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Inclusive Capitalism: Seven Strategies for Specific Action in Asset Management

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About the Milken Institute

The Milken Institute is a nonprofit, nonpartisan think tank focused on accelerating measurable progress on the path to a meaningful life. With a focus on financial, physical, mental, and environmental health, we bring together the best ideas and innovative resourcing to develop blueprints for tackling some of our most critical global issues through the lens of what's pressing now and what's coming next.

About MI Finance

MI Finance conducts research and constructs programming designed to facilitate the smooth and efficient operation of financial markets—to help ensure that they are fair and available to those who need them when they need them. We address challenges across the financial system to increase access to capital, savings, and investments, particularly for underserved individuals, businesses, and communities.

About the Inclusive Capitalism Program

The Milken Institute's Inclusive Capitalism Program aims to create a business environment that produces long-term value that benefits all stakeholders, including businesses, investors, employees, customers, governments, and communities. Our work focuses on the importance of diversity, equity, and inclusion across the business community and works toward greater diversity across the board in asset management, from entry to the C-suite.

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Executive Summary

Our December 2022 white paper, *The Path to Inclusive Capitalism: An Asset Owner Guide for Investment Portfolios*, lays out four core components to focus on for the path to inclusive capitalism: incorporating diversity and inclusion into governance, sourcing diverse talent, underwriting equitably, and committing to equitable monitoring and engagement.

In this companion piece, *Inclusive Capitalism: Seven Strategies for Specific Action in Asset Management*, the Inclusive Capitalism Executive Council (Executive Council) Subcommittees (Talent Research, Allocation, and Governance) build upon the industry findings and learnings from the first report to establish a set of seven specific actions that the asset management industry can directly execute to capture unrealized value and mitigate long-term risks for the industry. These activities will directly address the 1.4 percent representation of women and Black, Indigenous, and people of color (BIPOC) in an \$86 trillion industry. Each step will target either the human capital side or the allocation and governance side of the “equation”:

(1) Redirect Data and Metrics

Research Action Step

Our work must continue to be grounded in evidence that diversity is an element of fulfilling our fiduciary responsibility to optimize returns for our investors. Aggregating the data points of the last three years will provide directional guidance to accelerate other action steps. What are the most critical data points that make a difference to asset managers and asset owners? How can the industry avoid recycling existing research and leverage new data points to continue to strengthen the impact of efforts to diversify investments, boards, and talent pools?

(2) Expand the Talent Pipeline

Recruiting Action Step

Companies can expand their recruitment efforts beyond traditional target schools to include Historically Black Colleges and Universities (HBCUs), Hispanic Serving Institutions (HSIs), and other educational entities serving diverse backgrounds as a key resource to attract top-performing talent to their applicant pools. As an example, although the 107 HBCUs represent just 3 percent of all higher-education institutions, HBCUs produce 40 percent of all Black engineers, 40 percent of Black Congress members, and 80 percent of Black judges. Hiring strong candidates from these institutions also achieves geographic diversity and is a turnkey solution to expanding the pipeline of candidates in asset management, which can help capture unrealized value in the industry.

(3) Mentor and Track

Talent Sustainability Action Step

Asset management is an apprentice-based business that relies on strong relationships and significant work opportunities to gain additional responsibility and promotional pathways. A long-term mentorship program with an intentional tracking mechanism will increase employee retention and improve company cultures. A comprehensive approach to support and growth within the company is one in which the employee is mentored on a multiyear basis, with a focus on professional development, a social perspective, and performance goals.

(4) Standardize a Governance Diversity Pledge

Allocation and Governance Action Step

Together with the Inclusive Capitalism Executive Council, the Milken Institute proposes that asset management firms make efforts to include diverse persons as board members on open-ended funds within their fund complexes and on portfolio company boards within their private equity funds. Asset managers will advance the interests of their management companies and investors by strengthening the network of diverse persons in the industry.

(5) Expand Access to Diverse Managers

Allocation and Governance Action Step

At present, more than 6 percent of US fund managers across asset classes are diverse-owned but receive about 0.7 percent of US dollars under management, which impedes growth and the ability to create a successful track record. Calling for funds to adjust their policy statements to include first- and second-time funds can bring in a larger number of diverse-owned fund managers, lowering the barriers to building a track record and efficiently managing investments.

(6) Standardize a Scorecard Focused on Inclusive Capitalism

Monitoring and Evaluation Action Step

Transparency to and disclosure of data and business practices are critical for measuring the financial services industry's commitment to progressing diversity, equity, and inclusion. Standardizing an index that measures firms' inclusive efforts will provide a common baseline for an industry-wide monitoring and evaluation method.

(7) Convene Intentionally

Milken Institute Action Step

The Milken Institute is uniquely positioned as both a thought leader and a connection point for the financial sector. Leveraging the expansive Milken Institute network, the Inclusive Capitalism

Program aims to curate events that bring together established asset managers, asset owners, and emerging fund managers. By gathering asset allocators and emerging managers, the Milken Institute can facilitate a unique networking structure that connects asset allocators with leading emerging managers in the industry.

Introduction

In the first white paper of this series, the *Path to Inclusive Capitalism: An Asset Owner Guide for Investment Portfolios*, we laid out four core pillars to focus on for progressing diversity, equity, and inclusion (DEI) within the financial industry: incorporating diversity and inclusion into governance, sourcing diverse talent, underwriting equitably, and committing to equitable monitoring and engagement. We provided 17 strategies bucketed across these four components to ground the audience in the existing research and encourage those who haven't begun a thoughtful effort to expand inclusion internally.

This companion piece builds on the four pillars and serves as a guidebook for specific actions that we encourage the asset management industry to execute for enhancing efficiency and value-creation opportunities. This guide is designed for institutional investors, including public and private pension plans, family offices, foundations, and other allocators leading the effort to establish DEI within their institutions.

We collaborated with our Inclusive Capitalism Executive Council—an assembly of industry leaders in asset allocation, asset management, and top trade organizations pushing the envelope in the asset management space—and incorporated feedback from these bold industry professionals to elevate the best industry solutions that can be easily implemented. Additionally, we highlight how the Milken Institute is addressing these challenges directly. In some examples, our work is beginning to take shape, and we encourage industry feedback. In other examples, our solutions, both standalone and with partnerships, are ready for your collaboration.

Throughout this paper, we highlight the work and successes of others in the industry. Too often, there is a desire to reinvent the wheel when others are producing viable solutions. In underscoring the actionable steps we are taking and amplifying the critical work others are pushing forward, we hope to foster pathways to partnership across the industry. Why build solutions when you can collaborate to make the solutions of others better?

Finally, we hope that this guide provides a compass to those looking for what to do next. Our commitment to this work is impact-focused but has always been backed by data. Less diverse capital markets are less efficient and leave money on the table for asset owners, managers, entrepreneurs, and customers. If we are to achieve the goals of capitalism, efficiently allocating resources to the most efficient performers, inclusion must be at the center.

The Milken Institute defines DEI as the following:

- Diversity refers to all aspects of human difference, social identities, and social group differences, including but not limited to race, ethnicity, creed, color, sex, gender, gender identity, sexual identity, socioeconomic status, language, culture, national origin, religion/spirituality, age, (dis)ability, and military/veteran status, political perspective, and associational preferences.

- Equity refers to fair and just practices and policies that ensure all community members can thrive by acknowledging and addressing structural inequalities—historic and current—that advantage some and disadvantage others.
- Inclusion refers to a community where all members are and feel respected, have a sense of belonging, and are able to participate and achieve their potential.

“I am honored to serve as chair of the Milken Institute’s Diversity, Equity and Inclusion in Asset Management Executive Council. I would like to thank the members of the Council for their hard work in helping to craft this white paper and believe that it will be vital in providing a framework for engagement of all industry participants. We look forward to continued dialogue.”

—Jarvis Hollingsworth, Chair, Inclusive Capitalism Executive Council, Milken Institute



Redirect Data and Metrics

Inclusive innovation and diversity, equity, and inclusion topics have been growing in importance in the private markets in recent times. However, a number of challenges emerge when we attempt to measure and track diversity metrics, creating a complex landscape for limited partners (LPs), general partners (GPs), and portfolio companies alike. The lack of clear alignment on what diversity data are most material and helpful for private equity stakeholders is at the core of this issue, compounded by geographical differences.

First, different LPs will often request different diversity data points from GPs, depending on the topics that are most pertinent for them. With each LP seeking specific data points or metrics, GPs—and, as a result, portfolio companies—often find themselves grappling with a multitude of requests. Simultaneously, GPs' data collection practices differ: Some diligently capture DEI data, while others may only track them superficially.

Geographical context further complicates matters. Diversity isn't a monolithic concept; meaning varies in different regions and countries, depending on local context. A metric that is important in one area may be less relevant in another or even face restrictions on being monitored. Acknowledging this

complexity is crucial, as it underscores the need for a flexible approach that respects local nuances while striving for the benefits that come with taking a consistent approach.

These challenges require a coordinated effort to standardize reporting practices. One prominent endeavor is the Institutional Limited Partners Association (ILPA) Diversity in Action Initiative. The goal of the initiative is to motivate market participants to engage in the journey toward becoming more diverse and inclusive and to build momentum around the adoption of specific actions that advance DEI over time. It achieves that by providing the DEI Roadmap, which comprises best practices that both GPs and LPs can consider implementing to advance DEI efforts. ILPA also provides a Diversity Metrics Template that is tailored for LPs interested in collecting diversity data on GP organizations, as well as for portfolio companies. ILPA's metrics center around gender and race/ethnicity at different levels of the organization.

Another relevant initiative is the ESG Data Convergence Initiative (EDCI), an industry-led initiative (supported by Boston Consulting Group [BCG] and ILPA) that has brought together more than 325 GPs and LPs in its mission to drive convergence around meaningful ESG—including DEI—metrics for the private markets. The DEI-related metrics that the EDCI collects are focused on private portfolio companies and include the composition of boards (percentage of women, percentage of underrepresented groups, percentage of LGBT) and the proportion of women in the C-suite. As a result of the EDCI, hundreds of private equity funds globally are now using consistent definitions to track these metrics.

Another important element of the EDCI's mission is to generate useful, comparable, performance-based aggregated data to explore connections between sustainability performance and financial outcomes. In its role as the initiative's benchmarking and advisory partner, BCG will share some of the EDCI's findings on diversity later in the year.

The Milken Institute Inclusive Capitalism Executive Council aspires to continue to advance the private markets' understanding of, and convergence around, the diversity metrics that are most meaningful for social and financial

outcomes, building on the important work of ILPA and the EDCI. As a next step in this regard, the Milken Institute and BCG will collaborate with interested Inclusive Capitalism Executive Council GPs to explore further where there can be convergence around diversity metrics for the private markets and further understanding of links between diversity and financial outcomes.



Expand the Talent Pipeline

Pillar two in our first report, *Sourcing Diverse Talent*, highlights the challenges of a homogeneous workforce. A 2021 National Association of Investment Companies (NAIC) report finds diverse perspectives and differentiated behavior can lead to better decision-making and greater profits on a macro level.² Additionally, findings from a 2019 McKinsey study concluded that companies in the top quartile for gender diversity on executive teams were 25 percent more likely to have above-average profitability than companies in the bottom quartile.³ Research illustrates that sourcing diverse talent is proven to influence firm performance positively. However, it continues to be a challenge for many firms recruiting in asset management and other spaces within the financial industry.

Firms have traditionally recruited from a select number of “target schools” for internships and entry-level jobs, with the understanding that these highly selective and predominantly white institutions (PWIs) have the best talent. But target schools are chosen according to perceptions of prestige. A Harvard Business Review article observed that partners and other decision-makers typically relied on their personal opinions of which schools were “top-tier,” rather than on data-driven estimations of quality.⁴ Antiquated perceptions of talent distribution drastically skew opportunities away from qualified

and capable talent who might not have attended top schools for reasons beyond merit, and largely impede a talent pipeline reflecting the most qualified individuals.

Nicsa, a global nonprofit trade organization focused on global assets and the wealth management industry, asserts that a successful approach to recruitment means having multiple avenues to source diverse talent in alignment with the needs of the firm. This approach is important to ensure that firms are filling roles with candidates who are the best fit for the company and that the company is the best fit for the candidate.⁵ There are many methods to expand the talent pipeline, and incorporating HBCUs is critical to diversifying the financial industry.

As a recent UNCF report highlighted, HBCUs make up just 3 percent of America's colleges and universities yet produce almost 20 percent of all African American graduates.⁶ Asset management firms are increasingly aware of the rich talent emerging from these institutions, but often face roadblocks when identifying or connecting with HBCUs and cultivating strong relationships.

Fellowship programs specifically designed to spotlight the high-performing talent emerging from HBCUs and provide tailored training to fast-track students to compete in internship and analyst programs are rapidly cultivating an expansive talent pool of entry-level-ready professionals. These fellowship programs provide an invaluable training component that creates a foundational understanding of the financial industry through coursework, network building, and access to internship opportunities for practical application.

Firms looking to diversify their talent pools don't need to reinvent the wheel. They can start by actively engaging with and supporting established programs already closing the talent gap in the industry through intentional, consistent, and low-lift commitments.

Seek Out Fellowship Programs that Align with Firm Focus and Commit to Collaboration

Numerous programs designed with HBCUs and minority students in mind exist in today's financial ecosystem.

- SEO Career is a program that recruits and trains high-achieving, underrepresented undergraduates for summer internships that can lead to competitive full-time roles post-graduation. With a 40-year track record, SEO Career provides access and opportunity for students who've been historically excluded from corporate America, including Black, Latinx, and Native American students.
- Girls Who Invest (GWI) runs experiential programs to provide undergraduate women and gender nonbinary individuals from a variety of racial, ethnic, socioeconomic, and academic backgrounds with access to careers in investment management. Alumni of the organization's two educational and internship programs number more than 2,000 and continue to transform the industry, as 70 percent of the individuals who intern through GWI stay in finance.
- The AltFinance Fellowship, a program designed through the collaborative efforts of Ares, Apollo, and Oaktree, provides fellows with a custom curriculum, coaching, and career guidance in the alternative investment industry.
- Going beyond the undergraduate level and founded to reduce the barriers that entry-level minority business school graduates often face, The Toigo MBA Program is a two-year program that runs alongside a candidate's MBA program to prepare and promote diverse men and women for successful post-graduation careers in finance.
- Taking the top lessons and learnings of minority-centered fellowship programs, the Milken Institute created the Milken Institute HBCU Strategic Initiative and Fellows Program. This intensive eight-week course introduces fellows to the core concepts and avenues within the asset management industry while providing unique network-building opportunities and mentorship programming.

Firms should intentionally identify programs that align with their candidate requirements and establish a partnership to create a consistent flow of industry-ready talent.

Support Programs through Monetary Commitments

Investing in programs that produce professionally prepared and highly qualified talent contributes to sustainable growth and a positive impact on the financial industry.

DEI remains a pertinent focus of asset owners and managers—particularly the challenge of sourcing top diverse talent.

In finance, firms owned by White men manage just over 98 percent of the \$84 trillion managed by the US asset management industry and contribute to the maintenance of a homogeneous workforce: 88 percent of senior fund managers are White, and 70 percent of the more junior positions, including analysts and associate managers, are White.⁷

However, industry-wide acknowledgment of HBCUs as a source of high-performing, entry-level talent can narrow the talent gap. Firms can collaborate with programs that shift the status quo of the talent pipeline to a diversified talent pool that is widely recognized and seamlessly considered.



Mentor and Track

The asset management industry is well known for the importance of apprenticeship in mastering the craft of investing. The premium placed on apprenticeship, in turn, lays the foundation for mentorship as a powerful tool to accelerate professional development and expand opportunities for underrepresented groups. For a diverse workforce to flourish, companies must enhance their inclusion efforts, or the degree to which employees are supported and enabled to make meaningful contributions.⁸

When managed well, mentorship programs ensure a level playing field for individuals from all backgrounds and help talent navigate critical career decisions. The end result drives long-term retention and advancement, while also binding mentors and more senior talent to the firm by giving them a sense of purpose in developing talent. As just one proof point, a study by Cornell University's School of Industrial and Labor Relations⁹ found that diverse representation at the management level increased from 9 to 24 percent and impacted promotion and retention rates for minorities and women from 15 to 38 percent thanks to successful mentoring programs.

The Apollo Ascend Program and Girls Who Invest Organization

In the experience of Executive Council members Apollo and Girls Who Invest, several design factors are fundamental to a successful mentoring program. To start, a mentoring program should be adapted to and embedded in the organization's culture. Some mentoring programs struggle to gain traction when they do not align with how work gets done in a particular culture. Instead, they should be well synced with the day-to-day routines of that business.

It is also important to recognize that there are different types of mentoring relationships: those that may be structured around a program and those that naturally evolve through working relationships. People may have multiple mentors for different areas that they are looking to develop.

Additionally, successful mentorship programs need senior sponsorship from the leadership team and a multiyear commitment. It takes time for mentees to develop, and the real value of mentoring programs bears fruit as mentees are up for consideration for future roles and promotion opportunities. Sponsorship of the program should involve a committed, organized group of senior leaders to cocreate and manage the program and ensure executional excellence in the end-to-end experience. At Apollo, the CEO and co-presidents personally lead the mentoring of key leaders.

The adage says, "What gets measured gets done." It is critical that the organization establishes the right tracking processes. Pre- and post-360° feedback is a highly effective means of measuring the developmental progress of the mentee in the eyes of their stakeholders. The HR team should also track the advancement rates of program participants compared to their peers to ensure a healthy meritocracy and objective decision-making. The senior sponsors should regularly review a dashboard of the progress of the program participants, in terms of both their development areas and the career progress of the program's participants.

Mentors need training to be set up for success with clear expectations and a roadmap. Mentoring is a skill that can be trained and improved over time. The business case for mentor training is also to ensure that mentors build their awareness and understanding of their mentees' cultural norms and traditions to help increase the impact of their specific guidance and advocacy.

Girls Who Invest trains hundreds of mentors, called "Ambassadors," each summer. A GWI Ambassador is a seasoned investment industry professional who advises on all aspects of their experience in the GWI program and beyond. The GWI Ambassador training is not for the faint of heart and includes a live kickoff, an asynchronous communications campaign with deep dives into topics (e.g., Prioritization & Time Management, Combatting Imposter Syndrome & Self-Doubt, and Navigating Your Career Journey), and support calls with mentors and mentees to encourage meaningful connection. Progress is monitored through a survey that helps inform program oversight.

Apollo's Ascend development program focuses on full-time talent and ensures that mentors for high-performing women leaders are formally trained for their roles. Mentors ground themselves in key techniques to understand the specific challenges mentees are facing so they can customize their approach.

Setting Parameters: Outlining Mentorship Goals and Expectations

Expectations should be clear for the mentees on the investment they need to make to get the most out of the experience. Successful mentorship strikes the right balance between support and challenge and provides a clear compass to navigate key decisions and transitions. Mentoring relationships that work best have clear expectations and training on both sides of the relationship.

It is also important to recognize the invisible work that mentors do—and to reward them for this. It isn't easy to quantify the impact of being an effective mentor in terms of monetary or other productivity-related outcomes; therefore, that work is often not a factor in consideration of the mentor's performance. This point is further driven home by the fact that programs about mentorship for historically excluded individuals repeatedly tap mentors from similar communities, thereby compounding the invisible work that disproportionately affects the few in positions that share those identities.

To address this challenge, Carlyle created the Career Strategies Initiative, a global program for high-performing, high-potential mid-level talent from underrepresented groups. The program has a strong focus on developing the sponsorship and inclusive leadership skills of the managers and executive sponsors of the participants. One hundred twenty-one Carlyle managers and executive sponsors from around the world have been through the program. Heading into the fifth cohort, the success of the program has led Carlyle to educate executives of portfolio companies on the power of sponsorship in order to increase the capabilities of leaders within Carlyle's portfolio.

While mentorship programs take hard work and require focused and intentional design, they are also straightforward and measurably impactful. Mentoring is one of the most powerful tools in the developmental toolbox. Any company can match the commanding depth of expertise of senior leaders with the high potential of up-and-coming talent to help unlock the talent's full potential.

4

Standardize a Governance Diversity Pledge

Pledges and commitments, when carried out, have proved effective tools in diversifying boards, companies, and investment portfolios. At its most basic function, a diversity pledge for your organization communicates to external stakeholders your specific commitment to addressing diversity within your organization and acts as a roadmap for the organization to follow. In the United Kingdom, a 2011 review of corporate governance by Paul L. Davies (an acknowledged expert in company law and labor law and a founding member and fellow of the European Corporate Governance Institute) suggested that the largest publicly listed companies within the FTSE 100 should include 25 percent women by the year 2015.¹⁰ The effort has proved highly effective, as 40 percent of FTSE 100 corporate board positions are currently held by women, compared with 12.5 percent 10 years ago.¹¹ Recommendations are being made that FTSE 350 boards include 40 percent female representation by the end of 2025.¹²

The Path to Inclusive Capitalism highlighted other pledges that industry participants have signed: the ILPA Diversity in Action initiative,¹³ a pledge committing signatories to a public DEI

strategy, internal hiring tracking, organizational goals for more recruiting, and tracking demographic data for new LP/GP capital commitments; and the CFA Institute Diversity, Equity, and Inclusion Code, committing participants to promote and improve DEI outcomes, improve DEI results in the investment industry, measure and report on progress, expand the diverse talent pipeline, and implement inclusive hiring, onboarding, promotion, and retention practices.

Pledges have normally excluded movement with respect to fund board governance. Standardized language for internal governance diversity pledges in the asset management industry could yield the speedy results shown in the UK, where a review of corporate governance by John Parker (prominent in British and international business and currently lead nonexecutive director of the Bank of England) in 2016 recommended that every FTSE 100 board include an ethnically diverse member by 2021.¹⁴ By December 2021, 89 companies had reached that goal, with an additional eight publicly articulating plans to do so by the second quarter of 2022.¹⁵

Although there has been a push in recent years to allocate capital to majority minority-owned asset management firms, no such targeted efforts have taken place with respect to fund board governance.

Together with the Inclusive Capitalism Executive Council, the Milken Institute proposes that asset management firms consider their own pledges to include diverse persons as board members on open-ended funds within their fund complexes and on portfolio company boards within their private equity funds.

The language we recommend that firms incorporate in their pledges—the Milken Institute Asset Management Governance Diversity Pledge Framework—would involve an asset management firm committing to include a diverse cohort of candidates when building boards for its open-ended fund boards and portfolio company boards within a specified period from the date the pledge is made. Asset managers making the pledge would advance the best interests of their investors by providing a diverse perspective in terms of fund and private company governance. Asset managers would also promote

the interests of their management companies and investors by strengthening the network of diverse persons—future leaders and mentors—in the asset management field.

The framework builds upon many of the concepts underlying the movement to have more diverse public company boards. Specifically, the pledge will include: (1) a public commitment by asset management firms to include diverse candidates in their evaluation process for open-ended funds and each portfolio company over a set multiyear period and (2) a commitment to provide financial and time resources through existing or newly formed programs to identify and train diverse board candidates for future appointment.

The proposed Governance Diversity Pledge has positive implications, including the following:

- The proposal is focused on private asset management firms¹⁶ and, therefore, is not subject to the challenges faced by government-led initiatives, such as California Assembly Bill 979 (enacted August 2020) requiring corporations doing business in California to increase the representation on corporate boards of persons from “underrepresented minorities.”¹⁷
- Asset management firms have considerable influence over the selection of independent board members at the outset of structuring the open-ended funds that they manage. Although some private funds require the inclusion of Limited Partnership Advisory Committees (comprising investor representatives), such funds often also have oversight boards consisting of individuals independent from the asset management firm to resolve conflicts and address other fund-governance issues.
- The credentials to serve on open-ended fund boards are typically more flexible than public boards. Therefore, the pool of eligible fund board members is broader and can include those with non-investment backgrounds such as law, accounting, risk management, and compliance.
- Having a more diverse fund governance membership will have cultural implications within asset management firms, which are likely to result in greater conscious and unconscious efforts to foster more opportunities for diverse portfolio-management professionals.

- Diverse capital markets are more efficient and can take advantage of unrealized value-creation opportunities.

While this pledge would be a significant step in the right direction, there are some limitations:

- Serving as a director on a fund board carries less prestige and public prominence than serving on a publicly traded company board.
 - Mitigating this fact is that an asset management firm with multiple fund boards and portfolio companies can amplify its commitment to diversity by publicly adopting the Milken Institute Asset Management Governance Diversity Pledge Framework.
 - Also mitigating this limitation is that candidates for fund governance and private company board positions may be younger and less experienced than candidates for public board positions. There are many more opportunities for diverse candidates, as fund and private-company board positions are far more numerous than public-company board positions.
- Serving as a director on a fund board does not directly lead to an increase in the number of diverse persons involved in portfolio management-related positions within the asset management industry.
 - Mitigating this fact is that, as noted above, a more diverse fund-governance membership will have cultural implications within asset management firms. Moreover, a public push to have more diverse fund and portfolio company governance may foster investor-led pressure to diversify portfolio management teams within asset management firms.

Resources to Train Diverse Board Candidates

- The National Association of Corporate Directors (NACD) Center for Inclusive Governance was created based on an understanding that a diverse and inclusive board is critical to long-term value creation for every organization and to

society more broadly. Along with educational resources that help directors understand their role in diversifying the boardroom, the center houses the NACD Accelerate program—a unique, two-year program that creates a pathway for executives with little or no experience in the boardroom to prepare for board service. Participants receive the tools, resources, and exposure essential to launching a successful career as a director.

- Housed in the Santa Clarita Leavey School of Business, the Black Corporate Board Readiness (BCBR) program accelerates diverse representation in corporate governance by accompanying highly experienced, qualified Black leaders through a structured executive education program. The BCBR program connects participants to experienced board members, rigorously prepares them to excel, and builds a community devoted to better business performance and racial equity.
- The NxGen COACH Network Governance Training Camp is an intensive, year-long program that seeks to help participants find and secure positions on public and private company boards. In partnership with Womble Bond Dickinson, this training camp is designed to educate and empower the next generation of board directors. The program covers board dynamics, fiduciary duties, and strategic planning, providing individuals with the necessary skills and connections to become effective leaders in the boardroom and shape the future of organizations.

5

Expand Access to Diverse Managers

The 60/40 allocation model, dating back to the mid-20th century, has been (and is still) considered the mainstay of portfolio investing theory. Balancing a portfolio between stocks and bonds based on their respective risk and return characteristics has been a fundamental principle in investment theory for decades. The specific allocation of 60 percent stocks and 40 percent bonds gained popularity as a simple and balanced approach over time. This strategy is based on the belief that stocks offer higher growth potential, while bonds provide stability and income. The 60/40 model is often considered a more conservative approach, as it aims to balance risk and return through the diversification between stocks and bonds.

The endowment model of investing began to gain prominence in the 1980s and 1990s, largely influenced by the successful investment strategies of renowned university endowments such as Yale and Harvard. These institutions, under the leadership of financial managers (notably the late David Swensen at Yale), implemented the endowment model to diversify their portfolios and pursue long-term growth. The endowment model

was a major evolution in portfolio theory, and its benefits are still being debated today. However, there can be no debate that some endowments' investment portfolio returns have far outpaced more traditional investors still relying on 60/40 allocation models.

If you speak to any major manufacturer, you'll hear that supply-chain diversity plays a crucial role in protecting competition and mitigating supplier risk for companies. By having a diverse set of suppliers, businesses reduce their dependence on a single source, minimizing the potential impact of disruptions, such as natural disasters or geopolitical events. This diversity also fosters healthy competition among suppliers, driving innovation, quality, and cost-effectiveness. Additionally, it helps prevent monopolistic practices and reduces the risk of supplier price manipulation. By actively seeking and supporting diverse suppliers, companies enhance their resilience, ensure a more sustainable supply chain, and create a level playing field that benefits both their own operations and the broader business ecosystem.

According to a 2021 study by the Knight Foundation,¹⁸ more than 6 percent of US fund managers across asset classes are diverse-owned, but receive about 0.7 percent of US dollars under management. The same study finds that diverse-owned firms, segmented by asset class, control 3.4 percent of US dollars under management in hedge funds, 0.4 percent in mutual funds, and 1 percent in real estate. In private equity, where the barriers to entry are lower and growth is most likely to occur, diverse-owned firms control 4.5 percent, and women-owned firms control 1.6 percent—both lower than their respective 5.1 percent and 7.2 percent of US-based firms.

However, as endowments have grown, the ability to accept \$500 million checks and 20 percent concentration limits, coupled with economic disincentives for smaller, diverse, emerging managers, has fueled massive consolidation in the landscape. Not only have multibillion-dollar assets under management (AUM) firms become common, but we are also on the precipice of more than one firm having more than \$1 trillion in AUM. The risk is clear, but LPs continue to invest with the same GPs time and time again.

Promoting diversity and inclusion in asset management is not only an ethical imperative but also a strategic one to enhance performance and better reflect the needs of investors to create a more competitive supply chain, while supporting social values that advance equitable access to opportunities for diverse communities. One effective tactic to achieve this is supporting racially diverse-owned emerging managers and considering them as a potential asset class within the evolving endowment model. This approach aligns with the principles of the endowment model, such as diversification and long-term growth.

To execute this, the industry must address three key themes: Work to increase the number of diverse emerging managers, set terms that foster their long-term growth, and remain hyperfocused on the real problem and not get lost in generalizations.

1. As detailed extensively in the first report, Pillar 3 shows that allocators have used a set of onerous contractual terms that undermine the long-term organizational viability of diverse emerging managers. Be it negotiating lower fees or demanding European waterfall payments, diverse emerging managers have significant hurdles to overcome to build viable firms poised for future growth. In fact, one could say, allocators have made short-term decisions at the cost of long-term objectives, counter to their fiduciary responsibility. To resolve this issue, LPs must look to maximize risk-adjusted returns of the underlying investments, not by stifling their representative GP in trying to do the best job for them.
2. Again, with less than 2 percent of AUM under management by women and POC, roughly 30 percent of the US population (White and male) not only manages more than 98 percent of AUM but also receives the fees from managing those funds, as well as getting to decide which underlying businesses they invest in. Thus, in a very direct way, a lack of diversity in asset management fuels wealth inequality in America. To remedy this, LPs should be considering equitable management of their funds. With women and POC accounting for 70 percent of the US population, their representation should

increase, even if gradually. Just as a decision to invest 60 percent in stocks requires time to reach that threshold, reaching 70 percent diverse and women-owned allocation will take time.

3. In recent years, the term “diverse” has been universalized to the point that it is overinclusive. Diverse now not only means underrepresented racial or ethnic groups and women but also White male military veterans. Could a diverse emerging manager invest in an all-White, male-owned organization? Legally, yes. To be clear, supporting our fellow citizens who have sacrificed for our security is a must, but it should be its own focus and not get lost among efforts to support marginalized communities. To ensure intellectual honesty and truly reap DEI-fueled benefits, diverse emerging manager efforts also need to specify a focus on underrepresented groups, women, and principally racial minorities that the industry has historically marginalized.

LPs can unlock the full commercial potential of inclusive capitalism by developing the endowment model to incorporate diversity, equity, and inclusion as an asset class with explicit goals of investing and actively supporting racially diverse-owned emerging managers. A lack of inclusion has left trillions on the table. It is an LP’s fiduciary responsibility to consider diversity, equity, and inclusion to capture that value for its beneficiaries. Ultimately, this approach aligns with the principles of the endowment model while addressing the underrepresentation of racially diverse firms and individuals. Firms can take significant strides toward building a more diverse, inclusive, and successful asset management landscape through some of the other action steps (partnerships, dedicated investment policies, mentorship programs, data collection, and community engagement).

CASE
STUDY

Nuveen Diverse Managers Program

To expand access to diverse managers, the Board of Directors of TIAA approved an allocation of general account funds for the creation and development of the Nuveen Diverse Managers Program (NDMP), a joint effort between Nuveen and Churchill Asset Management.¹⁹ The initial \$100 million was earmarked for private equity and venture capital general partners where women and people of color own greater than 51 percent of the firm. Blueprint Capital Advisors, a diverse-owned investment advisor, was retained in September 2022 to assist in sourcing and underwriting diverse general partners.

In the program's first year, Nuveen and Churchill were exposed to 100 fund managers and invested in 12 new diverse-led funds. The vehicle has expanded access to first-time fund managers and provided the board of directors of TIAA with differentiated investment opportunities not pursued by larger asset managers, leading to expanded portfolio diversification. The early success has led to an additional vintage that will continue to deliver attractive returns to TIAA while lending its brand, reputation, strategic advice, and guidance to diverse managers to close capital disparities.





Standardize

a Scorecard Focused on Inclusive Capitalism

Defining relevant and more accurate data metrics is half the battle. Organizing those data into a system that holds firms accountable is instrumental in measuring the financial services industry's commitment to progressing diversity, equity, and inclusion. A recent study noted that among the biggest impediments to DEI progress that asset owners face are difficulties in measuring progress due to inconsistent definitions of DEI terms and standards.²⁰ Transparency and alignment of data and business practices are critical for measuring the financial services industry's commitment to progressing inclusive capitalism. Creating a standardized scoring method would provide a common baseline for an industry-wide monitoring and evaluation method.

Creating this scorecard should be a collaborative effort to allow for industry-wide participation. As a neutral expert in the field, the Milken Institute will work with the Inclusive Capitalism Executive Council and others to solidify relevant and comprehensive data points and methods of measurement. To this end, the Institute will also draw from successful case studies as models to create a scorecard that provides useful feedback.

Lessons in Standardization from the Private Equity Perspective: Ares Capital

AmpliFY DEI Initiative

The Ares Private Equity Group follows the adage quoted earlier: What gets measured gets done. Under the direction of Chief Diversity Officer Indhira Arrington, Ares created a truly differentiated approach to building more diverse, equitable, and inclusive companies by engaging directly with selected portfolio companies to develop and support data-driven, accountability-based DEI strategies within each company. “What *AmpliFY DEI* allows us to do is flex to different levels of DEI maturity and to scale support across the different private equity companies within our portfolio,” explained Arrington in an interview with the authors for this report.

Creating a DEI process that was both comprehensive and actionable required a mixture of research and practical application:

- Beginning in 2021, Ares hired a premier consulting firm to deploy a rigorous three-part assessment to measure DEI functional maturity, talent pipeline representation across role and level, and inclusion by diversity dimension.
- With the data collected, Ares worked with each of the 20 individual portfolio companies participating in the assessment to develop multiyear strategic plans with measurable key performance indicators and specific milestones.
- To ensure consistency, the DEI strategy process is reported at board meetings, placing accountability for progress at the highest level of each company.
- Understanding that collaboration is key, Ares organized a cohort to learn together, share best practices, and celebrate achievements together, truly supporting the changes that need to be made across the firm’s private equity (PE) portfolio and exemplifying the goal of being a catalyst for good and an advocate for change.

Now, Ares is setting its sights on scaling *AmpliFY DEI* to include all its portfolio companies and begin a data collection and evaluation process that will continue to measure DEI progress across the firm’s portfolio. In early 2023, Ares launched the assessment with a second cohort of PE companies, which is a mix of companies deploying the survey for the first time, and other companies, alongside Ares, gathering the first set of time-series data.

We can draw on the lessons and learnings from Ares’ *AmpliFY DEI* to inform the creation of a standardized scorecard that the broader asset management industry can use.



Convene Intentionally

Firms that have made commitments to build a more diverse and inclusive environment, have an interest in exploring what their commitment could look like, or are exploring ways to execute a long-term plan and are aware of the benefits of incorporating diversity into their investment theses and portfolios. For example, a 2015 McKinsey study found that companies in the top quartile of racial/ethnic and gender diversity were 35 percent more likely to have above-median financial returns.²¹ A separate study, Board of Director Diversity and Firm Financial Performance, found a significant positive correlation between diverse racial and gender representation on boards and both return on assets and return on investment.²²

Our first six steps provide practical and replicable frameworks intended to urge firms to send intentional signals to the market concerning established commitments to diversity. In our final step, we address the need to connect with emerging asset managers and women- and diverse-owned asset managers. We recognize that capital often flows not to the best ideas but to the strongest relationships. Suppose a relationship is to be built between an asset owner who is not currently investing or investing a small amount of their portfolio with women- and diverse-owned firms. In that case, there must be intentional spaces to foster engagements that could lead to allocation.

As we addressed with the talent pipeline, searching in the same places asset owners or consultants have always looked to connect with asset managers will only yield similar, homogeneous results. Those considering allocating to diverse and emerging managers might explore the following conferences to expand their current pool of asset managers:

- GCM Grosvenor Consortium Conference: a 20-year annual conference focused on the small, emerging, and diverse managers community.
- Culture Shifting Weekend/Summits: a series of deal-making events incorporating Innovation, Technology, and Social Impact, held in Miami, London, New York, and Silicon Valley.
- NAIC Annual Private Equity and Hedge Fund Conference: annual conference plus LP meetups throughout the year enabling NAIC members to engage with institutional investors to make new investor connections and expand existing relationships.
- All Raise: arms female founders and funders with access, guidance, and support to accelerate their success exponentially and propel the entire industry forward.
- National Association of Security Professionals Pension and Financial Services Conference: brings together more than 600 financial services professionals across sectors to learn about the latest concepts, trends, and solutions to pressing community issues.

At the Milken Institute, we understand the power of convening and the impact it can have on the world. To that end, we are committed to using that power of convening to expand access to capital for diverse and emerging fund managers. We will intentionally convene LPs from our council and the Milken Institute network at an annual event to introduce them strategically to qualified, diverse, and emerging managers.

Conclusion

This white paper and the Milken Institute's ensuing work that will emerge from it represent the Institute's continued commitment to providing the empirical data necessary to diversify the asset management industry. Additionally, the structure of the paper is intended to engender partnerships across the industry. Partnership only strengthens and expands the ecosystem of industry professionals, shedding light on the alpha-generating opportunities that a more inclusive industry presents.

No single stakeholder or group of stakeholders can effectively create new opportunities and frontiers of change. We will each need to advocate for more robust data, expand our talent pipelines, and move to a data-based approach to mentoring and tracking employee success. We each must set aspirational goals in our commitments to diversity, intentionally convene with diverse perspectives in and outside our companies, expand access to capital for diverse managers, and monitor and track progress as with any other part of our portfolio.

The opportunity for catalytic change must be recognized, and the options are limitless. We encourage you to choose the actions we've presented and deepen your work.

It is powerful to end with the story of Reginald Lewis, a Wall Street tycoon and the first African-American owner of a billion-dollar company. His story displays what is possible when an ecosystem works together.

Lewis was educated at Virginia State University, an HBCU, and attended a summer program at Harvard Law School, sponsored by The Rockefeller Foundation. During that summer program, Lewis made such an impression that Harvard invited him to attend school that fall. After graduating, Lewis built a law practice around a new Nixon Administration program—Minority Enterprise Small Business Investment Companies, venture firms formed by corporations or foundations.

After helping to structure hundreds of transactions, Lewis conducted a \$22.5 million leveraged buyout of the McCall Pattern Co., where he led the two most profitable years in the company's 113-year history and sold the company for a \$50

million profit. In 1987, he accomplished the largest buyout, at the time, of overseas assets by an American company.

Reginald Lewis's story isn't just one of hard work and opportunity meeting preparation. It's the story of a foundation valuing diversity and investing in a summer program to create new pathways, of a law school open to expanding its talent pipeline, of an HBCU adequately preparing a student to perform at a high level, of thoughtful public policy committed to creating opportunities for citizens historically left behind, of the capital markets operating efficiently, and of an investor committing to investing in a great business opportunity, despite blowback from the investment community.

We don't have to do everything, but we can each do something and keep getting better at it.

Disclaimer: This white paper is intended as a resource for asset managers at all stages of their DEI journey and to facilitate conversation and learning. It provides information that may be useful in the process of developing and implementing approaches to DEI. This report is not to be construed as a framework against which to measure firms' policies or programs.

The tools discussed herein may not currently or in the future align with the approach used by other asset managers, be preferred by prospective investors, comply with law or regulation, or align with market trends. This white paper is not meant to inform asset managers on how to comply with applicable laws or regulations and should not be construed as legal advice. Readers are encouraged to seek legal advice prior to implementing any changes to their processes discussed herein.

Endnotes

1. Involvement with the Milken Institute is not intended to convey current or intended alignment with or endorsement or approval of all of the information contained in this white paper. Rather, this white paper conveys information and examples gathered from multiple sources; individual firms' approaches may vary significantly. A firm's status as a contributor to this white paper does not purport to indicate that such firm endorses or agrees with every position, belief, or statement of the white paper, nor does it prevent a firm from taking a position, adopting a belief, or making a statement contrary to a particular position, belief, or statement of the white paper or of the Milken Institute. A firm may, in its sole discretion, determine at any time that involvement with the Milken Institute is no longer advisable or feasible. No firm is under any obligation to notify any person, organization, or entity other than the Milken Institute in the event that it ceases to be involved with the Milken Institute.
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15. A panel of three judges on the 5th US Circuit Court of Appeals rejected lawsuits seeking to block the rule approved by the US Securities and Exchange Commission in August 2021 requiring companies listed on the exchange to have women and minority directors on their boards or explain why they do not, saying constitutional claims do not apply to Nasdaq, which is a private entity.
16. In August 2020, the California legislature enacted a bill (California Assembly Bill 979) requiring corporations doing business in California to diversify their boards of directors to increase the representation on corporate boards of persons from "underrepresented minorities." The bill, which Governor Gavin Newsom signed into law in September 2020, expanded existing legislation (California Senate Bill 826) that had previously focused on gender diversity on boards. There have been a number of challenges to California's board diversity legislation, SB 826, the board gender diversity statute, and AB 979, the board diversity statute regarding "underrepresented communities." In two cases, *Crest v. Padilla I and II*, filed in state court, the plaintiffs notched wins, and the court issued injunctions against implementation and enforcement of these two statutes. Both of these cases are currently on appeal, and the injunctions remain in place. On May 15, 2023, the US District Court for the Eastern District of California concluded in a federal case that the unconstitutional aspects of the bill could not be severed.
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