insights and recommendations for advancing racial equity and inclusive growth to the public, private, and social sectors. Where investors are concerned, this includes guidance like that which is included in *A guide to impact investing in Black economic mobility*.

Milken Institute. In the 2022 report, *The Path to Inclusive Capitalism: An Asset Owner Guide for Investment Portfolios*, established four pillars through which asset owners can drive diversity, equity, and inclusion (DEI) in the asset management industry to set it on a path to inclusive growth: (1) incorporate DEI into governance, (2) source diverse talent, (3) underwrite equitably, and (4) commit to equitable monitoring and engagement.

PolicyLink. In March 2023, PolicyLink (in partnership with CapEQ and FSG) published the Investor Blueprint for Racial and Economic Equity, "a comprehensive guide for investors to advance shared prosperity, combat inequality, and help bring about an equitable economy." The Blueprint outlines why investors should work to advance racial equity and recommends three ways that investors can do so: (1) strengthen firm governance and culture, (2) reevaluate risk, and (3) build equitable portfolios.

Racial Justice Investing (RJI). RJI "is a group of investors, asset owners, and business leaders who are taking action towards racial justice within [their] own organizations, as well as in [their] engagements with portfolio companies." It develops and disseminates statements related to racial justice on behalf of its members, organizes collaborative shareholder action related racial justice (e.g., establishes proxy voting guidelines for racial and ethnic diversity in governance), and organizes working groups focused on racial justice issues in investing. RJI also collects and disseminates via its website resources for investing in racial justice.

Conclusion

Racial inequity threatens the U.S.' global competitiveness and economic growth, social stability, and, ultimately, long-term investment returns. It is a systemic risk that, like climate change, investors cannot "diversify away." While today's investment professionals did not create the systemic risk of racial inequity, they are perpetuating the problem by excluding people of color from full participation in the financial industry, investing in products/services, companies, and industries that underwrite racial inequity, and knowingly disregarding racial inequity and its long-term consequences in pursuit of short-term economic gain. They are contributing to slowed economic growth, helping to fuel social unrest, foregoing the business benefits of diverse teams, and harming their long-term investment prospects.

Investors must confront and address their contributions to racial inequity before it is too late. Investors are not powerless in the face of racial inequity. In fact, they can be quite powerful in generating meaningful change. The U.S. financial industry, with its more than $100 trillion in AUM, can leverage its power and work alongside government and civil society to effectively influence to address racial inequity to improve well-being throughout society and to support economic growth, improve business outcomes, fortify long-term investment returns, and help to set the U.S. on a path to racial justice.

Specifically, investors can utilize both portfolio- and system-level tools to:

1. Commit to equitably including people of color in the financial industry, and to ensuring that their investee companies and their supply chains do the same; and

2. Use their individual and collective voices to help to reform discriminatory and biased social structures in the U.S.

Investors must help to put an end to the anti-Black/African American, anti-Indigenous, anti-Latine/o/a/x, anti-Asian, anti-Arab, and anti-Middle Eastern, patriarchal, ableist, homophobic, classist practices, policies, and processes that underpin life and economic activity in the U.S. They must help put the U.S. on a path to racial justice, to make it a society free of racial hierarchies where people of color have "the dignity, resources, power, and self-determination to fully thrive."[119] Not only does the future of the U.S. social system depend on it, but racial equity and justice are crucial to the U.S.' global competitiveness, economic growth, long-term investment returns, and the health of the U.S. financial system.

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