[Securities Regulation Daily Wrap Up, SEC NEWS AND SPEECHES—Advisory committee recommends that SEC require investment advisory firms to make diversity disclosures, (Jul. 12, 2021)]

Securities Regulation Daily Wrap Up

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The recommendation called out "artificial barriers" such as assets under management and length of track record as examples of how women and people of color are excluded from competing within the asset management industry.

The SEC Asset Management Advisory Committee (AMAC) unanimously approved a recommendation of its Subcommittee on Diversity and Inclusion (D&I) aimed at increasing the participation of women- and minority-owned investment advisers within the asset management industry. In addition to recommending that registered investment advisers be required to provide transparency on gender and racial diversity, the committee also recommended that SEC staff develop guidance for fiduciaries for selecting asset managers, engage in a study of how "pay to play" rules impact the selection of advisory firms, and establish uniform practices for parties who contact the SEC about discriminatory practices.

Recommendation guided by studies and testimony. According to the recommendation, which contained several pages of footnotes and links, the AMAC spent many months studying data and hearing from experts on diversity and inclusion in the asset management industry. One "startling" statistic is that of the $70 trillion in global financial assets under management (AUM) in the investment universe, less than 1 percent are managed by minority-owned or women-owned firms. The subcommittee also found that widespread gender and racial bias exists in the decisions made by those making asset decisions regarding who manages money for governments, universities, charities, foundations, and the institutional market in general. Artificial barriers are being used by asset allocators under the guise of fiduciary considerations, the subcommittee advised.

In addition, performance myths regarding diverse asset managers have been dispelled because their investment performance is equal to or greater than the investment performance of firms that lack diversity in ownership and senior leadership, according to the subcommittee. Finally, the subcommittee stated that there is a direct link between the SEC's mission and investor calls for more transparency on diversity and inclusion in the asset management industry, advising that the concepts of "public interest" and "materiality" have evolved, making this area a worthy one for Commission action.

With these concepts in mind, the subcommittee developed four recommendations, which the full AMAC adopted:

1. Transparency: The SEC should require enhanced disclosure in SEC by registered investment advisers (such as on Form ADV) to provide transparency on issues of gender and racial diversity not only in the workforce, officer ranks, and ownership ranks, but also fund board and fund adviser diversity and for business practices of consultants who recommend investment advisers and their diversity policies.
2. Guidance: Citing earlier background that diverse managers tend to be filtered out by an inappropriately-limited diligence checklist of fiduciary considerations, the Commission or the staff should develop guidance that clarifies that a wide variety of factors should be considered by fiduciaries in their selection of asset management firms.
3. Pay-to-play study: The SEC should study whether current pay-to-play rules unfairly impact diverse firms because market participants with large PACs and extensive lobbying budgets are allowed to influence firms, while a small campaign contribution by the owner of a small and/or diverse firm would subject that firm to certain exclusions.

4. Reports on discriminatory practices: Noting that the differences between government procurement and private contracting processes and where to report discrimination can be confusing, the SEC should establish centralized and uniform practices for directing reporting parties to an office at a government agency designed for investigating complaints.

Discussion. Presenting the D&I subcommittee's findings and recommendations to the full AMAC, Subcommittee Chair Gilbert Garcia of Garcia Hamilton & Associates said that while talking about diversity can be difficult because it involves categorizing people, he implored how difficult it is to live with when minorities and women are reminded of it all the time, usually in a negative context. He also urged the SEC to look at D&I as not only an "item" but as a core value that should permeate the SEC inside and out.

D&I subcommittee member Scot Draeger of R.M. Davis Inc. noted that a conscious decision was made in crafting the recommendation not to mandate business decisions or practices on SEC registrants, but instead make the focus on disclosure and transparency.

SEC Chair Gary Gensler said he has asked the SEC staff to consider ways that the Commission can enhance transparency of D&I in the asset management industry. According to Gensler, this could include requiring disclosure of aggregated demographic information about an adviser's employees and owners or information about an adviser's diversity and inclusion practices in its selection of other advisers. Commissioner Caroline Crenshaw also stated her appreciation for the AMAC's proposed enhancements to the SEC's disclosure regime that could promote greater diversity and inclusion in the industry.

Commissioner Hester Peirce voiced concerns about the recommendations, however, which she sees as potentially creating government-mandated diversity classifications for the asset management industry. "What if, for example, an African-American woman who owns an asset management firm prefers to be identified by her Wharton finance degree and her deep knowledge of fixed-income markets rather than her ethnicity or gender?" Peirce pondered. She asked the AMAC to work through practical issues that might arise if the recommendations are adopted, including how "diversity" should be defined (such as how an American with Chinese, Ethiopian, Finnish, Irish, and Mexican roots would be categorized), what an asset manager should do if an employee does not wish to identify their ethnicity or gender, and what are the potential consequences if the firm's statements regarding its diversity end up being incorrect.

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