SEC Remarks
9/16/2020

Good afternoon Mr. Chairman, members of the Asset Management Advisory Committee, and distinguished guests.

My name is Michael Frerichs. I am the Illinois State Treasurer, an elected position by the great people of the State of Illinois. It is an honor to be invited to speak with you today.

The Illinois State Treasurer performs many roles. Chief among them, I am the state's Chief Investment and Banking Officer. In that role, we actively manage approximately $35 billion dollars. This portfolio includes $16 billion in state funds, $13 billion in retirement and college savings plans, and $6 billion on behalf of local and state governments.

As an institutional investor, we have an obligation to pursue value. This pursuit includes encouraging corporate boards to adopt external and internal strategies to promote growth. Today, I wish to address strategies designed to increase diversity and inclusion numbers across the financial services industry and the companies in which we invest. Specifically, I call your attention to approaches to increase diversity within the financial services industry workforce, its utilization of diverse firms, and its service to communities dominated by people of color.

This is not new territory for this committee. The committee was formed to provide the Commission with diverse perspectives on asset management and related advice and recommendations.[i]

Nor is this new territory for the Commission.

Indeed, the SEC requires public companies to disclose meaningful financial and other information to the public. This provides a common pool of knowledge for all investors to use to judge whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.[ii]

Commissioner Allison Herren Lee made this point in her statement on Regulation S-K and ESG Disclosures just last month.[iii] The Commissioner pointed to the "growing body of research showing the strong business case for diversity" and the importance of this issue to investors managing trillions of dollars in assets. And, she pointed to research from S&P indicating that "racial injustice has become a material issue" with the potential to change evaluations and credit.[iv]

Clearly, this must include diversity and inclusion data throughout the financial services industry and the companies in which we invest. The public must be able to see how those in the financial industry are addressing gaps affecting people of color within their workforce, their customers, and their communities.

We know this data is available. All private employers with 100 or more employees are required to report diversity data to the Equal Employment Opportunity Commission [on a confidential basis].[v] We also know that too many companies in the financial services sector refuse to provide this data. In 2018 the SEC received only 38 responses from the 1,500 registrants who were asked to complete a Diversity Assessment Report.[vi] We can only assume this refusal is embedded in either embarrassment or deceit.[vii]

Embarrassment because corporate leaders know the numbers do not reflect their stated commitments to reduce barriers of entry to their workforce, promotional opportunities, and leadership positions.

Deceit because corporate leaders know the public pressure to promote unrealized diversity goals is a hollow effort without an enforcement mechanism.

Today, we know it is possible to create dramatic change across the financial industry sector with relative ease, without increasing costs or sacrificing any level of service. It only takes a willingness to acknowledge past failures and the sincere desire to change.

Institutional investors and the investment consultants we utilize also have a pivotal role in advancing diversity. We should be constantly evaluating the diversity of our management teams and staff. We should vote proxy statements in alignment with fair and equitable corporate practices. We should invest with investment funds led by women and people of color We should invest in diverse-led businesses addressing issues in communities of color. And we should hire financial services firms with a proven track record of equity, diversity and inclusion.

(SLIDE)

Using diverse investment firms is not only about creating growth and opportunity in our communities, but it's integral to increasing our investment returns. How do we know this? Because in Illinois, inside the Illinois Treasurer's Office, we did it.

(SLIDE)

First, consider asset managers. We increased our assets managed by diverse-owned firms from $18 million in December 2014 to ***$3.9 billion*** as of last month. That's a 216-fold increase.

(SLIDE)

Second, consider broker/dealers. In 2014, before I took office, only 1 percent of assets were brokered by diverse-owned firms. This last fiscal year, 92 percent of assets were brokered with diverse-owned firms. Put another way, our total assets brokered by diverse-owned firms increased from $603 million in FY 2014 to ***$43 billion*** in FY 2020.

(SLIDE)

We also engage our portfolio companies to increase corporate board diversity, which is vital to performance. We lead the Midwest Investors Diversity Initiative, which is a coalition of institutional investors dedicated to increasing racial, ethnic, and gender diversity on corporate boards of companies headquartered in the Midwest. The Initiative has undertaken 54 company engagements, 40 of which added diverse board members and 32 adopted a diverse search policy.

We are also a leader of the Thirty Percent Coalition, which is a national coalition of institutional investors advocating for diversity on corporate boards. The Thirty Percent Coalition has successfully engaged over 300 companies that have now appointed diverse board members.

Finally, we take various actions to advance equity, diversity and inclusion in the financial services industry. **First,** all financial and investment firms that do business with our office, or seek to do business with our office, must disclose how their firm promotes equity, diversity and inclusion. This includes a 360-degree evaluation, conducted through an annual assessment, that simultaneously examines and promotes diversity among board members or owners, executive leaders, workers, and suppliers.

Second, we partner with key organizations, both nationally and locally, making real progress increasing the representation of diverse individuals, at all levels, within the financial services industry. This includes the Financial Services Pipeline and the Advancing Equity in Banking Commission, both of which convene leading institutions in the public and private sector to address longstanding gaps and devise practical solutions.

Mr. Chairman, and members of the Asset Management Advisory Committee, change only will come if it is required. The Commission has this authority in its rulemaking power. And, along with numerous other institutional investors, I have previously petitioned the Commission to exercise this power.[viii]

More importantly, however, the Commission itself recognizes the critical importance diversity brings to an organization. Consider the Commission's own offices, which include The Office of the Advocate for Small Business Capital Formation. Among this independent office's responsibilities is recommending changes to mitigate capital formation issues and promote the interests of small businesses and their investors.[ix]

Within the SEC itself, there is the Office of Minority and Women Inclusion that is responsible for all matters related to diversity in management, employment, and business activities at the SEC. The Office of Minority and Women Inclusion is committed to ensuring that diversity and inclusion are leveraged throughout the agency to advance the SEC's mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.[x]

There also is the Office of Equal Employment Opportunity, which works to ensure the agency's professional staff come from diverse backgrounds.[xi]

Therefore, it is time for the Committee to recommend four concrete steps that forcefully show the Commission's responsibility to diversity and inclusion.

> **Step One:** Adopt the Garcia rule and require regulated entities and issuers to consider enterprises led by women and people of color when selecting firms including broker-dealers and asset managers and to consider at least one woman and person of color when nominating directors or selecting executive officers. This must include a consistent and required evaluation explaining why women or people of color were not chosen and the steps needed to improve future applications.
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> **Step two:** Mandate the disclosure of data by regulated entities and issuers showing diversity within the workforce including race, gender, ethnicity, religion, nationality, disability, veteran status, and sexual orientation. Data utilization rates for outside vendors should also be disclosed. I believe this disclosure must be made every two years.
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> **Step three:** Require regulated entities and issuers to publicly disclose the race and gender of directors, nominees, and executive officers annually.

Step four: Commission a study to evaluate the practices of investment consultants including, but not limited to, the systemic and structural barriers for diverse investment firms.

I recognize that my perspective and call to action will not be warmly greeted by everyone. That is disappointing. At a time when the leader of the free world is ordering the dismantling of diversity training because he believes it to be un-American, we must show our country and the world that barriers to entry must be removed. Doing so is better than good business; it is the right thing to do.

Mr. Chairman, members of the committee, thank you for your invitation to address you today. I am ready and willing to answer any questions.

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[i] https://www.sec.gov/page/asset-management-advisory-committee

[ii] https://www.sec.gov/Article/whatwedo.html

[iii] Commissioner Allison Herren Lee, Regulation S-K and ESG Disclosures: An Unsustainable Silence, https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26

[iv] S&P Global Rankings, Why Corporations' Responses To George Floyd Protests Matter (July 23, 2020), https://www.spglobal.com/ratings/en/research/articles/200723-environmental-social-and-governance-why-corporations-responses-to-george-floyd-protests-matter-11568216.

[v] Equal Employment Opportunity Commission, EEO-1: Who Must File, https://www.eeoc.gov/employers/eeo-1-survey/legal-basis-requirements

[vi] SEC, Diversity Assessment Report for Entities Regulated by the SEC- Summary of Year One Results, https://www.sec.gov/files/SEC_Diversity_Assessment_Report_Year_One_Summary%20Report.pdf

[vii] As Commissioner Herren Lee said, "should we assume that management at the hundreds (if not thousands) of companies that don't provide data on workforce diversity have carefully and accurately determined that the information is not material to their business? That would be a questionable conclusion to make given the growing body of research showing the strong business case for diversity." https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26#_ftnref18

[viii] For example, Human Capital Management Coalition comments on the Proposed Rule: Modernization of Regulation S-K Items 101, 103, and 105, October 22, 2019, https://www.sec.gov/comments/s7-11-19/s71119-6322887-194462.pdf

[ix] https://www.sec.gov/Article/whatwedo.html

[x] Ibid.

[xi] Ibid.