TIIP THE INVESTMENT INTEGRATION PROJECT

Confronting Income Inequality

Practical guidance for how investors can address income inequality through action on labor relations, workers' rights, and financial and political equity

The first of two publications for investors addressing income inequality

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Disclosures

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Summary

Income inequality is one of the major systemic challenges of our time. Like climate change, it threatens to harm the economy, can lead to political polarization and paralysis, and can disrupt and undercut investors' opportunities across all asset classes. Investors' policies and practices can exacerbate income inequality's impacts or can reduce its scope and hence risks to their long-term goals. This report provides examples of how investors wishing to confront this challenge can take actions that enhance their current policies and practices as well as advanced approaches designed specifically to mitigate income inequality's systemic risks.

Income inequality—the gap in income between the very affluent and the rest of society—is a substantial systemic social challenge within most countries and across the globe.[1] Between 1980 and 2016, the incomes of the world's richest 1% of people grew twice as much as the poorest 50% of people.[2] As incomes soared for the wealthy, income inequality increased for more than half the countries worldwide. In the United States, wages grew by 160.3% for the top 1% of earners between 1979 and 2019, versus by just 26% for the bottom 90% of earners.[3]

Income inequality is inextricably linked to wealth and economic inequality and interconnected with inequality in racial, ethnic, and gender opportunity.[4] Structural barriers preclude women and racial and ethnic minorities from fully participating in economies and societies; this ensures, for example, that Black Americans make just 73.4 cents on the dollar earned by white Americans and that women across the globe earn less than men *at every single education level*.[5] Furthermore, sexism costs countries between $15 trillion and $30 trillion in lost lifetime productivity and earnings for women while racial inequality has cost the U.S. economy $16 trillion over the last two decades.[6]

Fundamental to income inequality's risks has been its hollowing out of the middle class through stagnation of wages, outsourcing and use of contract labor that cuts costs, and a diminution in the size and influence of unions. These trends have taken place in a political and theoretical context that emphasized deregulation of capital markets while relying on those same markets, and not governments, to rectify any market failures that ensued. In doing so, this paradigm has led to the prioritization of investors and management over workers and society, ignoring the long-term risks arising from the resulting disparities in societal incomes and wealth.

Workers, the financial system, and investors now face substantial challenges. Wages are stagnating, with American worker productivity rising 69.6% since 1979 while wages only increased 11.6%; labor standards are eroding, as Organisation for Economic Co-operation and Development (OECD) union membership has fallen from 30% in 1985 to 16% in 2019. At the same time, governments are starved of the revenue needed to fund services (e.g., infrastructure and healthcare) that benefit corporations and their workers.[7]

The resulting excessive income inequality slows economic growth, leads to more frequent and deeper recessions, limits upward mobility, aggravates social cohesion, and exacerbates political polarization. It is a systemic risk that cannot simply be diversified away and necessitates action to intentionally improve the fundamentals of the system, generating desirable outcomes in the process.

This toolkit reviews a range of conventional and advanced techniques and tools at the disposal of asset owners and asset managers to address systemic challenges such as income inequality.

Conventional techniques – such as portfolio construction, engagement, manager due diligence, and policies and beliefs about the functioning of markets – are a part of daily practice for all investors. These familiar activities can be extended beyond portfolio construction and risk management to encompass systemic risks as well.

Advanced "system-level investing" techniques can be used to influence the rules of the game and the culture within which the investment community operates to minimize systemic risks and maximize potential rewards. These techniques can be grouped according to three broad or overarching tactics: field building, investment enhancement, and opportunity generation.[1] As broad categories they show the path forward for the practice of systems-level investment: first, investors start working more collectively (field building), then change the way they make investments (investment enhancement), and then create investment opportunities that will improve systems (opportunity generation). These techniques, which are the foundation of system-level investing, vary in their usefulness from asset class to asset class, and in how they can be applied to specific systemic issues.

For example, when seeking to address income inequality, the advanced technique of Polity—a field building technique used to address social and environmental public policy debates—can contribute to crucial public discussions about what constitutes a minimum or a living wage, workers' rights, or equal pay for equal work, with particular applicability to the role of publicly traded companies.

In fixed-income, the advanced techniques of Additionality and Utility—opportunity generation approaches—can catalyze the development of new financial products such as "social bonds" that build income inequality into their design or enhance considerations in asset allocation of the wealth-creating benefits inherent in government-issued fixed-income products such as those supporting the affordability of home ownership.

In the private markets, the role of Standards Setting and Solutions —investment enhancement techniques—can call attention to business models with solutions to income inequality challenges built in or establish expectations of best practice on labor relations for entire segments of the financial markets—private equity, real estate, and infrastructure.

This toolkit offers these examples to illustrate the range of actions that investors might contemplate, whether they are addressing a systemic risk such as income inequality for the first time or having already engaged with its complexities. The examples provided here are not exhaustive and investors will decide which approaches are most appropriate given their current portfolio and investment styles, skill sets and resources, and inclination to act on their own or in collaboration with peers.

Whatever their ultimate decision, investors should also recognize that although they have an outsized influence in financial markets, ultimately government regulators and legislators hold in their hands many of the most powerful tools for addressing income inequality systematically. Investors nevertheless can play a constructive role in public discussions and debates about issues with policy implications.

[1] System-level investing entails managing non-diversifiable risks using tools that go beyond traditional portfolio risk management. System-level investing will be explained further later in the report (see page 18 for details).

Equally important for investors is to seize the opportunity to catalyze and set models for government actions where government can act most effectively, while at the same time fostering a culture that encourages not only compliance with the letter of the law but endorsement of its spirit. In this way investors can help address income inequality in order to build resilient and sustainable social and financial systems that are essential to their long-term investment opportunities.

This toolkit illustrates how investors can use the growing discipline of system-level investing to address income inequality. It discusses how they can modify their existing conventional activities and use emerging techniques to confront the issue through action on labor relations, workers' rights, and financial and political equity ("labor issues"). Ultimately, this builds resilient systems that support long-term opportunities for profitable investments across all asset classes.

Part 1: Income inequality and its impact on the labor market

A. What is income inequality?

The Big Idea

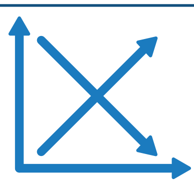
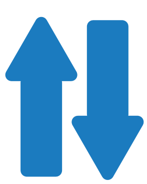
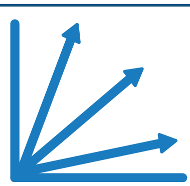
Income inequality is characterized by the gap in income between the very affluent and the rest of society, brought on in part by corporations shifting profits to executives and shareholders, at the direct expense of workers while also avoiding paying taxes.

Income inequality is inextricably linked to wealth and economic inequality. The world's wealthiest 1% of people, for example, have more than twice as much wealth—income plus other accrued assets (e.g., stocks, property, and retirement assets)—than nearly 90% of people combined.[8] Furthermore, today, 85% of people live in countries whose GDP per capita is lower than the real GDP per capita of the richest country (i.e. U.S.) 50 years ago.[9] In 2017, 48.6% of global income went to capital owners, while just 6.4% went to the bottom half of the population, most of whom are laborers.[10]

Scope and scale of the problem.

Income inequality is a substantial systemic social challenge within most countries and across the globe (see table 1).[11]

Table 1. Income inequality by the numbers

	Over the past 30 years, more than half of countries and nearly 90% of "advanced" economies have seen an increase in income inequality.[12]
	Between 1980 and 2016, the incomes of the world's richest 1% of people grew twice as much as the poorest 50% of people.[13]
	As of 2016, the share of total national income accounted for by the nation's top 10% of earners was 37% in Europe, 41% in China, 46% in Russia, 47% in the U.S. and Canada, and around 55% in sub-Saharan Africa, Brazil, and India.[14]
	On average, people in the European Union (E.U.) have income that is 11 times higher, and people in North America have income that is 16 times higher, than people in sub-Saharan Africa.[15] Workers in countries in the northern hemisphere generally earn substantially higher incomes than their southern counterparts, with 28 of the 30 countries with the highest income per capita falling in the northern hemisphere.[16]
	In the U.S., wages grew by 160.3% for the top 1% of earners between 1979 and 2019, versus by just 26% for the bottom 90% of earners. During that same time, those in the top 0.1% experienced wage growth of 345.2%.[17]

Workers pay the price.

Since the 1980s, governments, financial systems, and societies have put their faith in capital markets to generate wealth while simultaneously addressing systemic social and environmental challenges. They have been guided by the belief that unfettered markets can achieve the best economic outcomes, manage societal and environmental risks, and should not be obstructed by public policy and regulation.[18]

Consequently, increasing stock prices came to dominate society's perception of the true value of companies, rather than the long-term strength and resilience of their business models and relations with employees, communities, and other stakeholders. To incentivize ever-rising stock prices, corporations paid CEOs in company shares, avoided taxes paid to governments around the world, and outsourced and offshored operations in cost cutting moves.[19]

Subcontracting various business functions reduced labor costs and shifted responsibility for working conditions and other liabilities to third parties, often in developing countries with fewer worker protections.[20] Moreover, many of these subcontracted vendors in turn hired sub-subcontractors of their own. As these operations moved down the subcontracting ladder, profit margins decreased and labor as a share of overall costs increased, driving vendors to cut corners, reduce pay and benefits, and neglect worker safety.[21]

In the end, workers suffer. Wages have stagnated and labor standards eroded (see figure 1). In the U.S., real wage growth declined from 0.9% to 0.4% between 2016 and 2017 despite falling unemployment and has yet to recover to pre-2008 levels.[22] Wage growth in 22 advanced economies averaged just 0.7% per year between 2000 and 2018, a rate less than half their average growth per year.[23] In the U.S., wages have stalled while worker productivity increased; between 1979 and 2018, net productivity increased 69.9% while hourly pay grew by just 11.6%. In short, Americans are more productive than ever but are not paid accordingly.[24] Workers must also increasingly contend with unsafe working conditions. In 2014, 2.78 million people died from occupational accidents and work-related illnesses across the globe or approximately 7,500 people each day.[25] As of 2016, 40.3 million people worldwide were subject to modern slavery.[26]

Societies suffer too. Corporate tax avoidance and transfer pricing starves governments of the revenue needed to fund vital services, including public services used by companies and their employees that are essential to the smooth functioning of businesses and societies. This includes infrastructure, data gathering (census, weather, national security, and education), public health systems, and safety nets. Comparing statutory tax rates between 2000 and 2018 in OECD jurisdictions, 76 had lower rates in 2018, 12 jurisdictions stayed the same, and only one had a higher tax rate.[27]

A decline in the strength of unions worldwide, along with their ability to constrain abuses of labor and regulate the power dynamic between capital markets and workers, compound these problems. Across the countries of the OECD, union membership has dropped to just 16%, and the share of American workers in unions has plummeted from 35% in the mid-1950s to only 10% today (and 6.2% for private-sector workers).[28] Unionization is nearly non-existent among "non-standard" or "atypical" workers, particularly those that work for third-party subcontractors and in the "gig economy," who are commonly classified as "independent contractors" and therefore legally precluded from organizing in many countries.[29] Declining unionization dissuades workers from organizing to improve their pay and working conditions and "excludes workers from participating in the government of their workplaces."[30]

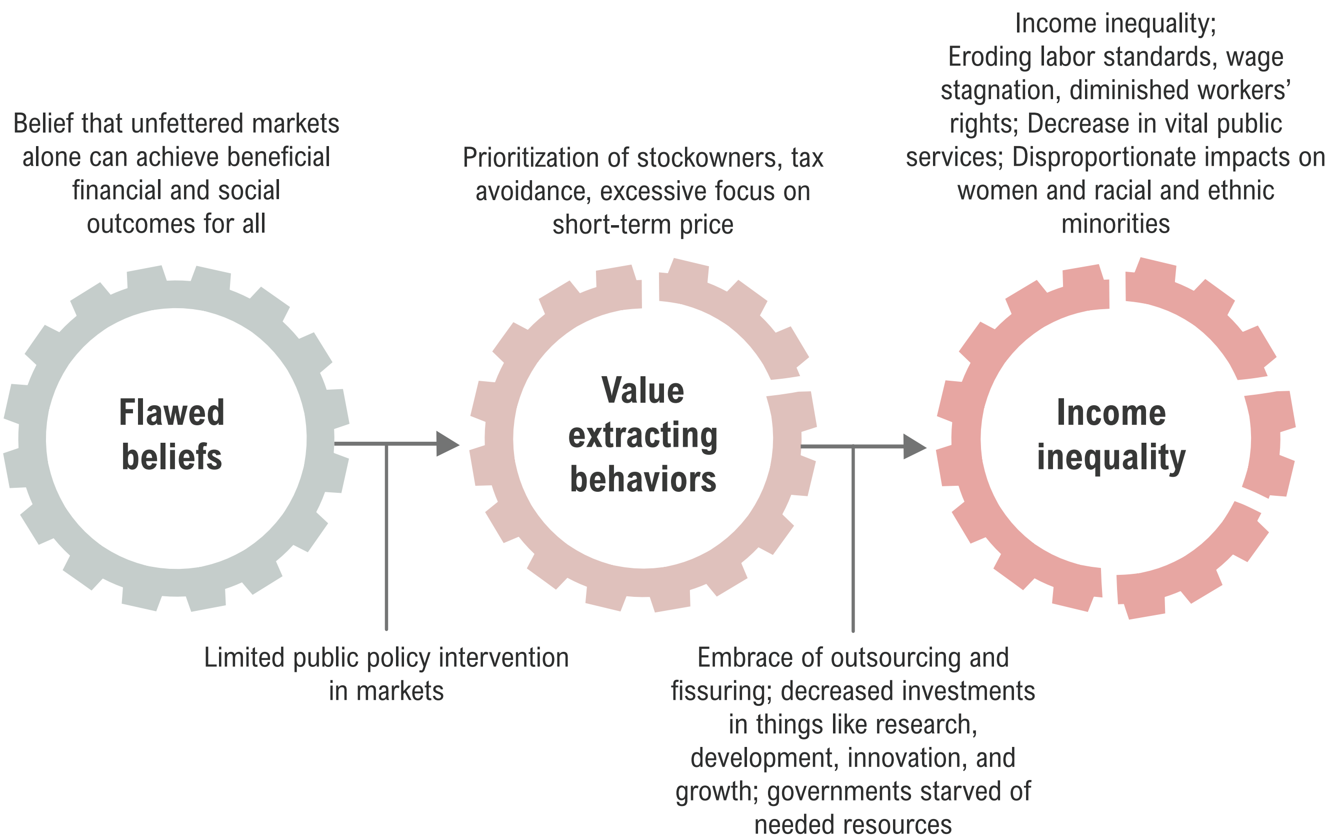
Racial and ethnic minorities and women suffer disproportionately.

Structural barriers to education, employment, homeownership, and healthcare keep racial and ethnic minorities and women at the bottom of income and wealth distributions worldwide. In the U.S., for example, the legacy of "Jim Crow" laws, segregation, and related voter suppression have resulted in Black Americans making 73.4 cents on the dollar earned by their white peers, owning homes at lower rates than white Americans, and being twice as likely to be unemployed.[31] Furthermore, Black women earn only 62 cents on the dollar compared to white men.[32] Black entrepreneurs in the U.S. have been denied access to loans and capital at a rate twice as high as their white counterparts, costing the U.S. as much as $13 trillion in lost revenue per year over the past 20 years.[33] This extends to other countries around the world; in France, GDP could jump 1.5% over 20 years by reducing racial gaps in employment; and in Australia racism cost the country $44.9 billion between 2001 and 2011.[34]

Practically speaking, income inequality is not uniformly experienced across all demographics and geographies. Discrimination is magnified by social identities, such as gender and race, and individuals with different cultural and racial backgrounds will have vastly different experience with income inequality. This paper highlights some of these inequities in order to illustrate the scale of income inequality. However, more research is needed to fully examine the breadth and depth of these issues.

Additional structural obstacles, including racial bias and limited racial and ethnic diversity within the criminal justice system, abound throughout the world and limit the ability of large sectors of the population to contribute fully to society and the economy.[35] The European Parliament, in June of 2020, introduced a resolution acknowledging structural racism as a problem in society; specifically, that Black, brown, and other people of color across Europe are subject to aggressive policing and profiling, and called for a plan of action.[36]

Figure 1. Income inequality: How did we get here?



Similar barriers ensure that women have less money and power than men and that they cannot otherwise fully participate in society. Women's labor force participation worldwide is just 47% (compared to 74% for men).[37] Those women who do work earn, on average, 85 cents on the dollar earned by men and have net wealth equal to just 62% of men's (on average, across a sample of 22 OECD countries).[38] Women earn less than men *at every single education level.*[39]

Key Takeaways

- Income inequality is a global problem; between 1980 and 2016, the incomes of the world's richest 1% of people grew twice as much as the poorest 50% of people.
- Structural barriers, such as racism and sexism, preclude women and racial and ethnic minorities from fully participating in economies and societies.
- The corporate behaviors partially responsible for income inequality create a self-reinforcing feedback loop. Corporations enrich investors and executives, avoid paying taxes, underinvest in their workforces; labor standards and worker protections deteriorate; income inequality gaps widen; and the cycle repeats.

The next section discusses why, in addition to simple matters of fairness and justness, investors should care.

B. Why investors should care about income inequality.

The Big Idea

Excessive income inequality slows economic growth, leads to more frequent and deeper recessions, limits upward mobility, aggravates social cohesion, and exacerbates political polarization, introducing more risk to investors due to these weakened social, environmental, and financial systems.

As a phenomenon, some degree of income inequality can be viewed as a positive; it can serve as an incentive to promote hard work. Given that cutting labor costs and avoiding tax payments can boost profits and stock price, it may be tempting for investors to conclude that income inequality is an unalloyed benefit.

In the extreme, however, income inequality can hollow out the middle-income sectors of the population, thereby stunting consumer spending, which is one of the main engines of economic growth. It can limit upward mobility for those at the bottom of the economic pyramid, thereby costing society the potential of productive workers and entrepreneurs. It can lead to deeper, more frequent recessions due to an impoverished, indebted class, thereby requiring a diversion of governmental resources to restoring yesterday's status quo rather than addressing tomorrow's challenges.

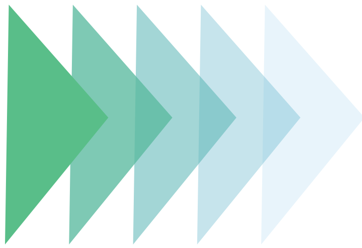
Inequality is a destabilizing force, and instability hinders effective long-term investing. Further, inequality has been shown to polarize politics, paralyze governmental action, promote nationalistic populism, prompt trade wars, and in the worst of circumstances destabilize democratic institutions and geopolitical relations.

Consequences.

Although it can be argued that income inequality can provide benefits, today's excessive income inequality and its cost to labor can be detrimental to, and have destabilizing impacts on, economies and the fabric of society (see table 2 and figure 2).

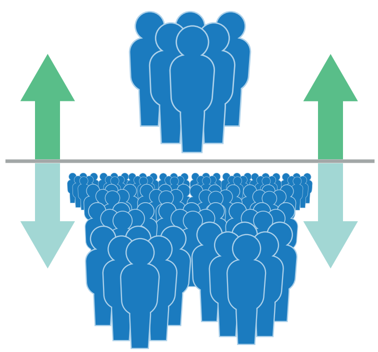
Table 2. The consequences of income inequality

Slowed economic growth



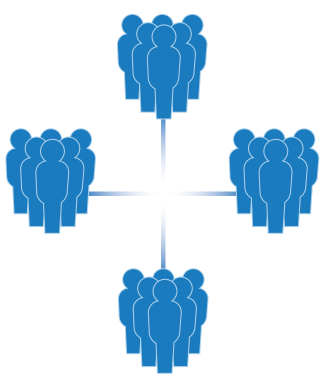
The middle-income sectors of the population are being hollowed out, with the wealthy saving more and spending less than the poor.[40] Consumer spending is the primary driver of GDP.[41] When the income share of a country's wealthiest 20% of people increases by just 1%, GDP growth is 0.08% lower in the subsequent five years, whereas an increase in the income share of a country's poorest 20% of people is associated with 0.38% higher growth.[42] Specific to race, the wage gap between Black and white Americans accounts for as much as 0.2% in lost GDP each year.[43] By addressing the wage gap between men and women globally, countries would add 0.6% to their GDP annually.[44]

Limited upward mobility



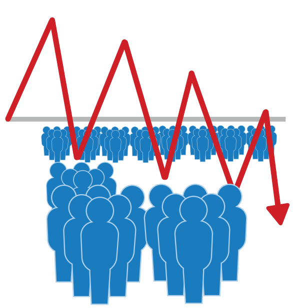
People at the bottom of the income distribution not only have less money than those at the top, but they also have less access to food, housing, education, and healthcare.[45] At the same time, their wealthy counterparts are increasingly more economically and politically powerful. American children born to parents in the bottom 20% of income earners have just an 8% chance of making it to the top 20% of earners.[46] Upward mobility has been diminishing over time as well; in 1970, 90% of 30-year old Americans made more than their parents earned when they were 30-years old. In 2010, that number was down to 50%.[47] This is not a uniquely American problem either; in the U.K., 64% of adult children earned equal to or more than their fathers in 2006; in 2015, that number had dropped to 44%.[48] Limited upward mobility costs the economy the potential participation in the labor force of productive workers and talented entrepreneurs and disproportionally impacts women and racial and ethnic minorities.

Deteriorating social cohesion, increased political polarity and instability



Major disparities in income, wealth, opportunity, and power lead to social discontent and tension, political polarity and tendencies toward nationalistic populism, trade wars, and general social and political unrest, instability, and dysfunction.[49] Income inequality arguably influenced the tenor of recent acrimonious elections in the U.K. and U.S.; has impacted the political climate in Austria, France, Germany, Hungary, Italy, the Netherlands, and Poland; and diminished faith in government, leading to growing support for anti-establishment parties and political figures.[50] Similarly, the diminished prevalence of labor unions has led to a downturn in workers' voting participation and the contours of how government acts on issues relevant to societal systems and workers.[51] Political and social instability can impact investment opportunities across all asset classes.

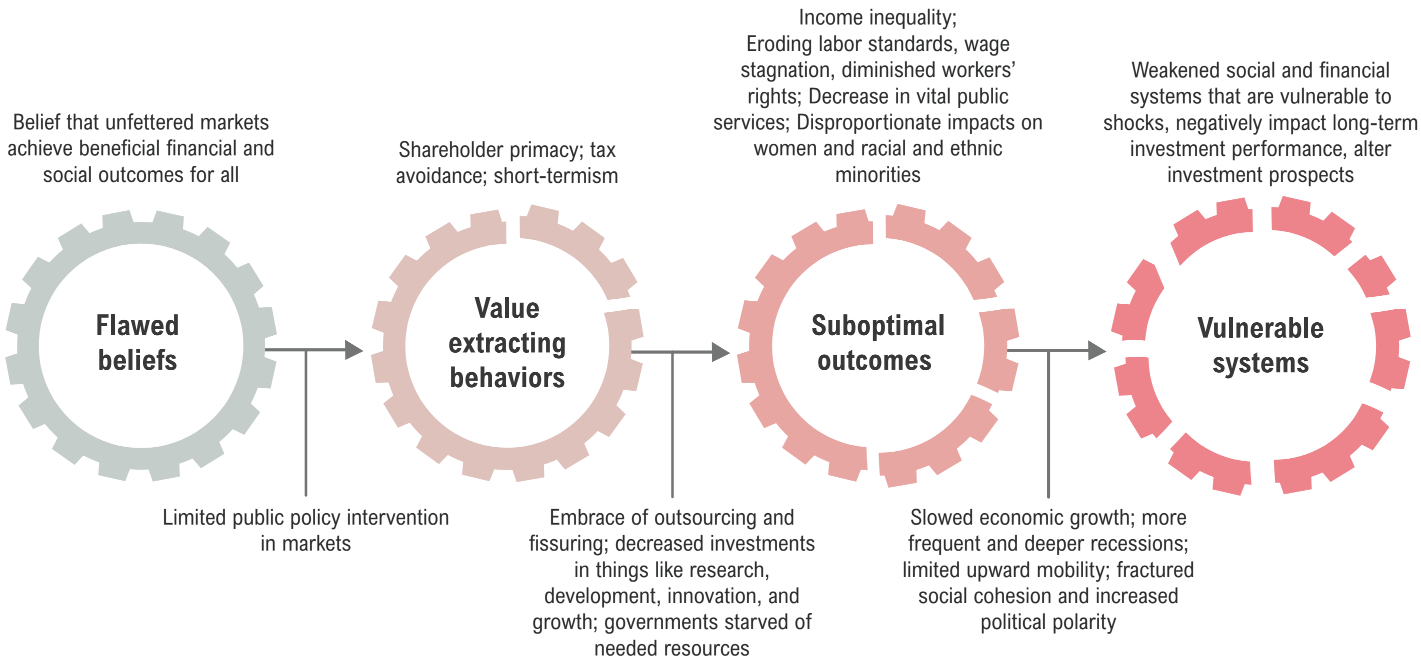
More frequent and deeper recessions



Prolonged periods of income inequality in advanced economies played a substantial role in the global financial crisis in 2008. It led to an intensification of leverage and overextension of credit against a backdrop of declining mortgage underwriting standards and increased financial deregulation. The crisis had negative repercussions on labor markets with economic recoveries, hampered by government austerity programs, remaining weak and patchy in certain markets nearly ten years later.[52]

These repercussions from income inequality and its related economic and social impacts can adversely impact investors across asset classes by destabilizing the financial and political systems within which investors operate and changing the risks and opportunities within the universe of investment prospects.[53]

Figure 2. Income inequality: Why does it matter?



The social and economic fallout from the Covid-19 pandemic.

The Covid-19 pandemic has exacerbated racial, ethnic, and gender inequalities including those of income and wealth. It laid bare already weak and vulnerable social and economic systems.

While everyone lived through the same pandemic, it did not affect everyone equally. Racial and ethnic minorities, women, and migrant laborers in many countries are more likely to get sick and die or experience the economic devastation caused by shutdowns.[54] These groups, when they have work, are more likely to be employed in healthcare and other "essential" industries and occupations where they face risks to their health, are poorly paid, are frequently furloughed or laid off, and are less likely to have access to sick leave (paid or unpaid) and health insurance or be able to work remotely.[55] Furthermore, in some places political polarity and fractured social cohesion have undermined individuals' acceptance of science-based public health recommendations, including decisions to wear face coverings and practice social distancing.[56]

In the meantime, stock markets have recovered from their initial sharp declines when the full extent of the pandemic became clear in March, 2020. Large-scale money-policy intervention by central banks contributed to this rebound, but have led to a disconnect between record-high stock prices and extreme lows in economic indicators.[57] Some projections for the ultimate declines in global GDP were as high as 4.5% for 2020, with lower than expected growth throughout 2021.[58]

Investors have, so far, remained fairly insulated from this shock, due in large part to the interventions of central banks and governments. If the burden of the pandemic continues to rest on the poorest in society, it is unlikely that investors will continue to enjoy protection from the long-term economic effects of income inequality.

Key Takeaways

- **Income inequality hollows out the middle–income sectors of society, impacting consumer spending – a main driver of economic growth.**
- **The Covid-19 pandemic has laid bare the systemic vulnerability created and perpetuated by a system that allows income inequality to run rampant.**
- **Income inequality leads to slowed economic growth, reduced educational and upward mobility for poor and middle-income people, deteriorating social cohesion, more frequent and deeper recessions, and increased political polarity. These factors destabilize interconnected social and financial systems and, ultimately, hurt investors' long-term prospects and bottom lines.**

The remainder of this toolkit provides practical recommendations for how investors can address income inequality through action on labor relations, workers' rights, and financial and political equity and how doing so can help them create long-term value and promote systemic stability while still operating profitably and enjoying competitive returns.

Part 2: How investors can address income inequality through action on workers' rights and financial and political equity

C. Extending Conventional Techniques

The Big Idea

Investors can extend conventional portfolio management techniques to address income inequality. These tools include security selection, manager due diligence, engagement with corporations, and transparency about beliefs.

The rising levels of income inequality have the potential to limit upward social mobility, slow economic growth, and shred the fabric of societal cohesion, leading to political polarity, governmental gridlock, nationalistic populism, trade wars, and loss of faith in democratic governments. Acknowledging this, investors should treat this issue as a systemic risk with the potential to harm their long-term returns across asset classes.

Because risks such as this cannot be easily diversified away, these investors would need to take actions that go beyond those traditionally associated with portfolio risk management. We refer to such an approach as system-level investing.

System-level investing helps investors recognize the scope and scale of their impact and influence on environmental, social, and financial systems and guides them in intentionally managing this impact toward the goals of:

- Minimizing long-term systemic risk;
- Capitalizing on related opportunities for long-term value creation; and
- Building resilient systems that support long-term opportunities for profitable investments across all asset classes.

Practically speaking it means extending conventional portfolio management techniques such as security selection, manager due diligence, engagement, and transparency about what drives markets to encompass systemic considerations.

Background on extending conventional techniques

Many investors already have adopted "ESG Integration" as a daily practice, incorporating material environmental, social, and governance factors into security valuation when they deem them material to performance. This is a first step on the road to extending other everyday investment practices to a system level. Taking well-established practices to a system level is relatively straight-forward.

Four areas of practice lend themselves to an extension to system-level considerations.

1. In their public communications, investors can expand the transparency of their beliefs about the financial markets to include their position on the significance, if any in their view, of social and environmental risks to their investments across all asset classes.
2. Investors' security and portfolio risk management techniques can look beyond individual security analysis to assess social and environmental issues that have adverse or positive impacts on entire industries or on stakeholder issues that cut across all industries.

3. Their engagement with corporations can extend beyond the financial implications of social and environmental challenges on the business models or stakeholder relations of individual firms. This extension can lead to engagement with entire industries on systemic challenges with regard to their business models or across industries to systemic impacts on stakeholder relations that cut across most or all industries.
4. Finally, their manager due diligence processes can evolve from assessments of managers' competencies at security- and portfolio-level to encompass that of management of systemic risks and skills.

Table 3 illustrates how these conventional approaches can be extended to system-level investing.

Table 3. Extending conventional investment management techniques to address systemic issues

	Transparency on beliefs	Security valuation and portfolio risk management	Engagement with corporations	Due diligence
Conventional use	Express beliefs about the nature of financial markets, the relationship between risk and reward, the materiality of environmental, social, and governance (ESG) factors, and related topics in public documents.	Include financial factors in security selection and portfolio construction. Incorporate the short-term financial materiality of ESG factors into individual security selection and specific portfolio risk management.	Engage companies when their stock-price performance is subpar relative to peers. Engage when improvement in social and environmental practices can improve the firm's financial performance and stock price.	Assess managers' thoroughness, skills, consistency in style, and performance regarding portfolio management. Incorporate managers' skills in integrating material social and environmental issues as well.
Extension to system levels	In addition, include beliefs about the potential risks and rewards of non-diversifiable social and environmental risks and opportunities for rewards across asset classes.	In addition, incorporate the long-term implications of systemic challenges on entire industries and asset classes in security selection, portfolio construction, and asset allocation.	In addition, extend engagement beyond company-specific engagement on financial or social and environmental concerns to entire industries to raise fundamental issues about business models and stakeholder relations.	In addition, include in due diligence assessments of managers' thoroughness, skills, consistency in style, and performance related to systemic risks and rewards. Extend this due diligence to investment consultants.

Extending conventional techniques to address income inequality

Investors can take initiatives to incorporate income inequality into their investment activities by extending well-established conventional techniques.

Table 4 describes extension of conventional techniques involving transparency on beliefs, security valuation and portfolio risk management, engagement with corporations, and due diligence. Each can be augmented to include a focus on income inequality's systemic impacts in order to manage risks and rewards across all asset classes.

Table 4. Extending conventional investment management approaches to address income inequality.

	Transparency on beliefs	Security valuation and portfolio risk management	Engagement with corporations	Due diligence
For labor issues	Acknowledge that income inequality poses fundamental risks to the economy and political stability, and hence to investments across all asset classes; acknowledge the importance of addressing labor issues in contending with these risks.	Incorporate consideration of labor-related risks relative to the long-term reputational viability and financial performance of entire industries (e.g., child and bonded labor in the apparel industry; labor practices in agricultural producers' supply chains).	Form, participate or otherwise leverage global coalitions of investors to engage whole industries on the financial and reputational risks posed to their business models and stakeholder relations with regards to labor and employee relations.	Assess managers' ability to contend with employee relations and labor issues, specifically with relation to income inequality. Identify financial consultants capable of selecting managers attuned to these issues.

Key Takeaways

- Taking well-established conventional techniques to a system level is relatively straightforward and allows investors to address income inequality through familiar processes.
- Investors must decide if extending conventional investment practices to a system level is an appropriate strategy to address income inequality.
- Investors can incorporate addressing income inequality into their strategies by extending conventional investing techniques such as portfolio construction, engagement, manager due diligence, and policies and beliefs about the functioning of markets to system levels.

The remainder of this toolkit outlines how investors can use system-level investing to help reduce income inequality through action on labor relations and workers' rights, and financial and political equity. It discusses how they can use several additional techniques at their disposal particularly effective within specific asset classes.

D: Leveraging advanced techniques

The Big Idea

Investors can utilize advanced techniques designed to create system-level impact to address income inequality. These tools fall into three categories: field building, investment enhancement, and opportunity generation.

Income inequality creates systemic risks in society: slowing economic growth, fracturing social cohesion, limiting upward mobility, and leading to frequent and deeper recessions. These social, financial, and economic risks cannot be simply diversified away and pose a direct threat to long-term returns across all asset classes.

Therefore, investors must adopt system-level investing techniques. Utilizing such practices will enable investors to minimize long-term systemic risks, capitalize on opportunities for long-term value creation, and enhance resilient systems that benefit long-term investment opportunities across all asset classes.

This means use of more advanced techniques designed specifically with system-level impact in mind in order to influence the rules of the game and the culture within which the investment community operates. Doing so serves to mitigate risks and maximize potential rewards that have an impact on the whole system. These approaches can be broadly categorized as field building, investment enhancement, and opportunity generation.

A system-level approach serves to complement security and portfolio risk management. Practitioners balance short-term returns with long-term value creation, private market influence with adjustments to public policy, and self-interest as a motivation with the intention to create public good.

To do so there are ten techniques that investors have at their disposal to exercise influence at key leverage points within a system. These ten techniques help investors concerned with systemic risks collaborate through peer-to-peer organizations, increase communications within the financial community and more. They help investors influence public policies relating to systemic risks, set broad industry level and cross-cutting, issue-specific standards and norms, create solutions that eliminate systemic risks, apply pressure at multiple leverage points within systems, and devise financial products with social and environmental criteria built into their structure. These techniques also serve to help coordinate investments within local systems, measure inherent systemic worth, and use the tools of finance and asset allocation to enhance the societal and environmental goods for which they were designed.

Background on advanced techniques

Investors can adopt advanced techniques not typically part of conventional practice to manage systemic risks and rewards. These are techniques explicitly designed to influence social and environmental systemic risks and rewards. They can help prevent undesirable outcomes impacting all asset classes from occurring in the first place, rather than forcing investors to confront them after they occur. They focus on building a base from which to exercise influence, applying leverage at key points within dynamic systems, and strengthening elements of social, financial, and environmental systems.

These techniques can be grouped in three broad categories: field-building, investment enhancement, and opportunity generation described below.

▶ Field-building: Creating a base

Investors can use field-building tools to strengthen a base from which they can act to contend with social and environmental challenges, increase their communications in regards to these issues, and help set rules of the game that facilitate their ability to act to protect their assets from these risks and create opportunities to identify system-level rewards.

Using these techniques, investors can build a base for needed collaborative initiatives, because no one investor can influence systems alone. They can share knowledge about the complexities of environmental, social, and financial systems and systemic issues, because communication is essential to building the trust and the aligning of interests necessary to avoid a "tragedy of the commons." They can also call attention to those public policy debates that play a crucial role in setting ground-rules that enhance their ability to manage systemic social and environmental risks and rewards.

There are three field-building techniques: Self-organization, Interconnectedness, and Polity.

Self-organization:	Interconnectedness:	Polity:
Investors participate in or create collaborative organizations that can act across the investment landscape to build the capacity to address social and environmental systemic issues and strengthen their resilience.	Investors increase the flow of information and communication about social, financial, and environmental systems among peers, with clients, and with the public at large to build the trust and increase the alignment necessary for shared goals and collaborative action.	Investors call attention to public policy debates about governmental rules and regulations that can positively or negatively impact their exposure to risks at environmental, social, and financial system levels.

▶ Investment enhancement: Exercising leverage

Investors can enhance the power of investment to exercise leverage within social and environmental systems. This leverage can be exercised through financial product-design, solutions-oriented business models, and multi-pronged strategies. Through these techniques that enhance the power of their leverage, investors can influence norms and standards that change systems' dynamics at the industry or cross-cutting-issue level so as to generate positive outcomes from the outset.

They can promote business models that solve systemic challenges entirely rather than profit from continued existence. They can adopt simultaneous multi-pronged strategies to align disparate elements of a system with commonly shared, positive, social or environmental impacts.

There are three investment enhancement techniques: Standards Setting, Solutions, and Diversity of approach.

Standards Setting:	Solutions:	Diversity of approach:
Investors establish standards and norms that provide the basis for engagement or investment/divestment in industries as a whole or with regard to cross-cutting issues.	Investors identify investments that resolve pressing systemic challenges entirely, rather than profit from their continued existence.	Investors use a diverse range of investment techniques simultaneously at key leverage points within a complex system to maximize their leverage in addressing systemic challenges.

▶ **Opportunity generation: Strengthening systems**

Investors can use their investments to strengthen the social and environmental systems upon which they depend for returns. They can do so through new design in financial products, the incorporation of intangible value of key social and environmental systems, creation of interlocking, mutually supporting local investments, and considering the social purposes for which specific asset classes were created.

Using these techniques, investors can promote changes in the nature of financial product design so as to force a balanced consideration of social and environmental impacts at a system level along with financial return. They can enhance the worth of local investment through support of interrelated networks. They can acknowledge and integrate the inherent value of natural and other intangible capitals into risk management and reward creation. They can take into account the societal purposes for which investment asset classes were created in their asset allocation models to take advantage of these assets' abilities to have systemic impact.

There are four opportunity generation techniques: Additionality, Locality, Evaluations, and Utility.

Additionality:	Evaluations:	Locality:	Utility:
Investors design and participate in the use of financial products that intentionally include addressing systemic challenges in their definition and structure.	Investors look beyond quantifiable price and evaluate inherent worth of systemic intangibles such as natural, social, and human capital.	Investors create interlocking investments in environmental and social systems within a given geographic region to strengthen resilience and value creation.	Investors maximize those societal purposes that each asset class was created to address, doing so as a means of enhancing system-level impact.

We turn now to specific examples of how investors might use advanced techniques to address the risks posed by income inequality and can take steps to increase potential rewards by contending with this challenge.

These examples illustrate a variety of approaches for investors, whether addressing income inequality and related labor and employee challenges for the first time or building on past initiatives. The appeal of those initiatives that build on daily conventional practice lies in the familiarity of the basic techniques themselves. Those that are more advanced may require investors to enter less familiar territory.

Incorporating advanced techniques by asset class

The following section describes how some of the advanced techniques, such as Polity, Additionality, Utility, Solutions, and Standards Setting, can be used to manage income inequality's risks and rewards in the asset classes of public equities, fixed-income, and private markets. Each asset class is designed to meet specific societal needs. Therefore, investors can enhance their impact on income inequality by intentionally capitalizing on those features of each asset class designed to address the societal challenges of inequality. For each of these asset classes, the report focuses on one or two advanced techniques to highlight their potential usefulness. The specific applications of these techniques described below are examples of system-level investment in action.

In practice, the distinction between various techniques occasionally blurs. In addition, other advanced techniques not illustrated here can prove useful for these asset classes. Whatever the particular variation on these system-level approaches, the impact in the end is the same: investors use advanced techniques to manage risks and rewards at the system, as well as the portfolio, level.

- **Public Equities: Polity (Field Building)**

In the asset class of public equities, use of Polity (public policy engagement) is well suited to enhancing investors' influence in addressing the challenges of income inequality. Governments have long served as a primary instrument to protect employees and labor from abuse by corporations. Investors perceiving systemic risks to their equity portfolios due to the risks of income inequality exacerbated by corporate policies and practices may understandably wish to turn to government as a particularly effective means of addressing abuses contributing to these risks.

<table>
<tr><th colspan="3">Public equities</th></tr>
<tr><th>Definition</th><th colspan="2">Techniques and corresponding actions</th></tr>
<tr><td>Ownership of stocks in large firms traded on regulated public exchanges</td><td>Polity
(Field Building)</td><td>Demand governments and corporations utilize their ability and influence to address:
◆ Inadequate pay and pay inequity;
◆ Lack of representation of women and historically underrepresented groups on corporate boards and in executive and managerial positions; and
◆ Insufficient labor-related data and disclosures.</td></tr>
</table>

Background

Public equities represent owners' shares of large corporations traded on publicly regulated exchanges. For decades, governments have seen a compelling public interest in the regulation of these exchanges and the mandated disclosure by firms traded on these exchanges of information deemed material to investors. Regulators have also taken the position that there is public interest in granting shareholders access to management on matters of corporate governance material to their investments.

In public equities, investors can use Polity (acknowledgement of public policy implications) due to the high visibility of public exchanges and the companies traded on them. In doing so, they acknowledge and build on the fact that government regulation is essential for the transparent, honest, and efficient functioning of these exchanges, along with the access and influence that a share of ownership in these firms provides.

The challenge and opportunity

In recent decades, investors have often been told to avoid considerations of political issues with social and environmental implications. Regulation protects shareholders and beneficiaries from conflicts of interest that place managers' personal considerations—be they financial or political—above their financial obligations to beneficiaries. It is therefore crucial that investors believing that income inequality poses a systemic risk be able to demonstrate that:

- **The dangers of income inequality are widely recognized, including its tendency to lead to a form of populist nationalism that can result in isolationism, trade wars, and geopolitical instability.**
- **Systemic risks like income inequality and their consequences have the potential to negatively impact economies and paralyze government's ability to act with implications for financial performance across all asset classes.**
- **As investors, they have the resources and skills to take actions that would reduce the systemic risks arising from income inequality and therefore have an interest in managing those risks.**
- **Their current portfolio risk-management techniques are insufficient to the risk management of income inequality at a system level and therefore they need additional tools to be effective in this endeavor.**

Definitions of the duties of investors as fiduciaries when it comes to social and environmental matters differ from country to country. In a wide-ranging 2020 survey of fiduciary duty across multiple jurisdictions, the Principles for Responsible Investment (PRI) concluded that, when ESG issues were material to security valuations, "Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty."[59] As of the writing of this paper, Freshfields, Bruckhaus, Dering (authors of the original 'Freshfields report') have been engaged by PRI, UNEP FI, and the Generation Foundation to conduct a legal analysis of investors' obligations with regard to impact. Specifically, the extent to which investors are required or permitted to take action to manage the social and environmental impact of their investments. In 2020, the U.K. Financial Reporting Council issued guidelines stating the consideration of systemic risks such as climate change was appropriate in investors' role as stewards of assets.[60]

Opportunities for action through Polity (Field Building)

Investors can use Polity to manage the systemic risks and rewards of income inequality and equity in the context of their investment decision-making. Three key leverage points on which they might usefully focus are the following:

- ***Compensation, workers' rights, and modern-day slavery.*** Addressing risks in these areas can build workforce and supply chain resilience, prevent reputational risks, and counteract excessive income inequality.
- ***Women and historically underrepresented groups.*** These key components of the workforce suffer disproportionately due to lack of opportunity in hiring, mentoring, advancement, and wage gaps relative to their male peers. Equitable representation of women and underrepresented groups on Boards and in top management along with closing the wage gaps that these groups frequently endure can ensure that corporations and other investment opportunities capture the full value that these groups can provide and mitigate the disruptive social dynamics that discriminatory policies can have within corporations and in society more generally.
- ***Mandated disclosure of material data.*** The availability of material information for investors in their decision-making has been a public policy objective for decades because of its ability to enhance financial markets' efficient functioning and the effective allocation of assets. To date, comprehensive data related to assessing workforce practices and policies have not been available, with the exception of that for French firms. The absence of comprehensive workforce data can handicap investors in their stock picking, industry weightings, and asset allocations. Although data does not guarantee that action will follow, it is a prerequisite for reasoned investment decision-making and related activities.

The following are examples of actions using Polity, an advanced tool in the implementation of system-level investment, that investors might consider in exercising influence at these key leverage points.

1. Support calls for fair compensation and a living wage.

The principle of government-mandated minimum wages is well-established. When such minimums are not sufficient to lift workers out of poverty and address basic needs, investors concerned about the systemic risks posed by income inequality can engage companies on what constitutes a living wage. An informed discussion of this issue between investors and companies helps inform public awareness of the issue and ongoing debates as to the need for upward revisions in minimum wage regulations. In addition, living wage calculations can amplify the voice of workers at specific firms or industries when wage issues are on the table, whether through collective bargaining or less formal negotiations. Investors can lend support to the concept of a living wage as a best practice in contending with this driving factor in the risks of income inequality.

The Platform Living Wage Financials (PLWF) is a collaborative effort of fifteen financial institutions with more than $3 trillion in assets that encourages companies using manual labor (e.g., garment and footwear, food, and beverage) to pay workers a living wage that enables them, at minimum, to cover basic living expenses in accordance with International Labour Organization (ILO), OECD, and U.N. guidelines and principles. Recognizing that living wages are a systemic issue, the PLWF investor members identify and highlight companies with best practices and encourage progress in consideration of this issue throughout entire industries.[61] In 2019, the PRI singled out the PLWF for praise for this active ownership project, which has led to various firms incorporating living wage policies into their management practices.[62]

2. Support efforts to ensure that corporations take appropriate responsibility for rooting out abusive and illegal employment practices in their supply chains, as well as the implementation of workers' rights to address these issues.

To avoid shouldering the expense of competitive wages and benefits for their in-house employees, large corporations often outsource services to vendors paying minimal wages and benefits and with poor working conditions. Investors can urge large, publicly traded corporations to address calls by workers within these supply chains to pressure their vendors to improve their pay and working conditions.

In addition, bonded and child labor are too often embedded in corporate supply chains. Investors have long participated in coalitions to set voluntary industry standards at company and industry levels. These voluntary standards have addressed working conditions in industries as varied as electronic goods, apparel and footwear, and agricultural and seafood products, among others. Despite these efforts, many cases of abuse persist. Investors can support calls for additional regulation and enforcement based on enhanced workers' rights to address these challenges and their impact on excessive income inequality.

The Coalition of Immokalee Workers' (CIW) Fair Food Program demonstrates the positive impact that workers can have on improving their working conditions when empowered to do so. After an extended confrontation with major publicly traded corporations, it won increases in the pay for agricultural farm workers in Florida.[63] In addition, the program's human rights and working conditions guidelines are designed, monitored, and enforced by the farmworkers themselves in partnership with farmers and retail food companies.[64]

In 2011, the U.K. passed the Modern Slavery Act of 2015. This legislation requires large U.K.-based companies to publish an annual slavery and trafficking statement detailing their management of human tracking, forced labor, labor standards, and health and safety measurements throughout supply chains. This data has the potential to lend strength to investors' call for company-specific improvements or governmental legal action, both of which can help reinforce norms in addressing these challenges.[65]

In addition, as of 2020, the European Union was considering proposed Human Rights Due Diligence Legislation that would require companies to conduct human rights due diligence as part of their standard processes or be subject to sanctions.[66] In 2020, the Principles for Responsible Investment embarked on a four-year initiative to ensure all its signatories align their policies and practices with those of the United Nations Guiding Principles on Business and Human Rights.[67]

3. Endorse and advocate for corporate governance practices that ensure boards adequately consider the needs, rights, and perspectives of workers at all levels when setting compensation and benefits policies.

Publicly traded corporations in the U.S. typically have Board-level committees that oversee executive compensation, and shareholders have the right to a non-binding vote on these compensation schemes at least once every three years. Given the importance of the long-term value that employees add to corporations, Boards should consider compensation and benefits policies at all levels of the firm as well as the implications of their corporation's decisions to outsource janitorial, food, security, and other basic services that could otherwise be part of the company's payroll as driving factors in the exacerbation of income inequality.

Investors can urge companies to require existing corporate compensation committees to expand their consideration of the firm's overall policies with regard to employees' pay and benefits beyond those of the CEO. Inadequate paid leave policies in times of crisis, for example, can force employees to deplete limited savings or go into debt. Failure to provide any pension benefits to workers living too close to the margin to set aside retirement savings can undercut their long-term ability to accumulate wealth sufficient for retirement. Inadequate benefits combined with low-wage jobs create a fragility in the workforce damaging to companies when facing external shocks and, more generally, to society's ability to function smoothly.[68] Similarly, investors can ask that Boards in the U.S. be expected to have an employee-relations or labor expert on its Compensation Committee, just as they now must have a financial expert on Audit Committees.[69]

4. Endorse corporate governance policies that prioritize the representation of women and underrepresented groups on corporate boards and top management.

Since the 1970s, investors have raised concerns about inadequate representation of women and historically underrepresented groups on corporate Boards of Directors and top management. For years progress in addressing these concerns was slow.

In the absence of adequate corporate action on Board representation, several countries around the world have established national mandates. In 2003, Norway was the first to pass a law requiring publicly listed companies to have at least 40% of board seats held by women. Italy, France, Germany, Belgium, Pakistan, Israel, India, and Spain have recently enacted board representation laws as well.[70] In the U.S., in 2018, California became the first state to pass a board diversity requirement, although it is being contested in the courts to date. Illinois and Washington have followed suit, passing their own Board diversity laws.[71]

In countries without such board representation mandates, investors have joined the efforts of groups like the 30% Club—a global campaign led by corporate executives and board members focused on increasing gender diversity in corporate leadership. It has set a target of "at least 30% representation of all women on all boards and C-suites globally." The Club maintains the investment case for diverse boards and senior management teams and contends that diverse and inclusive workplaces help to increase innovation, attract and retain talent, and enhance companies' reputations.[72]

5. Support pay equity.

Over the years, investors have raised persistent concerns about the gap between the compensation of women and underrepresented groups and that of their male counterparts. The legal principle of equal pay for equal work is well-established, although abuses persist. In addition, a number of other factors create a more general gap between men's wages and those of women. These include discrimination in advancement, female dominated professions' tendency to be poorly paid, and expectations that women will be the primary caregivers and therefore work part time, among others. Progress on this key aspect of income inequality has been slow. Mandatory disclosure of comprehensive, standardized data on these gaps helps determine the drivers of these discrepancies.

In 2017, the United Kingdom required companies with more than 250 employees to report on and publish their employee pay gaps each year. Companies must disclose the disparities in hourly, bonus, and overall pay between men and women. The U.K. government enforces these mandates and failure to comply can result in legal action and fines.[73] In 2019, 100% of these companies with over 250 employees reported this data to the U.K. government, with the gender pay gap for all workers falling from 17.4% in 2019 to 15.5% in 2020.[74]

6. Advocate comprehensive, mandatory, standardized disclosure of labor-related data.

As investors become increasingly concerned about the systemic risk posed by excessive income inequality, they have joined in calls for comprehensive disclosure of corporations' workforce policies and practices. Investors can continue to support this growing number of initiatives. This data can, in turn, help them assess company-specific risks as well as provide indications of some principle sources of the systemic risks of income inequality.

Although availability does not guarantee that data will be put to use by investors, it is a prerequisite for informed investment decision-making as well as for investors' ability to engage with corporations specifically or set norms and standards in the aggregate.

The UAW Retiree Medical Benefits Trusts' Human Capital Management Coalition, supported by 32 institutional investors with $6 trillion in assets under management, petitioned the Securities and Exchange Commission in 2017 to require companies to disclosure human capital management policies and practices, asserting that such disclosures are "fundamental to human capital analysis." These policies and practices included workforce culture and empowerment, workforce health and safety, human rights, and workforce compensation and incentives.[75]

The Committee for Workers' Capital, a coalition of global unions, has developed "Guidelines for the Evaluation of Workers Human Rights and Labor Standards" for use by investors.[76]

The Workforce Disclosure Initiative, a coalition of 49 institutions with $6.5 trillion in assets, surveys corporations on their employment policies and records and makes this data available to investors.[77]

Since 1977, France has required companies with more than 300 employees to complete a "bilan social" (societal balance sheet), which includes comprehensive data on employment policies and performance. These reports are filed with the firm's work councils and unions and are in turn available to the public.[78]

An August 2019 Business Roundtable statement signed by 181 chief executive officers has rekindled the public debate about whether corporate managers are obliged to reward stockowners first and foremost or should invest substantially in other stakeholders, including employees. In rekindling this long-standing debate between the primacy of a stockowner or stakeholder model of the corporation, the BRT has raised again for consideration by investors the question of the degree to which corporate investments in employees are or are not more likely than distribution of profits to stockowners to contribute to a company's long-term value creation and stock price appreciation and what constitutes an appropriate balance between the two forms of investment of their excess earnings.

- **Fixed income: Additionality and Utility (Opportunity Generation)**

In fixed income, the techniques of Additionality and Utility are well suited to expanding the opportunities for investors to use elements of this asset class to generate new and additional investment vehicles that target projects addressing financial and social equity and to intentionally use specific types of bonds already designed to address such concerns.

Bonds are flexible instruments that can be customized to investors' needs. The emergence of the "green," "sustainable," and "social" or "pandemic" bond markets demonstrates that flexibility. In addition, governmental bonds specifically supporting affordable housing, small business development, and urban and rural, social and environmental infrastructure can ameliorate societal inequalities that directly and indirectly impact income and financial well-being.

Fixed income		
Definition	**Techniques and corresponding actions**	
Fixed-income products	Additionality (Opportunity Generation)	• Support the development of the emerging market for "social bonds."[2]
	Utility (Opportunity Generation)	• Fixed-income as an asset class can directly address affordable housing, job creation, municipal infrastructures and other contributions to workers' financial well-being.

[2] The term "social bonds" refers here to traditional bonds that allocate investors' funds to specific types of projects with well-defined societal benefits and pay a predetermined coupon. It does not include "pay-for-performance" contracts that are sometimes referred to as "social impact bonds," which are designed to pay out when certain social goals are met.

Background

Fixed-income markets make up a broad asset class offering many types of securities and tools for financial risk management. Bonds are the primary traditional investment vehicle in this asset class, with governmental bonds accounting for 68% of the market.[79] Bonds issued by governmental, quasi-governmental, and civil society organizations provide existing opportunities for addressing income inequality through enhancing financial equity for the working public in both the public and private sectors. Bonds can also capitalize on the flexibility of their market to create new structures for fixed-income vehicles in response to investor demand for more such opportunities.

In fixed income, investors can use Additionality (integration of social and environmental considerations into the structure of new financial products) and Utility (use of the social purpose for which an asset class was created) to take advantage of the inherent ability of bonds issued by governments to create public goods.

Building on the model of the rapidly growing "green bond" market, a re-emerging class of "social bonds" support job retention and pay during crises such as the Covid-19 pandemic, a challenge disproportionally impacting low-wage workers and historically underrepresented groups. In addition, government agency and municipal bonds already offer opportunities to support affordable housing for low- and moderate-income workers, promote job-creating local economic development, invest in local infrastructure, and empower small businesses and those owned by women and underrepresented groups.

The challenge and opportunity

Although some investors neglect bonds to chase higher yields in other asset classes, this staple of the fixed income world has the virtues of the safety, stability, and predictability of returns that once made high-quality bonds the primary holdings in conservatively managed portfolios.

Because most bonds are issued by governments, the creation of public goods is an inherent part of their purpose, unlike that of corporate bonds or stocks. A substantial portion of bonds issued in the United States, for example, contribute to the affordability of the the housing markets. Other government asset-backed securities fund small businesses and farms. These public purposes, as well as the bond market's support for governments' general activities, are often not factored in to asset allocation decisions by fixed-income investors, to the extent that special classes of "green," "sustainable," and "social" bonds have recently emerged to call attention to this ability of the asset class to integrate public goods into its offerings.

Opportunities for action through Additionality

Investors can use Additionality to leverage the ability of the bond market to respond rapidly to customer demand, in this case, for the building of a class of social bonds that specifically meet well-defined principles for the creation of social benefits.

1. Demonstrate consistent demand.

Governments can issue bonds in response to crises, offering investors income while addressing specific, urgent needs. For example, in the wake of the 2008 financial crisis with its high unemployment, the U.S. government issued Build America Bonds to raise capital at the state, municipality, and county levels for public infrastructure projects subsidized by the federal government. Although these bonds were discontinued in 2010, the programs issued over $180 billion of bonds and state and local governments saved $20 billion in borrowing costs.[80]

The Climate Bonds Initiative's *Sustainable Debt: Global State of the Market* estimates that in the first half of 2020 approximately $30 billion in social bonds, $70 billion in pandemic bonds, and $250 billion in green and sustainability bonds came to market.[81] These bonds are frequently oversubscribed, demonstrating their viability in the financial marketplace and encouraging issuers to increase their supply. The fact of demand currently exceeding supply encourages the issuance of addition bonds of these types.

The European Commission established a Support to mitigate Unemployment Risks in an Emergency (SURE) program to address unemployment and other work-related issues caused by the Covid-19 pandemic. SURE issued a series of three "social" bonds totaling €40 billion Euros in October and November of 2020.[82] These bonds were issued under an E.U. SURE Social Bond Framework specifying that the proceeds were to be used to support E.U. member states' spending to keep jobs and to support workers financially, including the self-employed, during the Covid-19 pandemic.[83] Investor demand was high, with the first in the series oversubscribed by 13 times with demand for €233 billion worth of this €17 billion issuance.[84]

2. Join in setting voluntary and governmentally mandated standards.

Investors can play a valuable role in the legitimization and establishment of quality standards for these new classes of bonds. Already the financial community has established principles for the evaluation and certification of green, sustainable, and social bonds. In addition, government regulators, such as those in the European Union, have begun the arduous process of developing their own definitions. Definitions and standards are necessary for these markets to grow to scale.[85]

The International Capital Market Association, a trade association for the financial industry, has established voluntary Social Bond Principles, Green Bond Principles, and Sustainability Bond Guidelines. Its Social Bond Principles specify inclusion of affordable basic infrastructure, access to essential services, affordable housing, employment generation in times of crisis, food security, and socioeconomic advancement and empowerment, particularly for those living below the poverty line and the marginalized, underserved, underemployed, or otherwise vulnerable.[86] A 40-member advisory committee for the development of these principles included 19 financial services firms active in the development of this new class of bonds: five investors, nine issuers, and five underwriters.[87]

Similarly, investors and financial services firms account for approximately half of the 30 members of the Technical Expert Group advising the European Commission on its current development of a green bond standard.[88]

By creating demand and establishing defining principles and standards for social bonds, investors can help bring to scale a new financing mechanism that addresses the challenges of income inequality as part of its investment principles. Doing so also raises the profile of a long-term societal value that fixed-income products can bring.

▶ Opportunities for action through Utility

Investors can take advantage of the often-ignored ability of existing bond offerings to address income inequality through financial equity. Well-developed bond markets already support affordable housing, promote local economic development, empower small businesses and those owned by women and underrepresented groups, fund infrastructure projects, and tackle poverty alleviation, among other things.

3. Incorporate income inequality impact considerations into investors' fixed-income asset allocation decisions.

By intentionally incorporating the ability of currently available bonds to address the long-term systemic risks of income inequality along with traditional risk and rewards considerations, investors can help establish a model fundamentally different from how asset allocation is made today for the fixed-income asset class. Like Additionality, this use of Utility can also help enhance existing demand and thereby drive additional funds to this end.

A large, global market exists for U.S. government agency securities backed by affordable- and low-income housing loans. These mortgage-backed securities are issued by Fannie Mae, Freddie Mae, Ginnie Mae, and other agencies. Because they have the implicit full-faith backing of the U.S. government, they can contribute to lower borrowing costs for those qualifying as low- and affordable-housing purchasers. These bonds can be structured to be backed by mortgages in specific regions, cities, or neighborhoods, fund low-income multi-family housing, or target low-income mortgage holders. Investors with knowledge of these characteristics can target their portfolios toward specific impacts in ways that support the financial equity of the working public.

Foundations such as F.B. Heron put such bonds in their investment portfolios to align with their mission. Mutual fund companies such as Community Capital Management tailor portfolios by region and social and environmental theme to serve customer demand. Banks purchase such bonds that help fulfill their Community Reinvestment Act obligations.[89]

Multilateral development banks (MDBs) are quasi-governmental financial services organizations focused on poverty alleviation and economic development in emerging markets. Eight of these MDBs have jointly developed a set of principles for their financial products, including bonds, some of which are issued with a "social bond" label. These principles (which they describe as guidelines for the "additionality" of their financing efforts) specify, among other things, that their financial initiatives fill market gaps, mitigate market risks, enhance the design and impact of projects, and meet broadly accepted environmental, social, and governance norms.[90] Their bonds, including those qualifying as social bonds, help address income inequality by creating financial equity for low-wage workers and empowering women and small-scale entrepreneurs.

▶ **Private markets: Solutions and Standards Setting (Investment Enhancement)**

In the asset classes that comprise private markets (private equity, private debt, venture capital, infrastructure, real estate, timber and agricultural land, among others), investors can use the techniques of Solutions and Standards Setting to enhance their abilities to create and set norms for best practice in contending with income inequality and related labor issues.

Using Solutions as a strategy investors place funds with entities and projects that have successfully solved the challenges typically faced when confronting labor rights and income inequality. By setting standards in private markets investors can also play a direct role in the establishment of industrywide best practices and norms when it comes to labor rights, the challenges of income inequality, and related concerns.

Private Markets		
Definition	**Techniques and corresponding actions**	
Ownership and debt in privately held for-profit enterprises	Solutions (Investment Enhancement)	• Use investments in private enterprises to directly address the challenges of workers' rights and financial and political equity, individually or in partnership with peers.
	Standards Setting (Investment Enhancement)	• Advocate for and measure progress toward goals relating to workers' rights and financial and political equity.

▶ Background

Private markets include the asset classes of private equity, venture capital, infrastructure, real estate, private debt, and real assets such as timber and agricultural land.[3] Each of these comes with its own variations on the challenges for the abuse or enhancement of labor relations and, hence, opportunities to manage the systemic risks of income inequality. In each, investors can participate as majority owners or general partners of investment funds or as limited partners in such funds. Each of these roles offers opportunities to address income inequality and labor relations.

In private markets, investors can use Solutions (systematic resolution of the social, environmental, and financial risks) and Standards Setting (establishment of social and environmental industry- and issue-specific norms and best practice) to address the systemic risks and enhance rewards in relation to income inequality. Investors have the opportunity to do so directly when they are the ultimate decision-makers as general partners in the firms in which they are invested; as limited partners, they can exercise influence indirectly.

▶ Challenges

A variety of challenges face investors concerned about the systemic risks of income inequality in private markets. These challenges manifest themselves differently across asset classes. In large-scale private equity, issues adversely impacting employees include layoffs, overleveraging, and asset stripping that can destroy long-term firm value. In small-scale "impact" private equity, determining which business models, in fact, offer more than anecdotal solutions to poverty alleviation can be a challenge. In venture capital, business models that depend on the informal, contract labor of the "gig" economy raise labor-related concerns. Infrastructure investments that involve privatization of government-owned enterprises can come at the cost of secure, stable public-sector employment. In the real estate market, subcontracting janitorial, food, and security services can mean that owners shed the responsibility for providing decent wages and benefits for employees that would otherwise be on their payrolls.

3 For the purposes of this report we have focused our treatment of private markets on private equity because of the particular influence equity holders can exercise. Private and commercial debt nevertheless form a significant part of private markets.

▶ **Opportunities for action through Solutions**

Investors can use Solutions to address abuses of labor issues and promote alternative models through their decision-making powers as general or limited partners in funds making these investments.

1. Control of labor and employee relations policies.

Investors in private markets can control labor policies and practices, particularly when they are direct investors in companies or general partners of funds. In real estate, for example, various U.S. investors have established Responsible Contractor Policies (RCP) for those managing the properties in which they have invested.

The Oregon Public Employee Retirement Fund's (OPERF) RCP ensures that contractors provide fair wages and benefits if they plan to bid on construction and building services contracts when the state's pension fund owns a majority stake in real estate or infrastructure assets. Revised in 2020, this policy updates the original 2006 policy, defining a responsible contractor as one who respects labor laws and regulations, participates in state-registered apprenticeship programs and pays standard wages and benefits; this includes employer-paid health coverage and retirement benefits. The policy encourages employers to remain neutral in the event of a union campaign if a majority of workers are covered by collective bargaining agreements then the area wages and benefits should conform to those standards.

In the instance of less than majority ownership in a real estate or infrastructure asset, the policy serves as a non-binding recommendation but is strongly recommended to the manager.[91]

Among large investors that agreed in 2019 to implement RCPs for real estate or infrastructure investments primarily in the U.S. are Allianz Global Investors and BlackRock.[92]

In 2019, the Committee on Workers' Capital (CWC), an international network of unions, initiated an Asset Manager Accountability Initiative to support asset owners wishing to increase asset managers' attention to workers' rights considerations. CWC plans to issue reports on the progress of the current status of the world's largest asset managers on these issues. In October 2020, it published a report on BlackRock. Among its recommendations for BlackRock's private equity investment program were that it improve its project-specific agreements and enforcement in its Responsible Contracting Policy programs for real estate and infrastructure, join the Cleaning Accountability Framework in Australia, and enter into dialogue with global service unions on working conditions and workers' rights in the private nursing industry.[93]

Private equity investors acting as direct owners or general partners can adopt practices that directly address labor issues, thereby setting models for how addressing income inequality can be integrated into private markets generally.

▶ **Opportunities for action through Standards Setting**

Investors that are limited partners in private market funds can use Standards Setting to join with peers to enhance their influence on their general partners in setting standards for best practice in addressing the challenges of income inequality through labor and employee relations.

2. Set private-market industry standards.

Investors in private-market funds can set standards for best practices in managing the systemic risks of income inequality at the fund or asset-class level. These investors have the potential to set industry norms for conduct by fund managers by establishing standards for best practices with regards to labor issues. As noted in the section on the extension of daily conventional techniques, investors can also set standards in their own selection process for external managers, stressing the need for competence in the managing of risks associated with labor issues and income inequality.

In Australia, the Cleaning Accountability Framework (CAF) is a multi-stakeholder coalition of investors (including Australian Super and AMP Capital), unions, real estate developers, facility managers, academic institutions, and the Australian government's Fair Work Ombudsman department. It promotes RCPs that protect the rights of workers providing cleaning services to properties owned by institutional investors. The CAF provides its members, including investors, with a Code of Conduct and a procurement toolkit with industry- and market-specific pricing and quality-of-service benchmarks. To encourage the adoption of the standards, CAF has a certification and rating program for contractors.[94]

IRIS+, the standards-setting body for the Global Impact Investment Network, includes fair labor metrics in its measurement of the impacts of investments in what are often small-scale private equity funds.

These standards draw on those established by the ILO.[95] They include policies on forced labor, freedom of association, worker safety, and employee training.[96]

The U.N.-backed Principles for Responsible Investment has created guides for investors, including limited partners, in alternative investment strategies. Each guide maintains different standards depending on the asset class. Guidelines for real estate list labor standards and working conditions, while those for forestry focuses on labor standards in supply chains; farmland investment highlights paying workers a living wage; and infrastructure emphasizes labor standards.[97] Its private equity guide includes consideration of employee and workplace policies as useful ESG factors.[98]

To tip the scales toward concrete action on income inequality, investors in private markets can encourage and participate in the inclusion of standards-setting on labor and employee issues in the funds and companies in which they are invested. Doing so can help address the risks of excessive income inequality and of weakened workers' rights and financial and political equity.

Key Takeaways

- In the context of publicly traded companies, investors can use the advanced technique of Polity to contribute to crucial public discussions about pay equity and other workers' rights.
- For fixed-income, investors can use the advanced techniques of Additionality and Utility to catalyze the development of new financial products that build income inequality into their design or enhance considerations of the wealth-creating benefits inherent in government-issued securities in their asset allocation.
- In the private markets, investors can use Standards Setting and Solutions to call attention to business models that directly address income inequality challenges, or establish expectations as to best practices on labor relations for entire segments of the financial markets.

Investors must recognize the prominent role government plays in not only addressing income inequality but also other systemic issues. While policymakers set the rules, investors maintain important influence in those decision. Investors, therefore, must use their voice to alleviate the income inequality that exists today.

Conclusion

Unfettered markets, while not the sole cause of income inequality, have been a main driver in widening the gap between the rich and the poor. This gap has only grown in recent years and even more so during the Covid-19 pandemic with its disproportionate impact on ethnic and racial minorities and women. What's more, income inequality can lead to political polarization, paralysis of government, and social instability—all factors that threaten to adversely impact the economy and hence investment opportunities.

Ultimately, income inequality increases the likelihood of unstable systems, adversely impacting investors across all asset classes, jeopardizing portfolios and bottom-lines, hurting long-term investment performance, and changing the risks and opportunities that affect the universe of investment prospects.

Investors have several avenues to address and mitigate income inequality. Using the system-level investing approaches outlined here, they can act collectively to influence the rules by which finance and society play, create financial products with social purpose built in, set standards, seek solutions, and take advantage of advanced and conventional techniques for system-level impact already at hand.

These system-level investing approaches can be tailored to specific asset classes to address the causes of income inequality. Within public equities, Polity draws attention to public policy initiatives to limit the growth of inequality. In fixed income, Utility and Additionally help allocate assets to support workers' financial well-being and an emerging market for "social bonds." Within private markets, Solutions and Standards Setting offer ways to enable systematic resolution of the risks related to income inequality and establish industry and income inequality-specific norms and best practices. Investors have the opportunity to use these techniques to engage individually or collectively with companies to improve workers' rights and financial and political equity as a key point of leverage in addressing income inequality.

If investors ignore these tools and approaches available to them, they risk finding themselves in a more unequal and unstable society with increased economic disruptions and social strife. To support investors in taking on this challenge, this toolkit is the first of two to address how investors can help change the rules of the game along with the investment community's culture and norms to ones that acknowledge systemic risks when they appear on the horizon and act to reduce the potential of their disruptive impacts.

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About TIIP

TIIP. The Investment Integration Project's (TIIP) mission is to help investors understand how healthy environmental, social, and financial systems can benefit their portfolios. TIIP provides thought leadership, research, and consulting services that support investors' pursuit of system-level investing, an advanced sustainable investing approach that focuses on managing systemic risks and investing in solutions to systemic problems. For more information, visit https://www.tiiproject.com.

About Generation Foundation

The Generation Foundation is a UK registered charity and was established alongside Generation Investment Management LLP, the sustainable investment firm founded in 2004. Our mission is to drive the urgent transition to an equitable society in which global temperature rises do not exceed 1.5^{0}C. We operate a proactive grant-making and research programme that focuses on four priority areas: investor climate action; carbon pricing; gender inclusion and empowerment; and action on economic inequality. For further information, please visit www.genfound.org.

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