STEP

2

BUILDING SUPPORT FROM TRUSTEE, BOARD, AND STAFF LEADERSHIP

Be Your Board's Trustee Champion

"As we were looking at the people managing our Foundation's investment portfolio, it was obvious that there were no diverse managers," Roderick D. Gillum, Trustee of the W.K. Kellogg Foundation recalls. "This just wasn't what many of us [on the Board] would like to see. So it's not by happenstance when foundation staff reaches out to minorities. It's because a tone has been set."[11]

It takes time to build institutional capacity to affect changes in investment practices. But, as a trustee, you are in the unique position to start moving your institution in the right direction.

The CalPERS board, for example, has made a concerted effort to include more women, growing female representation from 1 to 4 out of 13 within a year in 2015. Additionally, after discovering that African-Americans make up a small percentage of CalPERS staff, board members are also advocating for CalPERS to hire a Chief Diversity Officer, who would report directly to the CEO and work to ensure diversity and inclusion within the staff. This includes efforts to widen the pool of candidates interviewed for positions to include more diverse candidates.[12] While this effort has not yet succeeded, these board champions have started a much-needed shift towards greater attention to and action concerning diversity within every aspect of CalPERS.

Theresa Taylor, who joined the CalPERS board in January 2015, urges other trustees to have patience as moving a board and an institution can be very slow. "The capacity is not always there to make immediate change," she says. "Change often requires the effort of trustees and/or senior staff to educate their colleagues and cultivate a commitment to diversity over time. While you will often encounter pushback, continuing to ask questions regarding diversity will ensure that the issues are not forgotten."[13]

> *Over many years, I have come to realize that moving the needle forward on diversity requires either a committed CEO or a board champion. Without a commitment from one or ideally both of these organizational leaders, the natural inertia that exists to maintain the status quo is likely to prevent any change.*
>
> *– Emmett D. Carson, Ph.D.,*
> *CEO, Silicon Valley Community Foundation[14]*

Legal Support[15]

One of the most prevalent misconceptions to overcome with your board and C-suite is the legal argument that considering racial, ethnic, and gender diversity with regard to asset manager selection is strictly not permitted under the Employee Retirement Income Security Act (ERISA). Rather, new Department of Labor (DOL) guidelines issued in October 2015 clarify that environmental, social, and governance (ESG) factors "'may have a direct relationship to the economic value of investments' and therefore may be considered in a fiduciary's primary economic analysis of plan investments."

ERISA "requires fiduciaries to act 'solely' in the interest of a plan's participants and beneficiaries and for the 'exclusive purpose' of providing benefits and paying reasonable administrative expenses." Yet according to former Secretary of Labor Thomas E. Perez, a 2008 guidance had "unduly discouraged plan fiduciaries from considering economically targeted investments" (ETIs), which are defined as "any investment that is selected, in part, for its collateral benefits, apart from the investment return to the employee benefit plan investors."

As with every investment, proposed investments with possible collateral benefits "may only be considered after the plan fiduciary has determined that the investment is expected to provide an investment return to the plan commensurate to alternative investments having similar risks." But, in what is known as the "everything being equal test," collateral benefits can be taken into account as "tie-breakers" when investments are "otherwise equal" with regard to economic and financial elements.

Even so, the 2015 guidance acknowledges that "ESG factors are not merely collateral considerations, but can be an integral part of the economic analysis performed by the plan fiduciary when considering an investment." It also affirms that fiduciaries may "address ETIs or incorporate ESG factors in investment policy statements and utilize ESG-related tools, metrics, and analyses to evaluate investments."

This new guidance is helpful in affirming that ESG considerations are legitimate. But keep in mind, the case for diverse managers goes one step further than the "everything being equal test." The case here is that lack of diversity undermines the fiduciary responsibility to generate the highest returns because it reflects a failure to fully consider the range of options for generating the best risk-adjusted returns.

For a legal briefing on the new guidelines from Groom Law Group, see: http://www.groom.com/media/publication/1638_DOL_Announces_New_Guidance_on_Social_Investments.pdf.

To access the Department of Labor's Interpretive Bulletin 2015-01, see: https://s3.amazonaws.com/public-inspection.federalregister.gov/2015-27146.pdf.

ENDNOTES

STEP 2: Building Support from Trustee, Board, and Staff Leadership

11. White Jr. & ABFE, “Who Manages the Money? A Case Study of the W.K. Kellogg Foundation,” p. 7.

12. Theresa Taylor, CalPERS Board Member, telephone interview by author, February 29, 2016.

13. Theresa Taylor, CalPERS Board Member, telephone interview by author, February 29, 2016.

14. Carson & Miller, “Investment Manager Diversity: The Hardest Taboo to Break,” p.3.

15. Unless otherwise noted, information in the following section is drawn from: Groom Law Group. Benefits Brief: DOL Announces New Guidance on Social Investments. October 2015. Available at *http://www.groom.com/media/publication/1638_DOL_Announces_New_Guidance_on_Social_Investments.pdf*