# Pensions&Investments

THE INTERNATIONAL NEWSPAPER OF MONEY MANAGEMENT | SEPTEMBER 19, 2022 | PIONLINE.COM | $16 AN ISSUE / $350 A YEAR | CRAIN COMMUNICATIONS


Alternatives

## Investors in for rude awakening on alts returns

### Quarter lag muddies picture on fiscal-year performance numbers

By ARLEEN JACOBIUS

Alternative investments proved to be the top-performing sectors in the wild ride of a fiscal year, but bad news is coming when managers report their actual June 30 returns this fall, industry insiders said.

The rosy numbers are not expected to hold. Most investors report alternative investment returns as of a quarter earlier than the rest of the portfolio, and consultants and managers anticipate the actual June 30 data and beyond to reflect significant write-downs across private markets.

For example, real estate investors expect total returns to plunge to 4.4% in calendar year 2023 from an estimated 8.8% in 2022, according to the results of the Pension Real Estate Association's third-quarter consensus forecast survey of the U.S. commercial real estate market, released Sept. 13. The appreciation return of the NCREIF Property Index, reflecting property values, is expected to plummet to 0.1% in 2023 from 4.7% in 2022.

**LOSSES:** Allan Emkin predicted private market assets will see write-downs the next few quarters.

The issue all stems from an anomaly in the reporting. Many institutional investors close their investment books for the fiscal years ended June 30 in July, months before their alternative investment managers have turned in their returns for those periods. So, investors' fiscal-year returns include returns from alternatives — ranging from private equity and private credit to real estate and infrastructure — that are lagged behind by a quarter while still reporting public markets as of June 30.

With stocks and bonds taking a beating in the second half of the fiscal year, alternative investments actually reported as of March 31 looked pretty good. But industry executives warn that private markets assets are not invulnerable to the downturn in markets.

"One piece of bad news" is that private market assets will be repriced, Allan Emkin, San Diego-based managing principal of Meketa Investment Group, told CalSTRS' investment committee on Aug. 31.

In the next three or four quarters, there will be write-downs in private market assets to reflect what has

SEE **ALTERNATIVES** ON PAGE 28

SPECIAL REPORT: HEDGE FUNDS

## Managers see growth in year ended June 30

By CHRISTINE WILLIAMSON

Hedge fund managers found themselves in two very different environments over the year ended June 30 with fairly benign market conditions in the second half of 2021 that benefited long/short equity and long-biased strategies.

But given expectations of rising inflation, higher interest rates and slower economic growth, hedge fund managers were forced to do a 180 halfway through the year and write new playbooks, shift to new strategies and deal with inquiries and allocations from investors looking to hedge funds for diversification, industry sources said.


**MORE ON HEDGE FUNDS**

- Global upheaval puts macro funds in spotlight. **Page 14**
- Hedge funds are pursuing ESG in unique ways. **Page 16**
- Hedge funds serving as odd pairing with ETFs. **Page 19**
- For the full report, go to **Pionline.com/hedgefunds22**


Despite tough market conditions and declines in some firms' assets, the 102 hedge fund managers that participated in *Pensions & Investments'* 13th annual survey had aggregate worldwide assets under management of $1.44 trillion in the year ended June 30.

That's up 8.3% compared to the hedge fund universe total of $1.33 trillion as of June 30, 2021.

By another measure, the worldwide AUM of the 73 hedge fund firms that participated in *P&I*'s survey in 2022 and 2021 was up 6% to $1.24 trillion for the year ended June 30.

SEE **GROWTH** ON PAGE 18

David Paul Morris/Bloomberg

ESG

## Investors dive into financial risks of water, scarcity

### Global water demand projected to exceed supply by 56% by 2030

By HAZEL BRADFORD

One year ago, a coalition of institutional investors launched a task force to drive corporate action on water-related financial risks, seeking better disclosure and water risk management.

This year, coalition members are no longer waiting patiently. Instead, they are taking their message straight to some of the world's biggest corporate users of water.

On Aug. 16, 64 institutional investors with a collective $9.8 trillion in assets helped to launch the Valuing Water Finance Initiative, coordinated by shareholder advocacy group Ceres and the government of the Netherlands.

Pension fund members include the $444.4 billion California Public Employees' Retirement System, Sacramento; $311.7 billion California State Teachers' Retirement System, West Sacramento; the A$261 billion ($177.6 billion) AustralianSuper, Melbourne; the U.K.'s Environment Agency Pension Fund and Local Authority Pension Fund Forum; and 2.1 trillion rand ($123.4 billion) Government Employees

SEE **WATER** ON PAGE 30

Defined Contribution

## Biden's student loan relief could help boost retirement savings

By COURTNEY DEGEN

The White House's new plan for student loan forgiveness could lead to increased savings in retirement plans, experts said, but the issue of student loan debt isn't going away any time soon.

"This loan forgiveness (is) very helpful for a lot of people, but it doesn't solve the burden of student debt," said Kirsten Hunter Peterson, Boston-based vice president of workplace thought leadership at Fidelity Investments. "For many borrowers it's really just a minor dent in their balance."

Announced by the Biden administration on Aug. 24, the plan promises to cancel up to $20,000 in debt for Pell Grant recipients and up to $10,000 for non-Pell Grant recipients. Eligibility is limited to individuals making less than $125,000 per year,

SEE **FORGIVENESS** ON PAGE 25

**HIGH BALANCES:** Kirsten Hunter Peterson said student debt is still a burden for many because of how much they've had to borrow.

**SOUND BITE**

TIAA-CREF'S **ELENA ZANUSSI** on the growing use of non-qualified DC plans: 'It's **a really different hiring environment** than what we've seen in 30 years.' **Page 4**

## IBM offloads pension liabilities

IBM purchased annuities to transfer $16 billion in liabilities, the largest pension risk transfer transaction in the U.S. in a decade. **Page 4**

## IN THIS ISSUE

VOLUME 50, NUMBER 18


### Courts
Cintas petitioned the Supreme Court to end confusion over whether ERISA cases should be handled in court or by arbitration. **Page 6**

### Defined contribution
To woo executives, employers are debuting non-qualified plans to help executives pad their retirement savings beyond their 401(k) plans. **Page 4**

ERISA lawsuits criticizing a BlackRock target-date series, if successful, could encourage performance-chasing. **Page 23**

### Exchange-traded funds
Hedge funds and exchange-traded funds have a complicated relationship. **Page 19**

### Pension risk transfer
IBM purchased annuities to transfer a total of $16 billion in U.S. pension liabilities, the largest pension risk transfer transaction in a decade. **Page 4**

### Regulation
Wells Fargo & Co. agreed to settle a Department of Labor investigation that found the company overpaid for company stock for its 401(k) plan. **Page 29**


### Departments


At deadline ....28
By the numbers ....12
Changes ahead ....31
Classified ....24
ETFs ....19
ESG roundup ....20
Frontlines ....8
Hirings ....22
Other views ....10
RFPs ....24


### DC strategies, index manager surveys in progress

*Pensions & Investments* is accepting late responses to the annual survey of **defined contribution strategies**. Firms managing proprietary mutual funds, ETFs or target-date strategies for U.S. institutional, tax-exempt DC plans are eligible. Results will run Oct. 17.

Responses to *P&I's* annual survey of **index mangers** are due Oct. 7. Firms managing index strategies — including passive, enhanced, ETFs/ETNs and factor based — for U.S. institutional, tax-exempt investors are eligible. Results will run Nov. 14.

To request a survey or obtain further information, please contact Anthony Scuderi at **ascuderi@pionline.com** or 212-210-0140, or visit **www.pionline.com/section/surveys.**

Entire contents ©2022 Crain Communications Inc. All rights reserved.
*Pensions & Investments* (ISSN 1050-4974) is published the first and third weeks in June, July and September; the second and fourth weeks in January, February, March, April, May and November; the first and fourth weeks in August; the first, third and fifth weeks in October; and the second week in December by Crain Communications Inc., 130 E. Randolph St., Suite 3200, Chicago, Ill. 60601. Periodicals postage paid at Chicago, Ill., and at additional mailing offices. Postmaster: Send address changes to Pensions & Investments, Circulation Dept., 1155 Gratiot Avenue, Detroit, Mich. 48207-2912. $16 per issue; $350 per year in the U.S.; $375 per year in Canada; all other countries $475. "Canadian Post International Publications Mail Product (Canadian Distribution) Sales Agreement No. 0293539" GST #136760444. Printed in U.S.A.

CRAIN COMMUNICATIONS

**Keith E. Crain**, Chairman
**Mary Kay Crain**, Vice Chairman
**KC Crain**, President & CEO
**Chris Crain**, Senior Executive Vice President
**Bob Recchia**, Chief Financial Officer

**G.D. Crain Jr.**, Founder (1885-1973)
**Mrs. G.D. Crain Jr.**, Chairman (1911-1996)

**Published semi-monthly by Crain Communications Inc.**
**Chicago offices:** 130 E. Randolph St., Suite 3200, 60601
**London offices:** 11 Ironmonger Lane, EC2V 8EY
**New York offices:** 685 Third Ave., 10th Floor, 10017

Address all subscription correspondence to Pensions & Investments, 1155 Gratiot Ave., Detroit, Mich. 48207-2732 or email customerservice@pionline.com.

www.pionline.com

**Economy**

# 75-point hike from Fed seen as a certainty

### But many other economic factors, like inflation, still up in air for market participants

By **PALASH GHOSH**

Markets overwhelmingly expect the Federal Reserve to raise the fed funds rate by another 75 basis points at the Federal Open Market Committee's Sept. 20-21 meeting — following similar hikes in the benchmark rate in June and July — in an effort to tamp down inflation.

Indeed, according to CME Group's FedWatch tool, as of Sept. 16, market participants' pricing of fed fund futures indicates there is a 84% probability that the Fed will increase rates by 75 basis points at the next meeting, and a 16% probability it will increase rates by 100 basis points.

Moreover, the disappointing inflation report on Sept. 13 — the Bureau of Labor Statistics said the consumer price index increased 8.3% from a year ago in August, compared with economists' expectations of an 8.1% rise — will likely give more ammunition to Fed hawks seeking to continue monetary tightening.

Cheryl Smith, Boston-based economist and portfolio manager at Trillium Asset Management, said this report will pose "a strong headwind for stocks and (be) bearish for

SEE **FED FUNDS** ON PAGE 29

Cody O'Loughlin

**MORE INCREASES:** Cheryl Smith expects the Fed to raise rates by at least half a point in November.

**Exchange-Traded Funds**

# 2 Texas funds' iShares ETFs not on divest list

### Pension plans should be able to keep those funds despite state's feud with BlackRock

By **KATHIE O'DONNELL**

Two big Texas retirement systems between them held iShares exchange-traded fund investments totaling about $436 million, 13F holdings reports show, and, despite Texas officials' feud with BlackRock Inc., it doesn't look like they'll be required to divest those holdings, assuming they still have them.

BlackRock, the world's largest money manager and the provider of iShares ETFs, was included on Texas Comptroller Glenn Hegar's list of financial companies that boycott energy companies, which he announced in an Aug. 24 news release.

Mr. Hegar was required to prepare the list in accordance with Senate Bill 13, which became law in September 2021. Listed companies are subject to the divestment provisions included in Texas Government Code Chapter 809, which, as the release noted, defines a financial company as a publicly traded financial services, banking or investment company.

The environmental, social and governance investing movement has produced a system in which some financial companies have stopped making decisions that are in the best interests of their shareholders or clients, but instead use their "financial clout" to push a social and political agenda cloaked in secrecy, Mr. Hegar said in the release.

However, Mr. Hegar wasn't the only one to detect a whiff of politics.

"Let's be honest: This is entirely performative," said Dave Nadig, a Lenox, Mass.-based financial futurist at VettaFi LLC, a data and analytics provider, of the law. "This won't make one bit of difference in the valuation of any energy company, and it won't put one more well in the ground, but I'm sure it makes for great fundraising."

State governmental entities subject to the divestment requirements include the $184.4 billion Teacher Retirement System of Texas and the $33 billion Employees Retirement System of Texas, both based in Austin. According to their 13F reports filed with the Securities and Exchange Commission for the quarter ended June 30, TRS and ERS held roughly $436 million worth of investments in iShares ETFs and $32.4 million of BlackRock stock between them.

SEE **TEXAS** ON PAGE 26

**Regulation**

# Industry gears up for T+1 settlement but needs SEC clarity

By **BRIAN CROCE**

Accelerating the U.S. securities settlement cycle is all but certain to happen in 2024, but to make sure the transition happens without a hitch, months of planning and testing are required, and industry leaders say clarity from the Securities and Exchange Commission is needed sooner rather than later.

"It's hard to set a testing schedule when you don't know the implementation date," said Joanne Kane, Washington-based chief industry operations officer at the Investment Company Institute, an association of regulated funds including mutual funds, exchange-traded funds and closed-end funds. "The sooner that the SEC can either give us an indication of the date or give us the final rule, the better."

ICI, the Securities Industry and Financial Markets Association and the Depository Trust and Clearing Corp. published in August an "industry implementation playbook" on shortening the settlement cycle to T+1 — settling a trade one business day after it is executed — from T+2, or two business days.

Thomas F. Price, New York-based managing director of technology, operations and business continuity at SIFMA, a trade group that represents securities firms, banks and money management companies, said the move to T+1 will be beneficial to the entire securities settlement ecosystem, including large asset owners and managers.

"All of those trades executing and settling in a shortened period of time really reduces risk ... that has to give, I would think, managers and pension plans a lot more comfort that there's a community effort to continue to reduce the risk," Mr. Price said. "Risk is the square root of time. The quicker you can reduce that period between trade and settlement, you're in effect reducing risk in the system."

Industry groups have been pushing for a move to T+1 for years and in February, the SEC issued a proposal to do just that. But while the proposal's comment period closed in April, the commission has yet to issue a final rule to let stakeholders know

SEE **T+1** ON PAGE 27

**IN LIMBO:** Joanne Kane cited the need for an implementation date to best prepare for the transition.

Money Management

# New U.K. leader's policies keeping managers on guard

Prime Minister Liz Truss plans to cap energy prices and also wants to cut taxes

By SOPHIE BAKER

The U.K.'s new prime minister, Liz Truss, has her work cut out for her: Not only is she taking over leadership of the government at a time when citizens and businesses are facing an unprecedented cost-of-living crisis due, in part, to rising energy prices, but she's also still dealing with runaway inflation and the fallout of Brexit.

And while she's working to address these issues, global money managers are worried her policies may hurt bond markets and the country's currency, have only a limited impact on rising inflation and fail to halt a looming recession.

Ms. Truss was appointed on Sept. 6 after a leadership contest following the resignation of former leader of the Conservative Party and Prime Minister Boris Johnson.

The new prime minister unveiled her energy package Sept. 8, with price caps on household energy bills and support for businesses struggling with spiraling costs as Russia's stance on gas and oil plus the war in Ukraine continue to squeeze public and corporate finances. She has already outlined a series of tax cuts.

Sources in the money management industry noted that Ms. Truss' policies also come at a time when inflation in the U.K. continues to climb, the Bank of England has begun raising interest rates, the U.K. is facing a recession, and the effects of the Brexit vote are still playing out.

"With this combination of wanting to cut taxes and also do a big fiscal expansion … ultimately it's going to be inflationary," said Gordon Shannon, London-based partner and portfolio manager in the investment-grade team at TwentyFour Asset Management, part of Vontobel Group. "Big picture, it's how are you going to fund the

SEE TRUSS ON PAGE 26

Leon Neal/Getty Images

LEADERSHIP CHANGE: Money managers are uncertain if new U.K. Prime Minister Liz Truss' policies will tame or inflame inflationary pressures.

Regulation

# New SEC rule could shed some light on executive pay

By HAZEL BRADFORD

Investors keen to better understand how companies connect executive compensation to financial performance gained a long-sought tool in August when the Securities and Exchange Commission finalized a rule seven years in the making.

A lot has happened in those years, including increasing shareholder attention to ESG factors that investors are now hoping will play a larger role in the executive compensation/financial performance equation.

Approved Aug. 25 and set to apply to the upcoming 2023 proxy season, the new pay-for-performance disclosure rule "makes it easier for shareholders to assess a public company's decision-making with respect to its executive compensation policies," SEC Chairman Gary Gensler said at the time.

"When we are looking at stewardship, we are looking to see if pay is aligned with performance," said Neaaz Mozumder, investment stewardship analyst at Legal & General Investment Management America Inc. in Chicago, "and it gives us something to compare companies."

While it remains to be seen how asset owners and managers will deploy the new rule, "it adds another layer to the process" of learning how much compensation corporate executives really take home, and should mean "seeing things a bit more clearly," said Mr. Mozumder.

While well-designed compensation programs can be "a powerful and effective tool to reward value-creating executives" in alignment with shareholders seeking long-term investment returns,

SEE EXEC COMP ON PAGE 30

Cryptocurrency

# Investors want regulations to assuage crypto concerns

LEGITIMACY: Ajit Singh said custody services for digital assets is still a roadblock.

By JOHN KIMELMAN

Though many public pension funds have shied away from digital assets tied to cryptocurrencies and the blockchain, some are nevertheless moving forward with small investments in this potentially transformational yet volatile sector.

Last year, for example, the $5.3 billion Houston Firefighters' Relief and Retirement Fund decided to establish a $25 million portfolio in crypto assets. The $199.9 billion Teacher Retirement System of Texas, Austin, and two different Fairfax County, Va., pension plans have also invested in this space.

These investments range from direct investments in cryptocurrencies to stakes in venture capital funds that hold a portfolio of cutting-edge startups tied to building out the infrastructure of a faster and less costly alternative payments system not tied to fiat currencies and the commercial banking system.

But most public pension funds and other institutional investors need to see more to like about the sector before building sizable stakes. For investment officers contacted by *Pensions & Investments*, rising confidence won't occur until stomach-churning volatility and falling prices give way to more stable returns over time. And that won't likely happen without greater technological advances including improvements in account security, more real-world applications, and coordinated oversight by government regulators, they said.

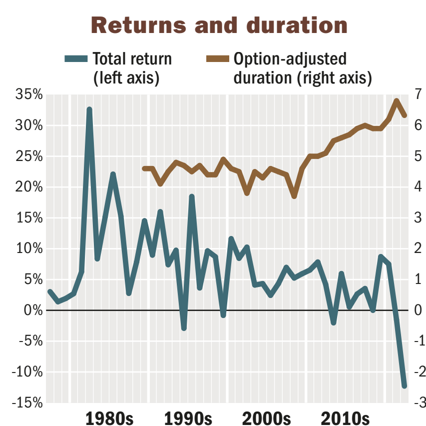
"Regulation will probably bring in more institutional (investors), which would have the effect of dampening

SEE CRYPTO ON PAGE 31

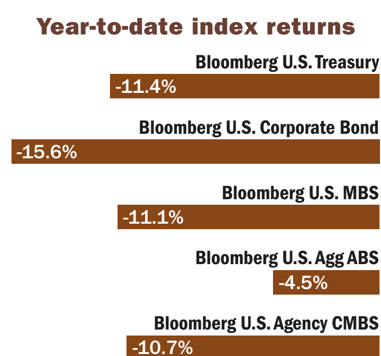
## U.S. bond investors' rough year

The Federal Reserve has moved aggressively to rein in inflation by raising short-term interest rates and allowing longer-term Treasuries and mortgage-backed securities to roll off the balance sheet. The current economic environment and the Fed's actions have resulted in higher Treasury yields across the board, hurting U.S. bond returns. But if inflation subsides, certain fixed-income sectors could bounce back after a tough 2022.

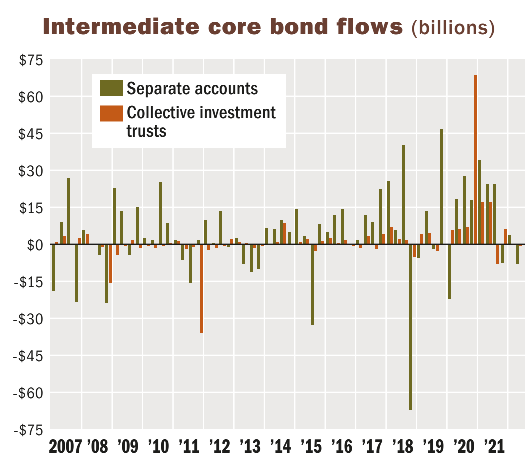
**Record losses:** The Bloomberg U.S. Aggregate Bond index lost 12.3% through Sept. 15, after a 1.5% loss in 2021. If this year's return holds, it would be the worst performance in its history. The index, with a 6.3 option-adjusted duration vs. about 5 a decade ago, has higher interest-rate risk.



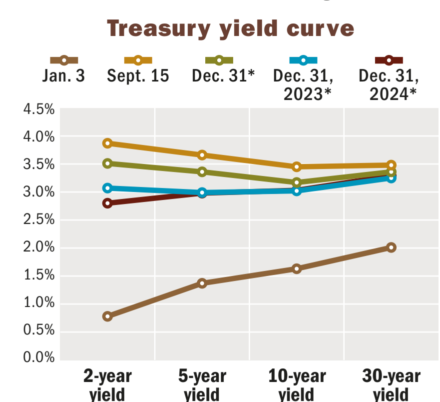

**Corporates drag:** Investment-grade corporate bonds, measured by the Bloomberg U.S. Corporate Bond index, have had the worst returns this year, falling by 15.6%. U.S. Treasuries, with a -11.4% return, were the next worst.




**Outflows:** Separate accounts experienced $7.9 billion in net outflows in the intermediate core bond category for the second quarter. Meanwhile, collective investment trusts saw $790 million in net outflows in that category during the most recent quarter, coming after more than $120 million in outflows the previous period.




**Yields up:** Treasury yields have spiked. The 2-year yield is 3.87%, 309 basis points higher than January, and the 10-year yield has more than doubled to 3.45%. However, economists predict falling yields over the next few years, with the 2-year dropping to 2.80% and the 10-year to 3.03% by year-end 2024. This likely assumes success in curtailing inflation.




*Forecast. Sources: Bloomberg LP, Morningstar Inc., U.S. Department of the Treasury

Compiled and designed by Larry Rothman and Gregg A. Runburg

Defined Contribution

# Employers rolling out 'supercharged 401(k) plans'

In war for senior talent, non-qualified plans used to help execs pad savings

By MARGARIDA CORREIA

As employers battle for talent, many are doing more than sweetening their 401(k) plans with better matches, faster vesting schedules and easier eligibility requirements. Many are taking the extra step of adding — or sprucing up existing — plans that help their senior-level employees save even more for their retirement.

In a bid to lure top executives and keep the ones they have from leaving, employers are rolling out non-qualified deferred compensation plans, arrangements that allow executives to sock away retirement money beyond what they're allowed to with their 401(k) plans.

These shadow 401(k) plans give executives the ability to defer a portion — or even all — of their compensation and avoid having to pay taxes on it until they actually receive it. In the meantime, the deferred compensation is invested in a lineup of funds often mirroring that of their employers' 401(k) offerings.

They're like a "supercharged 401(k) plan," said Kirk Penland, senior vice president of non-qualified markets at Voya Financial Inc. in Livermore, Calif., referring to non-qualified deferred compensation plans.

Many executives who contribute the maximum annual $20,500 to their 401(k) accounts often feel that they're still not going to achieve "the kind of retirement that they would like," he said, adding that non-qualified plans "are a great way" to help them boost their retirement savings to where they'd like it to be.

VITAL: Paul Visconti thinks non-qualified plans are 'absolutely crucial' for recruiting.

It's an executive perk that's in high demand in today's competitive labor market, Mr. Penland and other industry experts said.

Voya, for example, has seen a 33% increase from last year in the number of plan sponsors implementing non-qualified plans. Through the end of June, the record keeper had helped employers implement some 50 plans for their senior executives with another 60 implementations underway. Mr. Penland expects even more business as the firm approaches the last three months of the year, which he says are the "biggest" months for the record keeper as employers rush to make the plans available in time for open enrollment.

Companies want to recruit, reward and retain talent, Mr. Penland said, citing Labor Department statistics showing managers and professionals at near full employment.

"It's staggering," he said, referring to the 1.6% unemployment rate among managers.

With intense competition for leadership talent, plan sponsors are implementing non-qualified plans

SEE 401(K) PLANS ON PAGE 25

2023 Publishing Calendar

Sponsored Supplements

An excellent way to highlight your firm's investment expertise and the perfect platform for your top executives to discuss the latest developments on some of the industry's hottest topics.

2023 Market Outlook
Publishing: February 13

Innovations in DC
Publishing: March 13

Fixed Income
Publishing: April 3

Emerging Markets
Publishing: April 17

Infrastructure
Publishing: May 8

ESG - Climate Change
Publishing: May 22

The Evolution of DC Investment Menus
Publishing: July 17

ESG: Supporting the Transition
Publishing: August 14

Real Assets
Publishing: October 9

Retirement Income
Publishing: October 23

Private Markets
Publishing: November 6

Sustainability
Publishing: November 20

Risk Mitigation
Publishing: December 11

POSITION YOUR FIRM AS A THOUGHT LEADER

For more information on these multi-platform sponsorship opportunities contact Julie Parten at 952.495.0422 or julie.parten@pionline.com.

Pensions&Investments

Pension Risk Transfer

## IBM offloads $16 billion in liabilities

By ROB KOZLOWSKI

International Business Machines Corp., Armonk, N.Y., purchased group annuity contracts from Prudential Insurance Co. of America and Metropolitan Life Insurance Co. to transfer a total of $16 billion in U.S. defined benefit plan liabilities.

It is the largest U.S. pension plan buyout transaction in a decade and the second largest in U.S. history.

The purchases of the contracts, which closed Sept. 13, transfers the benefit-paying responsibility for about 100,000 retirees and beneficiaries covered by the IBM Personal Pension Plan, according to an 8-K filing with the SEC.

Each insurer will have an irrevocable commitment to pay 50% of the pension benefits for each transferred participant that are due on and after Jan. 1, 2023. Prudential will be the lead administrator. According to the filing, the pension buyout affects liabilities "related to certain pension benefits that began to be paid prior to 2016."

State Street Global Advisors acted as the independent fiduciary for the transaction, which was paid directly by assets from the plan.

It is the largest such transaction since General Motors Co., Detroit, announced in 2012 its plan to transfer $29 billion to Prudential via a pension buyout transaction.

Once the liabilities are transferred to Prudential and MetLife, IBM's U.S. defined benefit plan liabilities will be cut by a third.

As of Dec. 31, IBM's U.S. defined benefit plan assets totaled $51.85 billion, while projected benefit obligations totaled $48.18 billion, for a funding ratio of 107.6%, according to its most recent 10-K filing.

IBM officials could not be immediately reached for further information.

STATE STREET GLOBAL ADVISORS
SPDR®

# The middle can make all the difference.

Missing the middle of anything leaves a pretty big hole.
And that's especially true when it comes to the market.
See what owning a piece of the middle could do for you.
Make a portfolio complete with **MDY**.

Scan to learn more about **MDY**

Investing involves risk including the loss of principal. Investments in mid-sized companies may involve greater risks than those in larger, better known companies, but may be less volatile in smaller companies.
SPDR® S&P MidCap 400® ETF Trust, a unit investment trust, is listed on NYSE Arca, Inc.

ALPS Distributors, Inc. (fund distributor); State Street Global Advisors Funds Distributors, LLC (marketing agent).
This communication is not intended to be an investment recommendation or investment advice and should not be relied upon as such.

United States: State Street Global Advisors, 1 Iron Street, Boston, MA 02210-1641.
© 2022 State Street Corporation - All Rights Reserved.

*Before investing, consider the funds' investment objectives, risks, charges and expenses. To obtain a prospectus or summary prospectus, which contains this and other information, call 1.866.787.2257 or visit www.SSGA.com. Read it carefully.*

**Not FDIC Insured** **No Bank Guarantee** **May Lose Value**

4334321.1.1.AM.RTL

Courts

# Conflicting rulings prompt call for ERISA guidance

LOW ODDS: Jordan Mamorsky said the Cintas petition 'does not appear to address any obvious circuit splits.'

## Cintas asks high court to end confusion over court vs. arbitration

By ROBERT STEYER

Amid a legal landscape littered with conflicting court rulings, the U.S. Supreme Court has been asked to establish guidelines for when arbitration rather than a court is the proper venue for an ERISA dispute.

"This court's intervention is urgently needed," said the petition for review filed Sept. 8 by Cintas Corp., Mason, Ohio, which has lost attempts at the District Court and appeals court levels to compel arbitration in an ERISA complaint filed by two former employees in a company 401(k) plan.

"National uniformity is crucial in this area because many employers have employees based in jurisdictions throughout the country," said the review request — formally called a petition for a writ of certiorari — in the case of Cintas Corp. et al. vs. Hawkins et al.

"The uniform treatment of claims brought by ERISA plan beneficiaries is a matter of congressional policy," said the review request. "The issue could not be more cleanly presented because the language of the arbitration agreement here is unambiguous and comprehensive, leaving no room for doubt that the parties intended all ERISA claims that employees might bring to be subject to arbitration."

Cintas petitioned the Supreme Court because it disputed an April ruling by the 6th U.S. Circuit Court of Appeals, Cincinnati. Appeals court judges rejected the use of arbitration, noting the key factor was the absence of the Cintas 401(k) plan's consent to arbitration. Consent here means the 401(k) plan document didn't contain a specific arbitration requirement to settle ERISA disputes. Cintas said individual employment agreements governing arbitration are all that is needed.

"The arbitration provisions in these individual employment agreements — which only establish the plaintiffs' consent to arbitration, not the plan's — do not mandate that these claims be arbitrated," said the ruling by a three-judge panel of the appeals court. "The actions of Cintas and the other defendants do not support a conclusion that the plan has consented to arbitration."

The appeals court upheld the January 2021 pro-participant ruling by a U.S. District Court judge in Cincinnati who rejected the Cintas argument for arbitration. Plaintiffs had alleged that fiduciaries violated ERISA because the plan only offered actively managed investments rather than cheaper index-based investments and because the plan charged "imprudently expensive" record-keeping fees. The plaintiffs, who are seeking class-action status, filed their complaint in December 2019.

In its Supreme Court petition, Cintas attacked the 6th Circuit opinion as "wrong" and argued that the plan "included in its contracts with its employees an agreement to arbitrate any disputes related to their employment. That agreement expressly covered claims arising under ERISA."

Arbitration isn't prohibited in ERISA complaints, but the Cintas case is just part of the differing court rulings about arbitration in allegations of fiduciary mismanagement. For example, the 9th U.S. Circuit Court of Appeals, San Francisco, said a sponsor could arbitrate an ERISA dispute because an arbitration provision was contained in a 401(k) plan document. But the same court rejected another petition because the arbitration provision was part of an individual's employment agreement.

Yet, the 7th U.S. Circuit Court of Appeals, Chicago, acknowledged that even though a sponsor had an arbitration provision in a plan document, the court rejected arbitration because the document's wording didn't sufficiently protect participants' ERISA rights. Also, courts are wrestling with several other questions about arbitration in ERISA cases.

### Will they or won't they

ERISA attorneys who represent sponsors in ERISA cases said they weren't sure if the Supreme Court would agree to hear the Cintas case.

"It is impossible to tell, but the rate of success on petitions for certiorari is typically less than 5% on an annual basis," said Jordan Mamorsky, of counsel at the Wagner Law Group. The Supreme Court is often asked to review cases for which petitioners allege that different appeals courts produce different opinions — circuit splits — on specific issues.

The Cintas petition to the Supreme Court asserts that the 6th Circuit ruling conflicts with three different appeals court rulings on

SEE ERISA ON PAGE 29

P&I | CONFERENCES

Retirement Income

SEPTEMBER 20, 2022 | SAN FRANCISCO
SEPTEMBER 22, 2022 | NEW YORK
SEPTEMBER 29, 2022 | VIRTUAL

Preparing your participants and your next gen staff.

The population is aging, and the "Great Resignation" has added to the growing number of people that are moving to retirement readiness. **This not only affects your benefit plan but also your succession plan. Are you prepared?**

Preparing both your plan participants and next gen staff for the next phase.

Join Retirement Income conference with your colleagues for a day of immersive and interactive content that you can only receive in-person and at P&I. **Seize this unique opportunity to update yourself and your staff with the latest information regarding Retirement Income plan design, administration, and investment. There is no replacement for in-person learning and networking.**

Plan to include your next gen associates to expose them to fellow plan sponsors, expert advisors, and the following topics:

- Legislative & Regulatory Update including DOL rulings
- How Inflation and a lower return environment is affecting Retirement Plans and what to do about it
- Beginning at the beginning: Defining your plan and participants
- Options and Innovation in Plan Design
- Exploring and incorporating retirement tiers
- Financial Wellness: New and innovative offerings
- Interactive workshop – how to communicate retirement benefits to a multigenerational audience

COMPLIMENTARY REGISTRATION AT PIONLINE.COM/RI2022*

SPONSORS

BlackRock

STATE STREET GLOBAL ADVISORS

PARTNER:

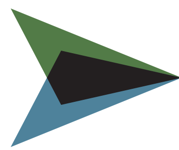
TIAA

AON

**Questions?** Please contact Kathleen Stevens kstevens@pionline.com | 843.666.9849 or Andy Jenkins andy.jenkins@pionline.com | 703.725.6161.

*Only asset owners and a limited number of consultants are invited to attend. All registration requests are subject to verification. P&I reserves the right to refuse any registrations not meeting our qualifications. The agenda for the Retirement Income is not created, written or produced by the editors of Pensions & Investments and does not represent the views or opinions of the publication or its parent company, Crain Communications Inc.

Investment
INSIGHTS



# CATCHING THE FORWARD WAVE ON ESG THEMES

*A quantitative approach to identifying financially-material ESG topics and positioning on stocks accordingly*

**PIERRE LENDERS**
Managing Director,
Head of Sustainability
Capital Fund Management (CFM)

As investors wrestle the challenges of incorporating key environmental, social and governance themes into their portfolios, data developments via machine learning and network data offer unique insights that can help identify potential opportunities and mitigate risks. At CFM, a quantitative and systematic asset manager, big data crunching and advanced modeling techniques provide a compelling path to understand and implement a sustainable approach to investments.

"When it comes to ESG themes, we look at phenomenon that haven't really manifested themselves much in the past, but that we expect could manifest more in the future," said Pierre Lenders, managing director and head of sustainability at CFM. "We know our entire production and consumption systems are in the middle of a massive overhaul towards becoming more sustainable, but it is hard to predict the next segment that will be disrupted or the next topic that will become financially material."

CFM's quantitative approach to sustainability investing is akin to a surfer watching the waves, then moving quickly to position her board on the most promising wave, Lenders said. The surfer needs to position herself before that wave reaches the shore, just as ESG investors need to position themselves for what's coming next. Aiming for green-based financial performance, positions are built only when sustainability factors gain traction in specific sectors, he said. "Just as you only surf towards the beach, we never position 'against' sustainability."

### LANGUAGE SIGNALS

Out of the full toolbox of quantitative techniques at its disposal, to identify investable sustainability-related themes, CFM increasingly uses natural-language processing, or NLP, a form of machine learning that uses multiple data sources and millions of texts to assess key changes in the investment ecosystem. "We track multiple ESG concerns and green technologies and identify those that are increasingly mentioned by financial sources," Lenders said.

While NLP is not new, its deployment in finance so far has mostly consisted of tracking sentiment on individual stocks to create price predictability signals, he noted. But it could also be used to signal when a material ESG topic becomes financially material. "In a way, when it comes to sustainability investing, narratives drive prices more than fundamental factors, so NLP is even more applicable." CFM uses NLP to track "indications that investors are catching up with non-governmental organizations or generalist commentators, that a wave is forming."

Being talked about is not enough though. Another condition for a particular topic to gain financially materiality is that corresponding metrics indicative of specific corporate performance need to exist and need to be increasingly used by investors. "Simplistic modeling based on observed sector averages and implying footprints in proportion of revenues may be sufficient for reporting but won't cause intra-sector reallocations," Lenders explained.

### CONSIDER EMERGING FACTORS

CFM's ESG integration philosophy, "sustainability-aware investing," is resolutely forward looking and focused on emerging financial materiality, with limited usage of ethical screening.

On climate, some companies have been moving faster than others to reduce their direct greenhouse gas emissions, and back-testing has suggested this has been reflected in stock performance over the last decade, Lenders said. But the same cannot be said about Scope 3 emissions, those related to a company's upstream suppliers and downstream clients. "Quite recently, we have seen an alpha tilt though," he said. While it's not yet statistically significant, it "could indicate growing concern by investors that, even when a company doesn't emit much carbon itself, it could get penalized in the future if its suppliers pay a heavier cost for emitting, or if its customers move to greener products. Scope 3 data is, still, only partially reflective of company-specific product mixes and value chains; but the urge to integrate this risk into investment decisions may nevertheless start impacting the price discovery mechanism," he said.

CFM is also closely watching companies in the food sector that may be "more capable and faster than others at moving away from animal proteins into alternative proteins, or at promoting regenerative agriculture," Lenders said. "This is a very material theme, with huge societal, biodiversity and climate impacts, but investors are not yet equipped with enough bottom-up data, so it is not yet financially material", he noted, adding that "hopefully, the Sustainability Accounting Standards Board may soon suggest new metrics for the food sector, notably to assess innovation in alternative proteins, but regulators and data providers still need catching up on deforestation, pollution and soils degradation," all quite challenging areas for data collection.

> *When it comes to ESG themes, we look at phenomenon that haven't really manifested themselves much in the past, but that we expect could manifest more in the future.*

### A PART OF THE WHOLE

Once CFM creates sustainability-related predictors, they become additional ingredients in its overall quantitative approach to security selection and portfolio construction, as is the case in its $8 billion flagship fund. "On a stand-alone basis, sustainability predictors may create exposure to temporary underperformance risk; when you combine them with other predictors, more short-term oriented and orthogonal to the transition, you can aim for enhanced Sharpe ratio potential," Lenders said.

Another differentiating factor relates to portfolio concentration: originally, in green or clean tech funds, there was only room for discretionary managers, picking up pure-play stocks from a small subset of the universe, mostly small caps. "The transition is now a universal concern though, so we believe there is room for systematic and highly-diversified formats, relying on the law of large numbers and using NLP and networks data to identify how thousands of firms connect to financially-material ESG topics," he said. "Positive overall performance may statistically emerge from enough of those different signals working on different time scales when applied in a large-enough universe."

### DOUBLE MATERIALITY

In the U.S., ESG's integration is mostly about mitigating reputational and financial risks and detecting investment opportunities, Lenders noted. It is consistent with the Securities and Exchange Commission's approach towards promoting climate risk disclosure as useful for investors. With the recently passed Inflation Reduction Act, green electricity production and transportation will be substantially incentivized.

In Europe, regulators use "sticks as well, not only carrots," Lenders said. "Carbon prices are three times higher, and sales of internal combustion engines will stop before 2035. European regulators have also extended ESG disclosure requirements well beyond carbon, and asset owners are contending with the concept of double materiality" — risks faced by companies and companies' impacts on outside stakeholders. There is a legitimate debate around whether an alpha-driven effort is compatible with this broader definition of sustainability "It is only when externalities are perceived to embark on a path towards becoming internalized by substantial regulatory action that the two dimensions coincide," Lenders opined.

On climate, there is global recognition that "massive investment to reduce our dependency on fossil fuels is unavoidable," he said. "It's going to be messy, but it's going to happen. Therefore, our investment programs should try to surf those waves."

### TACKLING DATA QUALITY

Data challenges persist. "We don't need more aggregated scores and interpretations, but fact-based granular ESG data, similar to ingredients of traditional financial statements such as EBITDA," Lenders said, referring to earnings before interest, taxes, depreciation and amortization. "We need mandatory disclosure to encompass all financially-material information, annual emission data included."

Meanwhile, independently established, often closer to real-time ESG data has become increasingly available, just as there are more sector datasets that provide intelligence on meaningful dimensions, Lenders said. For example, "you're starting to see, combining satellite data with sample data collected from the ground and AI, not just whether forest surfaces are being reduced, but also how actual biomass and biodiversity are evolving."

As asset owners continue to focus on ESG investing, Lenders advocates they should not only demand ESG implementation from their asset managers but also lobby governments on implementing changes in the real economy to support progress towards a greener economy. "In the scaling up phase, government intervention is indispensable", he noted, citing the example of Germany and other European countries that heavily subsidized solar power, which helped spark industry growth, adoption and going through grid parity. "For hydrogen it's a bit of the same," he noted. "Businesspeople and investors are, on average, not selfless enough to change behaviors unless properly incentivized, so regulations focusing on disclosure alone would be the equivalent of setting webcams on the Titanic." Ultimately, if asset owners want ESG integration to be more than a fad and net zero targets to be met, they should ensure that changes in the real economy continue to happen at a pace allowing sustainable investing to remain financially rational." ■

*sponsored by:*

pionline.com/cfm-esg2022

Any description or information involving investment process or allocations is provided for illustration purposes only. There can be no assurance that these statements are or will prove to be accurate or complete in any way. All figures are unaudited. This article does not constitute an offer or solicitation to subscribe for any security or interest.

P&I CONTENT SOLUTIONS GROUP

This sponsored Investment Insights is published by the P&I Content Solutions Group, a division of *Pensions & Investments*. The content was not produced by the editors of *Pensions & Investments* and *www.pionline.com* and does not represent the views of the publication or its parent company, Crain Communications Inc.

FRONTLINES

WOMEN AT THE HELM

# Emerge launches sustainable ETFs run by women portfolio managers

LIFT UP: Emerge wants to empower women portfolio managers, including, from left, Grace Capital's Catherine Faddis; Emerge's Lisa Langley; Channing Global's Josephine Jimenez; Catherine Avery Investment Management's Catherine Avery; and Zevin Asset Management's Jane Li and Sonia Kowal.

It's hard for women to get seats at the portfolio management table — something that doesn't sit well with Lisa Langley, president and CEO of Emerge Capital Management Inc. So, earlier this month, Emerge Capital Management launched five sustainability-focused exchange-traded funds — its first-ever ETFs — and put women at the helm of all of them.

The ETFs are part of the EMPWR program — a cross-border initiative between Buffalo, N.Y.-based Emerge Capital Management, which Ms. Langley founded in January 2016, and its Toronto-based affiliate Emerge Canada Inc., which she started three years later. Ms. Langley is also president and CEO of Emerge Canada.

"EMPWR is our brand to represent women portfolio managers and sustainability," said Ms. Langley, who cited a "terrible dearth of women portfolio managers in North America."

The same five actively managed portfolios were launched "on both sides of border," Ms. Langley said, albeit with 10 different tickers for a total of 10 ETFs.

While the funds launched in the U.S. represent Emerge Capital Management's first ETFs, Emerge Canada has offered ETFs previously, she said.

Subadvisers for the EMPWR ETFs are Catherine Avery Investment Management LLC, Grace Capital, Zevin Asset Management LLC and Channing Global Advisors LLC, according to a Sept. 6 prospectus.

CAIM CEO Catherine Avery manages the Emerge EMPWR Sustainable Dividend Equity ETF, while Grace Capital CEO Catherine Faddis manages the Emerge EMPWR Sustainable Select Growth Equity ETF. Jane Li, a portfolio manager at Zevin Asset Management, manages the Emerge EMPWR Sustainable Global Core Equity ETF and Channing Global Chief Investment Officer Josephine Jimenez manages the Emerge EMPWR Sustainable Emerging Markets Equity ETF.

Ms. Langley is also a portfolio manager on each of those four funds. The Emerge EMPWR Unified Sustainable Equity ETF is managed by all five women, according to the prospectus.

Emerge weighs environmental, social and governance factors as part of its securities-selection process, the prospectus said. Emerge, as of the date of the prospectus, excludes from its investment companies that get 20% or more of their revenues from biological and chemical weapons, thermal coal extraction, gambling, adult entertainment, tobacco production and recreational cannabis.

Ms. Langley expects the EMPWR ETFs will appeal to institutional investors, such as pension funds, she said. "It was pension plans that asked us for ETFs," Ms. Langley said, adding that the EMPWR format had been available already in separate accounts. "I think institutions are — I know they are — significant buyers of ETFs."

Together, Emerge Capital Management and Emerge Canada have close to $1 billion in assets under management, Ms. Langley said.

— KATHIE O'DONNELL

Greg Swales

NEXT GEN: Kim Kardashian and Jay W. Sammons are launching a PE firm.

KEEPING UP WITH PRIVATE EQUITY

# Kim Kardashian starts firm with former Carlyle exec

Jay W. Sammons has traded a top post at name-brand alternative investment firm Carlyle Group Inc. to form a private equity firm with media powerhouse Kim Kardashian.

The new firm, SKKY Partners, will make both control and minority investments in consumer and media companies, according to a Sept. 7 tweet.

Mr. Sammons, former global head of consumer, media and retail, left Carlyle in August, according to Bloomberg.

The "next generation" private equity firm is expected to target sectors including consumer products, digital and e-commerce, consumer media, hospitality and luxury, the firm tweeted.

Mr. Sammons, co-managing partner, is not a stranger to those sectors. During his more than 16 years at Carlyle, he was associated with investments including Beats by Dre, skincare company Philosophy, Beautycounter, Every Man Jack and Vogue International, Carlyle's website shows.

Co-managing partner Ms. Kardashian also is no stranger to the private equity world. Her shapewear line, Skims Body Inc, was valued at $3.2 billion after receiving $240 million in its latest funding round in January led by Lone Pine Capital LLC, according to Bloomberg.

"Together we hope to leverage our complementary expertise to build the next generation consumer and media private equity firm," Ms. Kardashian tweeted.

And like Ms. Kardashian's rise to fame through reality TV, the new firm will be a family affair. Her mother and manager, Kris Jenner, is a partner in SKKY Partners, according to Bloomberg. SKKY executives could not be reached for comment.

— ARLEEN JACOBIUS, WITH CONTRIBUTIONS FROM BLOOMBERG

BREAKING BARRIERS

# Fiera Capital award directed at minority medical researchers

Montreal-based asset manager Fiera Capital Corp. will commit C$120,000 ($91,500) over the next three years to reward promising medical researchers who come from Black, Indigenous, Asian or South Asian backgrounds.

Fiera is collaborating in this endeavor with McGill University Health Centre Foundation and with the Research Institute of MUHC, according to a Sept. 7 news release.

Specifically, the Fiera Capital Awards for Diversity, Equity and Inclusion in Health Care will provide support to Master of Science and Ph.D. research students with "high-risk early-stage innovative ideas with a great potential for advancing medical research," in an effort to "break the systemic barriers and root causes of racial inequalities," the release stated.

"High-risk/early stage innovative ideas" refer to research that is not typically funded from traditional sources. "This can be because the research is too early stage or because it came from a scientist who is still too junior to compete with larger, well-established laboratories," said Julie Quenneville, president and CEO, MUHC Foundation.

The research institute will call for proposals from research students active in a laboratory at RI-MUHC later this fall; finalists will be chosen by a scientific advisory committee.

"World-class research needs scientists of all backgrounds to bring unique perspectives to the lab so our physicians can provide better care at the bedside," Ms. Quenneville said in the release.

RECOGNIZE: Lyne Lamothe said a Fiera board member was pivotal in the effort.

Lyne Lamothe, global chief human resources officer at Fiera, said this is the asset manager's first partnership with the MUHC Foundation. "Norman Steinberg, who sits on the board of Fiera Capital and also co-chairs the MUHC Foundation Board, was pivotal in sharing Fiera Capital's interest to innovate and prioritize racial equity in a tangible way," she said. Ms. Lamothe added that Fiera's support will provide five awards for three Ph.D. and two MSc students each year, for three years, for a total of 15 winners.

Fiera had C$156.7 billion in AUM as of June 30.

— PALASH GHOSH

NAVIGATING A GLOBAL TRANSITION

# CalSTRS aims to be head of class with energy tool

CalSTRS is creating an energy transition tracker — the first among asset owners — as the nation's second-largest pension plan pursues its net-zero strategy.

The goal of the California State Teachers' Retirement System, West Sacramento, is to cut its $311.7 billion portfolio's carbon emissions by 50% by 2030.

But CalSTRS' net-zero plan will "only work if the world moves in the same direction," said Kirsty Jenkinson, investment director of sustainable investment and stewardship strategies at CalSTRS, at the investment committee's Aug. 31 meeting.

The tracker, when it is fully developed, will be part of CalSTRS' net-zero investment decision-making process, said Scott Chan, deputy chief investment officer, at the same meeting.

The transition tracker will measure how the rest of the world is doing in cutting its carbon footprint, looking at such things as changes in the world's energy sources, methods of transportation, building materials used, and integrating that information into its funding plan and asset-liability study.

If CalSTRS gets too far out ahead or too far behind the rest of the world, it could impact its portfolio by introducing risk, Mr. Chan said.

The transition tracker will not only help CalSTRS but any asset owner that is focused on "real economy reductions in carbon emissions," said a memo to the committee by Meketa Investment Group Inc., CalSTRS' general investment consultant.

"Chris (CIO Christopher Ailman) and I want to set the standard in the industry," Mr. Chan said.

— ARLEEN JACOBIUS

# ESG: MULTI-ASSET INVESTING

P&I CONTENT SOLUTIONS GROUP

As institutional investors continue to explore and adopt environmental, social and governance integration, the evolution of the field has expanded to take a total portfolio view on sustainability across all asset classes. This supplement discusses the different paths and approaches to ESG investing, how asset owners today are taking a multi-asset approach, and how they can develop a sustainability framework to meet their portfolio objectives. Our panel of experts shares the top ESG themes today as well as developments in data, benchmarks and regulation that are powering continued inflows into ESG investing across both public and private assets.

Read all the articles and access exclusive sponsor content online:

**pionline.com/ESGma-Report2022**

## FREE WEBINAR

**SEPT 21 | 2:00 PM ET**

**PANELISTS:**

Joshua Kendall
Head of Sustainable Fixed Income
Bloomberg LP

Sunny Ng, CFA
Managing Director,
Portfolio Manager, Global Multi-Asset
PineBridge Investments

Dulari Pancholi, CFA, CAIA
Principal, Head of Credit
and Multi-Asset Investments
NEPC

MODERATOR:

Gauri Goyal
Director, Content Solutions
Pensions & Investments

**WEBINAR REGISTRATION:**
pionline.com/ESGmultiasset-Webinar

Sponsored by:

Bloomberg

*The content of the supplement and webinar is not created, written or produced by the editors of Pensions & Investments and does not represent the views or opinions of the publication or its parent company, Crain Communications Inc.*

Pensions&Investments

**KC Crain** CEO

**Jennifer Ablan** Editor-in-chief/chief content officer JENNIFER.ABLAN@PIONLINE.COM
**Julie Tatge** Executive editor
**Kevin Olsen** Managing editor
**Gennady Kolker** Audience development editor GENNADY.KOLKER@PIONLINE.COM
**John Fuller** News editor JOHN.FULLER@PIONLINE.COM
**Sophie Baker** International news editor
**Meaghan Offerman** Associate editor MEAGHAN.OFFERMAN@PIONLINE.COM
**Colette Jordan** Chief content editor
**Jason Blue** Content editor JASON.BLUE@PIONLINE.COM
**Patrick Roth** Web producer
**Trilbe Wynne** Editorial assistant

REPORTERS
**Douglas Appell** International
**Hazel Bradford** International
**Margarida Correia** Defined contribution
**Brian Croce** Washington
**Courtney Degen** Washington COURTNEY.DEGEN@PIONLINE.COM
**Palash Ghosh** Money management PALASH.GHOSH@PIONLINE.COM
**Arleen Jacobius** Private equity/real estate
**Rob Kozlowski** General assignment
**Kathie O'Donnell** ETFs KATHIE.ODONNELL@PIONLINE.COM
**Paulina Pielichata** International
**Robert Steyer** Defined contribution
**Michael Thrasher** Money management MICHAEL.THRASHER@PIONLINE.COM
**Christine Williamson** Money management

ART
**Gregg A. Runburg** Art director
**Roger Schillerstrom** Editorial cartoonist

DATA/RESEARCH
**Aaron M. Cunningham** Director of research and analytics
**Larry Rothman** Data editor LARRY.ROTHMAN@PIONLINE.COM
**Anthony Scuderi** Directory manager
**Valerie Ge** Research analyst

**Nikki Pirrello** Chief operating officer
**Julie Parten** Head of sales JULIE.PARTEN@PIONLINE.COM
**Lauren DeRiggi** Digital specialist/account executive LAUREN.DERIGGI@PIONLINE.COM
**Joshua Suguitan** Executive assistant to the publisher, special projects associate JOSHUA.SUGUITAN@PIONLINE.COM
**Judy Kelly** New York JUDY.KELLY@PIONLINE.COM
**Ed O'Farrell** Midwest & West ED.OFARRELL@PIONLINE.COM
**Thomas Markley** Account executive THOMAS.MARKLEY@PIONLINE.COM
**Steve Middleton** EMEA SMIDDLETON@PIONLINE.COM
**Eduardo de Alcantara Machado** Sao Paulo, Brazil POINT@POINTCM.COM.BR
**Stacey George** Manager of sales operations STACEY.GEORGE@PIONLINE.COM

CONFERENCES/MARKETING
**Christine Zahn** Senior director of conference operations CHRISTINE.ZAHN@PIONLINE.COM
**Kimberly Jackson** Director of conference sales
**Diane Pastore** Director of conference programming
**Tammy Scholtes** Director of conference programming
**Joshua Scott** Director of conference programming JOSHUA.SCOTT@PIONLINE.COM
**Kathleen Stevens** Investor relations director
**Andy Jenkins** Investor relations manager ANDY.JENKINS@PIONLINE.COM
**Michelle DeMarco** Director of relationship marketing
**Assel Chanlatte** Conference marketing manager
**Mirjam Guldemond** Conference manager, WorldPensionSummit +31-6-2333-2464
**Ashley Perrucci** Conference & events manager
**Andy Jang** Conference & events coordinator
**Rachel Lopez** Conference administrative assistant

CUSTOM CONTENT/CLIENT SOLUTIONS
**Gauri Goyal** Director of content solutions
**Howard Moore** Associate editor, content solutions HOWARD.MOORE@PIONLINE.COM
**Corina Lewis** Associate project director
**Tetyana Saucedo** Digital campaign manager
**Deanna Speziale** Senior marketing associate DEANNA.SPEZIALE@PIONLINE.COM

SUBSCRIPTIONS/SITE LICENSES
**Ed Gorman** Director, EMEA/international site licensing +44-(0)20-3823-9891
**Erin Smith** Sales manager, site licenses
**Jack Follansbee** Account executive, site licenses JOHN.FOLLANSBEE@PIONLINE.COM

REPRINTS
**Laura Picariello** Sales manager 732-723-0569 LPICARIELLO@CRAIN.COM

ADVERTISING PRODUCTION
**Robert T. Hedrick** Media services manager 312-649-7836; BHEDRICK@CRAIN.COM

Subscription information - single copy sales: 877-812-1586

TO CONTACT A P&I STAFFER
Unless otherwise noted above, email us at **firstinitiallastname@pionline.com** or find phone numbers at **pionline.com/staff**.

OPINION

**OTHER VIEWS CHRISTOPHER HUEMMER**

# Real assets offer an attractive, flexible hedge against inflation

With inflation levels the highest in 40 years and the Fed dramatically raising rates to combat inflation, institutional investors are increasingly recognizing the benefits of exposure to real assets, specifically focusing on natural resources, infrastructure and real estate. Though many investors believe we may have reached peak inflation levels, most agree that the transition back to the Fed's stated inflation target of 2% is a long way off. This has created a risk that inflation and subsequent Fed rate hikes may surprise to the upside for 2023.

In an increasingly volatile global market environment, real assets can offer what many investors are looking for: the potential for income, diversification and capital preservation, all while providing inflation protection. Thanks to product innovation within real asset sectors in recent years, investors now have access to a wide variety of investment vehicles and an unprecedented supply of opportunities.

We believe all three asset classes (natural resources, infrastructure and real estate) are compelling tools to combat inflation on their own — but consider them particularly effective when combined, since each tends to perform well at different points of the economic cycle. Let's explore the case for each of these investment types in an environment of volatile inflation and growing investor concerns.

The case for commodities as an inflation-hedging asset class is based on the tendency for inflation to translate into higher prices for raw materials such as oil, natural gas, metals and agriculture products. Investors have seen this play out in portfolios year to date. Crude oil, for example, jumped 41% from January through June, while soybeans and wheat prices grew 12% and 10%, respectively. Prices have started to come down in recent weeks, but supply issues still exist and global events such as the fallout from Russia's invasion of Ukraine are still affecting commodities markets.

**Christopher Huemmer** is a Chicago-based senior investment strategist at FlexShares ETFs, part of Northern Trust Asset Management.

Our preference is to invest in natural resource equities over commodity futures contracts for three reasons: it avoids the need to roll commodities futures contracts that can be a performance drag over the long term; it allows for investment in commodities such as water and timber with limited futures coverage; and many natural resource companies pay dividends, leading to income generation that commodities futures do not provide.

Of course, investors should be aware that a key risk for equity-based natural resources strategies is that the same inflationary pressures causing raw materials prices to rise could increase the input costs for companies that process, transport or distribute finished products. To address this, investors need to focus on the earlier part of the natural resources supply chain, or what we call the upstream portion, which is where companies are involved in the extraction of commodities before higher prices are ultimately passed on to downstream producers.

Attractive, late-in-the economic-cycle infrastructure securities, such as access to water and waste services, can be viewed as a longer-term defensive play. Due to the nature of infrastructure assets, these projects tend to be highly stable and less sensitive to shifts in the broader economy, and provide protection against rising prices.

Infrastructure investments often operate in pseudo-monopolistic environments that are highly regulated, have large barriers of entry and enjoy inelastic demand. This translates into fairly predictable cash flows and maintenance costs, many of which allow for price increases tied to inflation. For example, utilities that face higher prices for the fuels they use to generate electricity generally are allowed to pass those costs on to their customers, keeping their cash flow more predictable in volatile energy markets.

Beyond price stability, there's also a significant income component for investors. Our research shows that over the past 10 years, 45% of the total return of global real estate and 52% of global infrastructure has come from dividend income.

However, infrastructure is not without risks, as changes in regulatory environments and governments can lead to a more conducive or restrictive operating environment for single infrastructure projects. This is why we advocate for a globally diversified approach to infrastructure investing that covers as many different types of infrastructure assets as feasible. We believe that by including areas such as communication infrastructure and outsourced government services, such as health-care facilities and postal systems, greater diversification can be achieved than through a strategy overly concentrated in energy utilities and pipelines.

**Thanks to product innovation within real asset sectors in recent years, investors now have access to a wide variety of investment vehicles and an unprecedented supply of opportunities.**

Investment in global real estate — commercial and residential — can similarly offer a range of benefits in the current environment. Some types of real estate stocks are less resistant to rising interest rates, while at the same time the sector has historically paid higher dividend yields than other equity classes, offering an alternative source of potential income.

Today, the increasing cost of raw materials and supply chain bottlenecks from the pandemic have affected real estate projects. Resulting delays in the completion of new residential real estate projects have hampered

SEE HUEMMER ON NEXT PAGE

OPINION

**OTHER VIEWS** CHARLES E.F. MILLARD

# One size will not fit all when investing PBGC financial aid

About a year ago, I wrote in this space about a singular challenge facing the PBGC along with plan sponsors, consultants and asset managers. Each of those groups was trying to decipher Congress' intent in its decision to provide billions of dollars in Special Financial Assistance to seriously underfunded multiemployer plans. Everyone faced the same problem: how to make assets that yielded about 2% meet liabilities that were calculated with a discount rate of 5.5%.

**Charles E.F. Millard** is a senior adviser for Amundi US, based in New York. He is the former director of the U.S. Pension Benefit Guaranty Corp.

The amount of assistance was to be calculated using a discount rate (approximately 5.5%) but, under the PBGC's interim final rule, that amount would have been required to be invested entirely in investment-grade fixed-income securities (then yielding 2% or so). The PBGC asked for comments on its interim final rule, and sure got them.

Stakeholders argued variously and vigorously for a permissible allocation to "return-seeking assets." To its credit, the PBGC and the Biden administration listened and made changes that are now expressed in the final rule. The most significant change is that up to 33% of the SFA funds may be invested in return-seeking assets (essentially, public equities).

Paradoxically, the solution to the problem that faced all stakeholders has highlighted a different reality — the reality that, in fact, there is not one solution that fits all situations. Each trustee board will have to answer certain fiduciary-level questions before determining how it will allocate SFA assets.

Some plans have such low levels of funding that, as a practical matter, the SFA will be the entirety of the plan's assets. Thus, in those cases, the greatest allocation to return-seeking assets will be 33%.

Other plans will have significant legacy assets, which are permitted to be invested as the trustees see fit. So, for example, if a plan is currently 40% funded (e.g., $400 million of assets for $1 billion of liabilities), then it might receive $600 million in SFA. Then $200 million of that SFA could be invested in equities, while the total legacy assets could also be invested in equities. Then the overall asset allocation would be 60/40 equities/fixed income.

The legislation that created the SFA only requires that the PBGC provide sufficient funds for the plan to meet its liabilities through the year 2051. Should trustees adopt conservative asset allocations to attempt to ensure that the plan remains solvent until 2051? Or should they take marginally increased risk in order to increase the potential that the plan can continue (perhaps indefinitely) beyond 2051? And how will younger participants view their post-2051 security?

There is one simple question facing all eligible plans — what to do with the SFA. But it is a problem that will be solved differently depending on the plan's demographics, current funded status and philosophy.

The PBGC has provided extensive guidance to address many stakeholder questions. The questions above, however, cannot be answered by the PBGC, because they were not addressed in the legislation. Trustees whose plan demographics are young will view the challenges differently than trustees whose demographics are older. Relatively better-funded plans will think differently than worse-funded plans. And predictions about Congressional actions 30 years in the future are surely unreliable.

So, while the PBGC did well to solve the math problem that affected everyone, now consultants and investment managers must address the needs of each plan on a case-by-case basis. ■

This content represents the views of the author. It was submitted and edited under *Pensions & Investments* guidelines but is not a product of *P&I's* editorial team.

# Huemmer

CONTINUED FROM OPPOSITE PAGE

new supply and sent prices for existing single-family and multifamily properties higher. On the commercial side, as businesses look to protect themselves from goods shortages by increasing inventories closer to major sales hubs, demand for warehouses and industrial real estate has been extremely strong.

To implement real assets exposure in a portfolio, investors have several options. The three investment types discussed herein have diverse risk and return profiles, so in aggregate, the asset allocation can be very agile and tailored to suit specific needs.

Investors seeking to capture higher growth and willing to tolerate more risk can build an asset allocation that more heavily weighs global real estate and natural resource equities. Those looking to blend a real asset mix with historically less price variance can tilt their allocation toward global infrastructure.

With a backdrop of inflation and interest-rate uncertainty, real assets offer an attractive and flexible addition to any institutional portfolio seeking both the potential for attractive returns and a hedge against inflation, particularly in today's challenging environment. ■

This content represents the views of the author. It was submitted and edited under *Pensions & Investments* guidelines but is not a product of *P&I's* editorial team.


Connect with us.

Like us
pionline.com/facebook

Follow us
pionline.com/linkedin

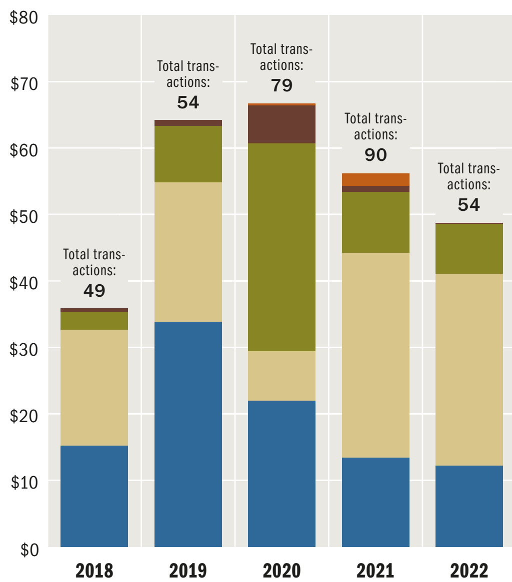
Follow us
@pensionsnews

Pensions&Investments

# BY THE NUMBERS

## PENSION RISK TRANSFER ACTIVITY

### Annual volume by category (billions)

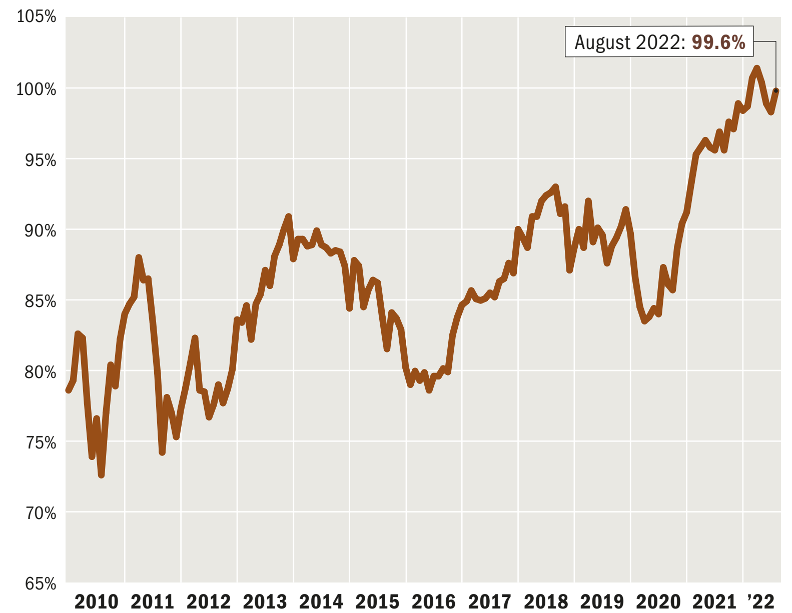



### Most recent transactions (millions)

| Type | Sponsor | Date | Assets |
|---|---|---|---|
| | IBM | Sept. 13 | $16,000 |
| | Barloworld UK Pension Scheme | Sept. 7 | $557 |
| | Gannett | Aug. 25 | $450 |
| | Walgreens Boots Alliance | Aug. 12 | $61 |
| | TransDigm Group | Aug. 10 | $188 |
| | TransDigm Group | Aug. 10 | $107 |
| | FreightCar America | Aug. 9 | $28 |
| | VF | Aug. 8 | $330 |
| | WH Smith | Aug. 8 | $1,200 |
| | Domtar | Aug. 8 | $140 |
| | Domtar | Aug. 8 | $105 |
| | Domtar | Aug. 8 | $85 |

For details on all recent pension risk transfers, go to pionline.com/pension-risk-transfer.

## MONTHLY CORPORATE FUNDING RATIO




## TRAILING 12-MONTH RETURNS BY ASSET CLASS

**2020**

| September | October | November | December |
|---|---|---|---|
| S&P 500 15.1% | S&P 500 9.7% | S&P 500 17.5% | Russell 2000 20.0% |
| MSCI EM 10.4% | BB U.S. Agg 6.2% | MSCI EM 15.0% | S&P 500 18.4% |
| BB U.S. Agg 7.0% | Global ex-U.S. fixed income 5.0% | Russell 2000 13.6% | MSCI EM 16.3% |
| Global ex-U.S. fixed income 5.5% | MSCI EM 4.9% | MSCI ACWI ex-U.S. 9.5% | MSCI ACWI ex-U.S. 10.7% |
| High Yield 3.3% | High Yield 3.5% | Global ex-U.S. fixed income 8.9% | Global ex-U.S. fixed income 10.1% |
| MSCI ACWI ex-U.S. 3.0% | Cash 0.9% | BB U.S. Agg 7.3% | BB U.S. Agg 7.5% |
| Cash 1.1% | Russell 2000 -0.1% | High Yield 7.2% | High Yield 7.1% |
| Russell 2000 0.4% | MSCI ACWI ex-U.S. -2.6% | Cash 0.8% | Cash 0.7% |
| Real Estate -16.6% | Real Estate -21.5% | Real Estate -10.5% | Real Estate -9.2% |

**2021**

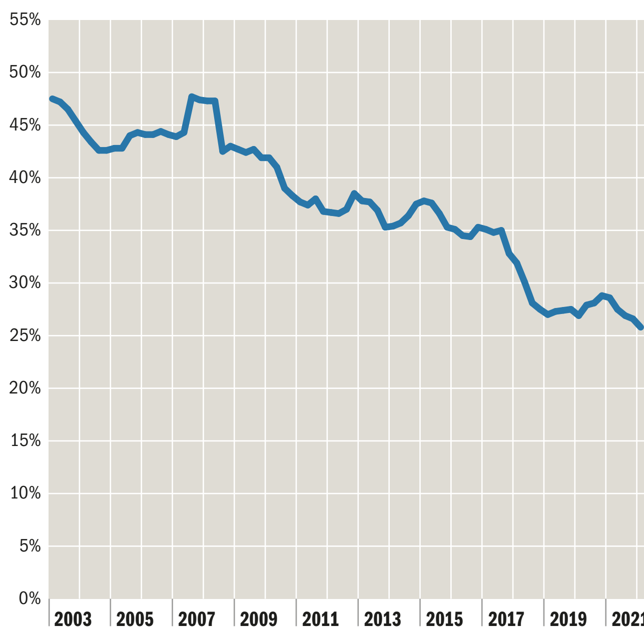
| January | February | March | April | May | June | July | August | September | October | November | December |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Russell 2000 30.2% | Russell 2000 51.0% | Russell 2000 94.8% | Russell 2000 74.9% | Russell 2000 64.6% | Russell 2000 62.0% | Russell 2000 52.0% | Russell 2000 47.1% | Russell 2000 47.7% | Russell 2000 50.8% | S&P 500 27.9% | S&P 500 28.7% |
| MSCI EM 27.9% | MSCI EM 36.0% | MSCI EM 58.4% | MSCI EM 48.7% | MSCI EM 51.0% | MSCI EM 40.9% | S&P 500 36.4% | S&P 500 31.2% | S&P 500 30.0% | S&P 500 42.9% | Russell 2000 22.0% | Real Estate 23.0% |
| S&P 500 17.2% | S&P 500 31.3% | S&P 500 56.4% | S&P 500 46.0% | MSCI ACWI ex-U.S. 42.8% | S&P 500 40.8% | Real Estate 31.2% | Real Estate 30.5% | Real Estate 27.1% | Real Estate 38.3% | Real Estate 19.7% | Russell 2000 14.8% |
| MSCI ACWI ex-U.S. 14.0% | MSCI ACWI ex-U.S. 26.2% | MSCI ACWI ex-U.S. 49.4% | MSCI ACWI ex-U.S. 43.0% | S&P 500 40.3% | MSCI ACWI ex-U.S. 35.7% | MSCI ACWI ex-U.S. 27.8% | MSCI ACWI ex-U.S. 24.9% | MSCI ACWI ex-U.S. 23.9% | MSCI ACWI ex-U.S. 29.7% | MSCI ACWI ex-U.S. 9.1% | MSCI ACWI ex-U.S. 7.8% |
| Global ex-U.S. fixed income 8.2% | High Yield 9.4% | Real Estate 34.4% | Real Estate 32.6% | Real Estate 35.1% | Real Estate 31.6% | MSCI EM 20.6% | MSCI EM 21.1% | MSCI EM 18.2% | MSCI EM 17.0% | High Yield 5.3% | High Yield 5.3% |
| High Yield 7.4% | Global ex-U.S. fixed income 6.3% | High Yield 23.7% | High Yield 19.7% | High Yield 15.0% | High Yield 15.4% | High Yield 10.6% | High Yield 10.1% | High Yield 11.3% | High Yield 10.5% | MSCI EM 2.7% | Cash 0.0% |
| BB U.S. Agg 4.7% | Real Estate 1.6% | Global ex-U.S. fixed income 7.2% | Global ex-U.S. fixed income 6.7% | Global ex-U.S. fixed income 7.8% | Global ex-U.S. fixed income 4.6% | Global ex-U.S. fixed income 1.7% | Global ex-U.S. fixed income 0.7% | Cash 0.1% | Cash 0.1% | Cash 0.1% | BB U.S. Agg -1.5% |
| Cash 0.6% | BB U.S. Agg 1.4% | BB U.S. Agg 0.7% | Cash 0.1% | Cash 0.1% | Cash 0.1% | Cash 0.1% | Cash 0.1% | BB U.S. Agg -0.9% | BB U.S. Agg -0.5% | BB U.S. Agg -1.2% | MSCI EM -2.5% |
| Real Estate -9.8% | Cash 0.4% | Cash 0.1% | BB U.S. Agg -0.3% | BB U.S. Agg -0.4% | BB U.S. Agg -0.3% | BB U.S. Agg -0.7% | BB U.S. Agg -0.1% | Global ex-U.S. fixed income -1.2% | Global ex-U.S. fixed income -2.0% | Global ex-U.S. fixed income -5.0% | Global ex-U.S. fixed income -7.0% |

**2022**

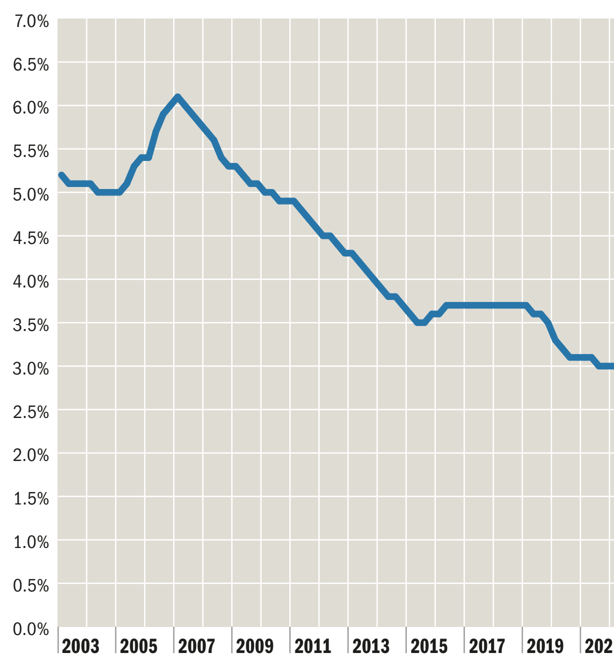
| January | February | March | April | May | June | July | August |
|---|---|---|---|---|---|---|---|
| S&P 500 23.3% | S&P 500 16.4% | S&P 500 15.6% | Real Estate 0.7% | Cash 0.1% | Cash 0.2% | Cash 0.2% | Cash 0.4% |
| Real Estate 18.1% | Real Estate 10.6% | Real Estate 12.2% | S&P 500 0.2% | S&P 500 -0.3% | BB U.S. Agg -10.3% | S&P 500 -4.6% | High Yield -10.6% |
| MSCI ACWI ex-U.S. 3.6% | High Yield 0.6% | Cash 0.1% | Cash 0.1% | Real Estate -5.2% | S&P 500 -10.6% | High Yield -8.0% | S&P 500 -11.2% |
| High Yield 2.1% | Cash 0.0% | High Yield -0.7% | High Yield -5.2% | High Yield -5.3% | High Yield -12.8% | BB U.S. Agg -9.1% | BB U.S. Agg -11.5% |
| Cash 0.0% | MSCI ACWI ex-U.S. -0.4% | MSCI ACWI ex-U.S. -1.5% | BB U.S. Agg -8.5% | BB U.S. Agg -8.2% | Real Estate -13.5% | Real Estate -9.8% | Real Estate -16.6% |
| Russell 2000 -1.2% | BB U.S. Agg -2.6% | BB U.S. Agg -4.2% | MSCI ACWI ex-U.S. -10.3% | MSCI ACWI ex-U.S. -12.4% | Global ex-U.S. fixed income -18.8% | Russell 2000 -14.3% | Russell 2000 -17.9% |
| BB U.S. Agg -3.0% | Russell 2000 -6.0% | Russell 2000 -5.8% | Global ex-U.S. fixed income -15.5% | Global ex-U.S. fixed income -16.7% | MSCI ACWI ex-U.S. -19.4% | MSCI ACWI ex-U.S. -15.3% | MSCI ACWI ex-U.S. -19.5% |
| MSCI EM -7.2% | Global ex-U.S. fixed income -7.1% | Global ex-U.S. fixed income -7.9% | Russell 2000 -16.9% | Russell 2000 -16.9% | Russell 2000 -25.2% | Global ex-U.S. fixed income -18.5% | MSCI EM -21.8% |
| Global ex-U.S. fixed income -7.9% | MSCI EM -10.7% | MSCI EM -11.4% | MSCI EM -18.3% | MSCI EM -19.8% | MSCI EM -25.3% | MSCI EM -20.1% | Global ex-U.S. fixed income -22.0% |

## LOWER INTEREST AND TAX EXPENSES BOLSTERED CORPORATE BOTTOM LINE

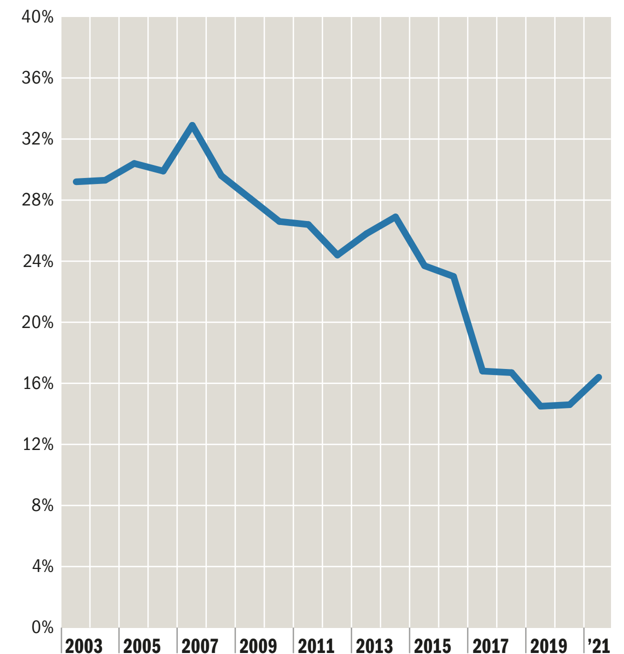
### Interest and tax expenses as a percentage of the S&P 500's operating income




### S&P 500's interest rate on debt




### S&P 500's effective corporate tax rate




Sources: *P&I* Research Center; NISA Investment Advisors; Bloomberg LP; Federal Reserve

Investment
**INSIGHTS**

# AN OPPORTUNE TIME FOR HEDGE FUND STRATEGIES

*Consider rebuilding the 60/40 portfolio with alternative diversifiers such as fixed-income relative value, credit arbitrage and merger-arbitrage strategies*

**DARREN WOLF, CFA**
Global Head of Investments for the Alternative Investment Strategies Desk, abrdn

As institutional asset owners contend with an environment of rising interest rates and recession risks, their concerns about the durability of the 60/40 portfolio have grown, along with the need to find alternative sources of diversification and return. With traditional assets moving in tandem and facing low-return expectations, hedge fund strategies, such as fixed-income relative value, merger arbitrage and other strategies can build long-term resilience for institutional portfolios.

"There are always unknown risks, but risks that we see on the horizon are apparent and known risks. It is volatility, recession risk, rising inflation and potential gas pipeline shutdowns because of the Russian war against Ukraine," said Darren Wolf, global head of investments for the Alternative Investment Strategies desk at abrdn. It has taken this confluence of events — as well as "the global pandemic and an interest rate tightening cycle that the U.S. hasn't seen in 40 years — to remind investors that they need diversifying exposures in their portfolios."

## DO THE MATH

Institutional asset owners need to assess whether performance from a traditional 60/40 portfolio can approach target returns, Wolf said. "With 60% in equities, our internal macro and thematic team expects equity returns at between 3% and 4% over the next five years, and their forecast for interest rates is slightly over 1%. The math doesn't work as far as trying to generate most investors' required returns."

These challenges make a strong case for rethinking classic asset allocation by introducing or increasing exposure to hedge fund opportunities. "Given the outlook for traditional assets, we think strategies that don't rely on an underlying market beta or alternative risk premia in order to generate returns are the strategies that we're really leaning into over the next several years," Wolf said.

In this new market context, abrdn is counseling institutional investors to incorporate long-term allocations to alternatives in their core portfolios. "We are advising them to always have [a portion allocated] to diversifying strategies because if markets start to get a little bit less friendly and a little bit more volatile, one can't suddenly move to dial up hedge fund exposures. We find that you get a pretty good bang for your buck at somewhere in the 10% to 20% range. It improves Sharpe ratios by keeping returns flat and slightly higher while risk is significantly reduced," he said.

## CONSIDER RISK-RETURN PROFILES

Two traditional hedge fund strategies that exploit inefficiencies in fixed-income securities, relative value and credit arbitrage, are well poised to perform. They seem similar but offer investors different risk-return profiles.

"One approach to fixed-income arbitrage is to invest in cash bonds, then short synthetic bonds against it or vice versa. Another approach involves identifying anomalies across the curve and trading, for instance, the three-month T-bill against the two-year Treasury toward a convergence when the two-year becomes the three-month bill. This situation is relevant now because the curve is flat or even inverted," Wolf explained. A significant subset of the fixed-income relative-value trading market is trading those two assets against each other. "Because the spreads are tight, you need significant leverage to get an acceptable return," he pointed out.

Credit arbitrage follows a similar approach using corporate credit instruments, such as long senior debt versus short subordinated debt, or long convertible debt bonds versus short nonconvertible bonds. "It is not quite the same as fixed-income arbitrage," he said, explaining that since "spreads are much wider on credit arbitrage, investors will not use as much leverage."

## SEIZE THE MOMENT

Since these types of strategies focus on anomalies along the yield curve and the relative value between assets, they benefit from market volatility and rising rates. For example, with fixed-income relative value, "higher volatility across the Treasury curve is beneficial for this strategy because it allows managers to trade [and] reset their portfolios more actively, and to monetize trades more frequently," Wolf said.

Hedge funds can also take advantage of the market volatility that impacts long-only investors. "If there's a flight to quality, people are looking for a safe haven in U.S. Treasuries. They're not really considering the relationship between the front end of the curve and the back end of the curve. It might be uneconomic, but its what's in their immediate best interest," he said, which creates opportunities for managers who can act on spread anomalies.

The impact of higher rates can be beneficial as well. "At this point in the cycle, as interest rates reset higher, spreads on fixed-income relative value and rates trading also widen. When yields are higher, similar parallel curve shifts lead to more magnified changes that create juicier spreads through which managers can find opportunities," Wolf added.

## PROCEED WITH CAUTION

While relative value and credit arbitrage offer enhanced returns, investors need to be cognizant of potential risks of overuse by managers — making manager selection a key consideration. "Asset owners need a manager who understands and respects risk management, especially in fixed-income relative value. As the position moves against expectations and the spread widens, it looks theoretically much more attractive. It is easy to say, 'I like the spread at X and I love the spread at 2X,' which can motivate managers to load up on risk if they are not disciplined."

Widening spreads are an opportunity or a risk. "It doesn't mean you should immediately sell if spreads widen. It just underscores the importance of having risk frameworks and protocols in place," Wolf said.

For investors looking for an optimal path to proceed, both active and passive approaches can be viable. "Path one is [for] firms like abrdn to find the best individual managers within themes like merger arbitrage or fixed-income arbitrage. We do due diligence, cast a wide net and find the best managers in the space," he said. Alternatively, "investors could passively invest in an underlying strategy benchmark tied to these hedge fund approaches and eliminate single manager risk, while providing a type of pure exposure to these strategy themes."

## WATCH THE SPREAD

Another traditional hedge fund strategy well suited for the current market environment is merger arbitrage, a spread strategy based on the convergence of corporate equity securities. Wolf offered an illustration: "Suppose GM was buying Ford. At some point, the two stocks become one stock and one ticker, which is the expected convergence. One collects the spread derived by purchasing the stock being acquired and then shorting the acquiring stock. Investors will likely lose money if the deal doesn't close because things will trade back to pre-deal levels."

Merger arbitrage does well when rates rise. "The higher the interest rates, the bigger the discount rate and the more significant that spread will be before the deal closes. Merger arbitrage, historically, has done very well in rising and high-interest rate environments for that reason," he noted, adding that current spreads are also attractive.

"Merger arbitrage is considered a low-risk strategy. Investors usually get steady high single-digit returns — 7% and 8% — in this environment as interest rates go higher and the markets are more volatile," Wolf said.

Investors need to be cognizant of the strategy's unique risks. The strategy "seems fairly straightforward, but it is not just one buying the target and shorting the acquirer. Certain deals are much more complex. [For instance,] deals with collar structures can hide how much the acquirer is paying. And cross-border deals add complexity that [can be] really tricky."

The profile of a merger-arbitrage deal is short volatility. "It is described as picking up nickels and dimes in front of a steamroller, which sounds kind of scary, but that's the profile," Wolf said. "You can make a small amount of money 97% of the time when deals close, but then that one time that a deal breaks, you could wipe out the money that you made on the previous [several] deal closings, something that investors need to appreciate fully. That doesn't make it a bad investment approach, but investors must understand the risk-return outlook." ■

pionline.com/abrdn-60/40-2022

**FOR PROFESSIONAL INVESTORS ONLY. NOT FOR USE BY RETAIL INVESTORS.**

Alternative investments involve specific risks that may be greater than those associated with traditional investments; are not suitable for all clients; and intended for experienced and sophisticated investors who meet specific suitability requirements and are willing to bear the high economic risks of the investment. Investments of this type may engage in speculative investment practices; carry additional risk of loss, including possibility of partial or total loss of invested capital, due to the nature and volatility of the underlying investments; and are generally considered to be illiquid due to restrictive repurchase procedures. These investments may also involve different regulatory and reporting requirements, complex tax structures, and delays in distributing important tax information.

The information contained herein is intended to be of general interest only and does not constitute legal or tax advice. abrdn does not warrant the accuracy, adequacy or completeness of the information and materials contained in this document and expessly disclaims liability for errors or omissions in such information and materials. abrdn reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice.

The above is for informational purposes only and should not be considered as an offer or solicitation to invest in any product.

Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. The reader must make his/her own assessment of the relevance, accuracy and adequacy of the information contained in this document, and make such independent investigations as he/she may consider necessary or appropriate for the purpose of such assessment.

Any opinion or estimate contained in this document is made on a general basis and is not to be elied on by the reader as advice. Neither abrdn nor any of its agents have given any consideration to nor have they made any investigation of the investment objectives, financial situation or particular need of the reader, any specific person or group of persons. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the reader, any person or group of persons acting on any information, opinion or estimate contained in this document.

Fixed income securities are subject to certain risks including, but not limited to: interest rate (changes in interest rates may cause a decline in the market value of an investment), credit (changes in the financial condition of the issuer, borrower, counterparty, or underlying collateral), prepayment (debt issuers may repay or refinance their loans or obligations earlier than anticipated), call (some bonds allow the issuer to call a bond for redemption before it matures), and extension (principal repayments may not occur as quickly as anticipated, causing the expected maturity of a security to increase).

In the United States, abrdn is the marketing name for the following affiliated, registered investment advisers: abrdn Inc., Aberdeen Asset Managers Ltd., abrdn Australia Limited, abrdn Asia Limited, Aberdeen Capital Management, LLC, abrdn ETFs Advisors LLC and Aberdeen Standard Alternative Funds Limited.

P&I CONTENT SOLUTIONS GROUP

This sponsored Investment Insights is published by the P&I Content Solutions Group, a division of *Pensions & Investments*. The content was not produced by the editors of *Pensions & Investments* and *www.pionline.com* and does not represent the views of the publication or its parent company, Crain Communications Inc.

# HEDGE FUND MANAGERS

# Why ‘everyone’ is talking about global macro

## Worldwide events have many institutional investors talking about funds expected to do well in chaotic times

By **MICHAEL THRASHER**

Inflation, central bank rate hikes, the war in Ukraine, elections in the U.S., Brazil and elsewhere, and more world events are causing institutional investors to consider global macro hedge funds or celebrate existing investments in them.

Kenneth Tropin, the chairman of Graham Capital Management LP, an $18.6 billion, Norwalk, Conn.-based macro hedge fund firm he founded in 1994, isn't cheering for economic distress, but hedge funds like his are designed to perform well in market environments like the current one. Mr. Tropin described the period between 2015 and 2020 as "pretty dull" for macro strategies, but this year they have performed well and he said they will continue to in the coming years.

Central bank rate changes and market volatility don't happen in lockstep across countries and regions, creating macro strategy opportunities in markets like fixed income, foreign exchange, commodities, and emerging markets, according to Mr. Tropin.

"Did it feel like we were kind of playing an away game for five years? I guess so. And now does it feel like we have the home field advantage? I think that's fair," Mr. Tropin said.

Graham's five largest funds have done well so far this year. The Tactical Trend Series A fund, which gained 3.31% in 2021, was up 3.45% in August and 32.77% year-to-date; the Graham Quant Macro Series A, which lost -1.57% in 2021, is up 1.67% in August and 21.82% year-to-date; the K4D-15V fund, which gained 1.41% in 2021, rose 3.64% in August and has returned 46.93% year-to-date; the Absolute Return Series A gained 4.72% in 2021, but returned 3.45% in August and 19.82% year-to-date; and the Prop Matrix fund returned 6.52% in 2021 but returned 3.85% is August and is up 29.77% year-to-date, an investor in the funds told *Pensions & Investments*.

Inflation is proving to be a hard problem for central banks to solve, supply chain issues will persist, energy will remain expensive and other things like the psychology of employees — who have gained the upper hand bargaining with employers on remote work and compensation — won't quickly reverse, according to Mr. Tropin.

"I see this environment for what we do continuing to be fertile for a long time, not just a year, not just next year, but as far as I can see. Now that will end at some point, but I don't see that ending anytime soon," Mr. Tropin said.

For those reasons, institutional investors are talking about global macro again.

### A breakout year

So far, 2022 has been a breakout year for discretionary and systematic macro strategies for the State of Wisconsin Investment Board, Madison, which manages more than $145.8 billion in assets, and SWIB has been increasing its exposure to them, said Derek Drummond, portfolio manager of funds alpha at SWIB. In 2021, most of the $6.2 billion that SWIB invested in multiasset strategies were invested in hedge funds and that part of the portfolio returned 16.3% last year, according to its annual report.

While macro strategies can act as a hedge for portfolios, Mr. Drummond said that SWIB has "never" believed hedging should be their purpose and that global macro strategies are really a way to diversify and add alpha overlay to a portfolio. Put another way: a diverse collection of macro strategies sometimes is a hedge, often delivers good returns, and can do exceptionally well in periodic markets, according to Mr. Drummond. Investors also like global macro strategies for their liquidity.

"Macro is one of those areas where you can modify your position or sizing very quickly. And, generally speaking, you don't necessarily need to be with the really big managers or the really small managers" because global macro strategies are not limited by or require certain capacities like some other investment strategies, Mr. Drummond said.

Jonathan Glidden, the chief investment officer of Atlanta-based Delta Air Lines' $19.1 billion pension fund, said it has a dedicated allocation to global macro hedge funds that makes the portfolio more dynamic with both modest growth and liability hedging. "We are hopeful that the allocation to macro strategies can help mitigate maximum losses. It has worked great this year. The macro portfolio also adds an element of diversified liquidity to the portfolio, which can be helpful in managing margin calls associated with LDI derivatives and the private market denominator effect," Mr. Glidden said in an email.

**VOLATILITY:** Chairman Kenneth Tropin said Graham Capital's funds are designed for current market conditions.

Delta is happy with its dedicated allocation to macro and doesn't plan to make any changes. However, it is leaning more into macro strategies in its large portable alpha program, designed to outperform Treasury bills with "very low beta to equity and other traditional risk premia," Mr. Glidden said. Delta is increasing its exposure to macro managers, especially commodities traders, he said.

"Volatility is up significantly across most asset classes. We believe macro managers can benefit from micro-opportunities presented by investors' reactions to economic, policy and geopolitical news in today's volatile environment," Mr. Glidden added.

The Missouri Local Government Employees Retirement System, Jefferson City, is not expanding its 10% allocation to what it calls the alpha asset class that is invested entirely in global macro hedge funds. If anything, "we may be trimming as the asset class" because it has performed well compared to other asset classes and the 10% allocation is growing as a result, said Brian Collett, chief investment officer of the $10.7 billion plan.

Missouri LAGERS is invested in global macro hedge funds that are focused on public fixed income, public equity, and some that invest in any public market, Mr. Collett said.

Bill Li, senior investment officer at the Massachusetts Pension Reserves Investment Management, Boston, said the $92.4 billion pension fund is currently invested in global macro hedge funds and that it doesn't plan to allocate more, at least in the near future.

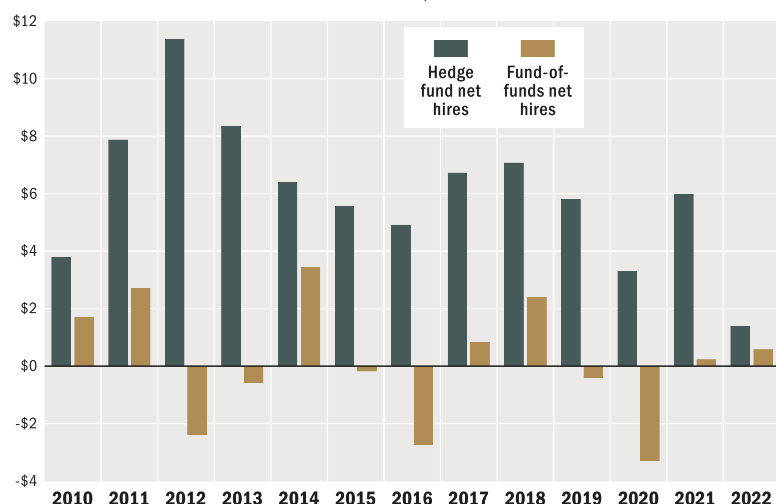
Outside of the systematic commodity trading advisers, or CTAs, and trend-following managers, the macro hedge fund universe is diverse. "Investors should be clearheaded

SEE GLOBAL MACRO ON PAGE 19

## Hedge fund stats at a glance

### Net hedge fund hiring volume

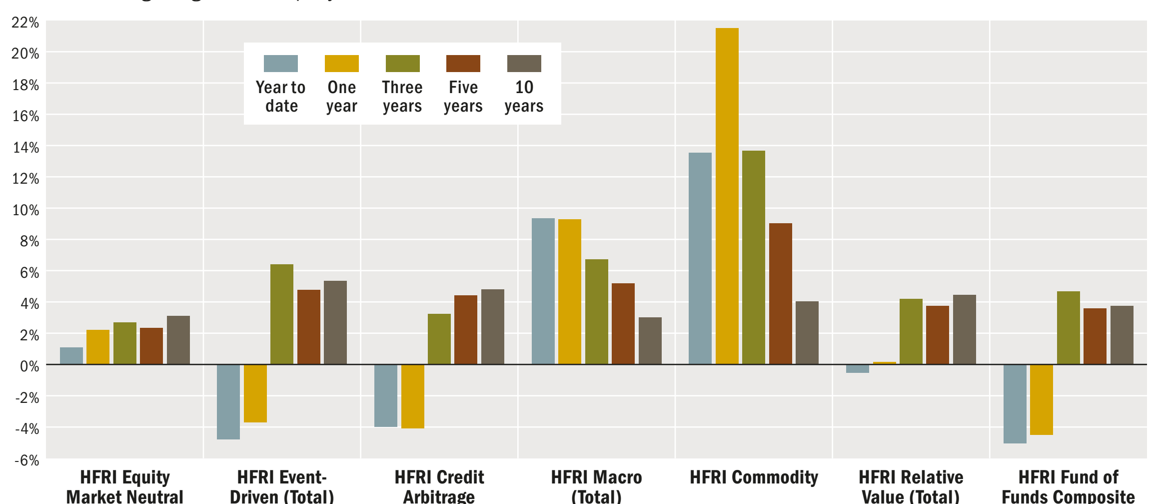
Assets are in billions. 2002 data are as of Sept. 8.





### Hedge fund index returns

Data are through Aug. 31. Multiple-year returns are annualized.





Sources: *P&I* Research Center, HFRI Inc.

# The largest hedge fund managers

Ranked by discretionary assets managed in hedge funds worldwide, in millions, as of June 30 unless otherwise noted.

| Rank | Manager | Assets | Change from 2021 | Five-year change | 10-year change |
|---|---|---|---|---|---|
| 1 | **Bridgewater Associates** | $126,400 | 19.6% | 2.8% | 67.9% |
| 2 | **Man Group** | $73,500 | 15.9% | 131.1% | 191.7% |
| 3 | **Renaissance Technologies** | $57,000 | -1.7% | 17.3% | 157.9% |
| 4 | **Millennium Mgmt.** | $54,968 | 5.1% | 59.9% | 250.1% |
| 5 | **Citadel** | $52,970 | 40.8% | 95.4% | 328.1% |
| 6 | **D.E. Shaw Group** | $47,861 | 20.4% | 74.1% | 154.9% |
| 7 | **Two Sigma Investments/Advisers** | $40,969 | 3.6% | 15.7% | 418.6% |
| 8 | **Davidson Kempner Capital Mgmt.** | $37,450 | 0.3% | 38.2% | 91.9% |
| 9 | **Farallon Capital Mgmt.** | $37,400 | -1.8% | 57.1% | 88.9% |
| 10 | **TCI Fund Mgmt.** | $36,200 | -9.5% | 128.3% | |
| 11 | **Marshall Wace** | $34,400 | 3.9% | 43.9% | 421.2% |
| 12 | **Ruffer** | $31,662 | | | |
| 13 | **AQR Capital Mgmt.** | $28,200 | 8.0% | -63.2% | 24.2% |
| 14 | **Anchorage Capital Group** | $27,100 | -12.8% | 61.3% | 165.7% |
| 15 | **Baupost Group** | $26,300 | -15.2% | -15.4% | 10.7% |
| 16 | **Point72 Asset Mgmt.** | $26,100 | 19.7% | | |
| 17 | **Capula Investment Mgmt.** | $25,000 | 4.6% | 67.8% | 92.3% |
| 18 | **Wellington Mgmt.** | $24,968 | 10.5% | | |
| 19 | **Brevan Howard Asset Mgmt.**[1] | $23,353 | 46.0% | 96.7% | -36.4% |
| 20 | **PIMCO** | $23,054 | 25.3% | 32.9% | 202.0% |
| 21 | **BlackRock** | $21,816 | -5.5% | 34.5% | 10.2% |
| 22 | **D1 Capital Partners** | $20,600 | -6.4% | | |
| 23 | **GoldenTree Asset Mgmt.** | $19,338 | -2.0% | 61.0% | 168.6% |
| 24 | **Universa Investments** | $19,091 | 54.4% | | |
| 25 | **Graham Capital Mgmt.** | $18,331 | 3.1% | 30.1% | 140.2% |
| 26 | **Hudson Bay Capital Mgmt.** | $17,100 | 57.2% | 612.5% | 1165.7% |
| 27 | **Balyasny Asset Mgmt.** | $16,000 | 60.0% | | |
| 28 | **Systematica Investments** | $15,877 | 55.7% | | |
| 29 | **Sculptor Capital Mgmt.** | $15,490 | -11.0% | -29.6% | -48.2% |
| 30 | **SPX Capital** | $14,600 | | | |
| 31 | **Appaloosa Mgmt.** | $14,000 | -2.8% | -17.6% | 0.0% |
| 32 | **Schonfeld Strategic Advisors** | $13,800 | 71.0% | | |
| 33 | **ExodusPoint Capital Mgmt.** | $13,400 | -0.7% | | |
| 34 | **Angelo Gordon** | $13,300 | 0.0% | 7.3% | |
| 35 | **Pershing Square Capital Mgmt.**[1] | $13,274 | -0.4% | -10.3% | 17.6% |
| 36 | **Magnetar Capital** | $12,725 | -1.9% | -3.6% | 18.7% |
| 37 | **Canyon Capital** | $12,700 | -22.1% | -39.5% | -11.2% |
| 38 | **Tudor Investment** | $12,300 | 9.8% | | 11.1% |
| 39 | **Third Point** | $12,287 | -24.2% | -25.5% | 41.2% |
| 40 | **Waterfall Asset Mgmt.**[2] | $11,000 | 12.2% | 70.6% | |
| 41 | **UBS O'Connor**[3] | $10,872 | 14.9% | 112.6% | 80.5% |
| 42 | **King Street Capital Mgmt.** | $10,333 | -11.7% | -45.0% | -40.6% |
| 43 | **Cheyne Capital** | $10,164 | 7.2% | 72.9% | |
| 44 | **Aspect Capital** | $9,896 | 12.4% | 57.4% | 45.6% |
| 45 | **Pictet Asset Mgmt.** | $9,683 | | | |
| 46 | **Capital Fund Mgmt.** | $9,619 | | | |
| 47 | **Winton Group** | $9,224 | 29.8% | -66.5% | -67.5% |
| 48 | **Crabel Capital Mgmt.** | $8,989 | 2.1% | | |
| 49 | **Capstone Investment Advisors** | $8,936 | -0.1% | 122.3% | 422.6% |
| 50 | **Nephila Capital** | $8,543 | -12.6% | -18.2% | |
| 51 | **PDT Partners** | $8,500 | 6.3% | 70.0% | |
| 52 | **Garda Capital Partners** | $8,420 | 25.2% | 176.4% | |
| 53 | **Ellington Mgmt. Group** | $8,400 | -1.2% | 52.7% | |
| 54 | **Taconic Capital Advisors** | $8,191 | -6.7% | 36.5% | -0.6% |
| 55 | **Pharo Mgmt.**[4] | $8,000 | -33.3% | | |
| 56 | **Diameter Capital Partners** | $6,648 | 9.1% | | |
| 57 | **HG Vora Capital Mgmt.** | $6,600 | -1.5% | 106.3% | |
| 58 | **Aristeia Capital** | $6,162 | 20.8% | | |
| 59 | **Mariner Investment Group** | $6,096 | 10.4% | | 29.7% |
| 60 | **Samlyn Capital** | $5,900 | -9.2% | 31.1% | 15.7% |
| 61 | **Eminence Capital** | $5,800 | -28.4% | 21.8% | |
| 62 | **Lone Pine Capital** | $5,423 | -50.9% | | -71.8% |
| 63 | **Napier Park Global Capital** | $5,115 | -8.0% | 53.5% | |
| 64 | **LibreMax Capital** | $4,970 | 4.6% | 116.1% | |
| 65 | **Deer Park Road** | $4,750 | 21.5% | | |
| 66 | **VR Advisory Services** | $4,582 | -14.6% | | |
| 67 | **Saba Capital Mgmt.** | $4,430 | 20.4% | 195.3% | -20.9% |
| 68 | **Lighthouse Partners** | $4,409 | 25.6% | | |
| 69 | **Paloma Partners** | $4,300 | 2.4% | -18.9% | 126.3% |
| 70 | **CQS** | $4,200 | -6.7% | -36.5% | -63.0% |
| 71 | **Gramercy Funds Mgmt.** | $3,956 | 5.7% | 1.9% | 97.3% |
| 72 | **Abbey Capital** | $3,821 | | | |
| 73 | **J.P. Morgan Asset and Wealth Mgmt.** | $3,748 | 8.8% | -31.9% | -87.0% |
| 74 | **Haidar Capital Mgmt.** | $3,558 | | 1074.3% | |
| 75 | **AS Birch Grove** | $3,454 | 43.9% | 283.0% | |
| 76 | **Empyrean Capital Partners** | $3,417 | -14.6% | 6.8% | |
| 77 | **Candlestick Capital** | $3,400 | 13.3% | | |
| 78 | **Versor Investments**[5] | $3,400 | 8.1% | | |
| 79 | **Weiss Multi-Strategy Advisers** | $3,200 | -8.6% | | |
| 80 | **Statar Capital** | $3,190 | 112.7% | | |
| 81 | **TIG Advisors** | $3,100 | 3.3% | | |
| 82 | **P. Schoenfeld Asset Mgmt.** | $2,885 | 0.4% | | 67.2% |
| 83 | **Bardin Hill Investment Partners** | $2,600 | 18.2% | | |
| 84 | **Graticule Asset Mgmt.** | $2,600 | 4.0% | | |
| 85 | **Hildene Capital Mgmt.** | $2,600 | -13.3% | | |
| 86 | **Quest Partners** | $2,512 | | | |
| 87 | **Acadian Asset Mgmt.**[6] | $2,486 | 304.9% | -19.7% | |
| 88 | **Senvest Mgmt.** | $2,435 | -34.1% | 83.1% | |
| 89 | **Valley Forge Capital** | $2,324 | | | |
| 90 | **Anomaly Capital** | $2,300 | 35.3% | | |
| 91 | **EJF Capital** | $2,300 | -37.8% | | |
| 92 | **Owl Creek Asset Mgmt.** | $2,208 | -15.1% | | |
| 93 | **Greenlight Capital** | $2,200 | 0.0% | -68.6% | |
| 94 | **Long Pond Capital** | $2,000 | -20.0% | -10.6% | |
| 95 | **Kepos Capital** | $1,900 | -5.0% | -38.7% | |
| 96 | **Rubric Capital Mgmt.** | $1,900 | 35.7% | | |
| 97 | **Shenkman Capital** | $1,820 | 23.0% | | |
| 98 | **Hein Park Capital Mgmt.** | $1,810 | 3.4% | | |
| 99 | **Massar Capital Mgmt.** | $1,222 | | | |
| 100 | **Wexford Capital** | $1,200 | | | -65.7% |
| 101 | **Indus Capital Partners** | $1,030 | -15.6% | | -74.8% |
| 102 | **Cambrian Asset Mgmt.** | $245 | | | |
| | **TOTAL** | $1,439,861 | | | |

**Notes:** 1 Data are from a company source such as a spokesman, website or financial report. 2 Data are as of July 1. 3 Data are as of April 1. 4 No date available; data are from a company source such as a spokesman, website or financial report. 5 Data are as of Jan. 1. 6 Reclassified worldwide hedge fund assets under management as of June 30.

Historical data may include retroactive updates.

Source: *Pensions & Investments* survey

# Hedge funds are pursuing ESG in unique ways

## Managers include ESG considerations as both risk factors and alpha generators

By BAILEY McCANN

Hedge fund managers are including ESG considerations as both risk factors and alpha generators in their strategies — but not in ways allocators might expect.

Rather than focusing on proxy votes or engagement strategies, these money managers are looking at how to use classic hedge fund strategies to achieve positive ESG outcomes. These efforts are putting new pressure on companies with high emissions to collect and improve ESG data, and may also impact how allocators think about portfolio construction when it comes to ESG.

Environmental, social and governance investing has been top of mind for allocators and money managers for a number of years now, but the debate over how to do it and whether to do it seems to be entering a new phase. Both money managers and investors are putting a new focus on financial materiality in an effort to avoid greenwashing.

Much of the focus at the moment is on the "E" factors — specifically carbon emissions. Emissions have emerged as a metric that many asset managers and allocators are focusing on because they can be measured, sources said.

As more institutions focus on net-zero goals, measuring emissions has become a key factor of evaluation at the company and portfolio level. But any evaluation creates winners and losers. When it comes to emissions, fossil fuel companies emit more and end up having lower ESG scores, which can equate to them being labeled as higher-risk investments from an ESG perspective.

James Jampel, founder and co-CIO of $780 million Newton, Mass.-based energy market-neutral hedge fund firm HITE Hedge Asset Management LLC, argues that investors are in a difficult position when it comes to decarbonization because of the potential impact on the long-term financial performance of companies, which can raise fiduciary issues if pushing for change results in adverse financial results. HITE trades energy as a core part of its strategy and notes that these fiduciary concerns arise for any investor but especially those that are attempting to align portfolio construction to decarbonization or net-zero goals.

"Back before the pandemic, most of the energy companies were climate deniers. And investors became very frustrated with climate deniers. So really the only logical response then was to divest from these energy companies," he said. "Then the pandemic hit, and energy companies performed very poorly in 2020. It looked like divestment was a winning strategy. Then, energy rebounded while at the same time the energy companies got smarter."

For example, in 2021, after activist investment firm Engine No.1 ran a successful proxy campaign and board shakeup at Exxon Mobil Corp., Exxon and a number of other fossil fuel companies including ConocoPhillips joined the Oil & Gas Methane Partnership 2.0, an international consortium of high emitters that is focused on finding ways to improve the sustainability of legacy energy businesses.

According to Mr. Jampel, after these efforts got underway, "investors pivoted to engagement strategies with these companies so that they could reinvest. But that puts investors in a difficult place. They think they can change these companies from the inside and maybe they can or maybe they can't but that remains to be seen."

### Argue against interests

Mr. Jampel argues that if investors want to push for change inside these companies, they may have to argue against their interests.

"If the U.S. really wants to push decarbonization, the first step is a carbon tax, which other countries already have. We also need emissions limits. But if you're an investor pushing for these things, you have to accept the value loss that can come from those and that gets tricky from a fiduciary standpoint," he said.

IMPROVE: DSC Meridian CIO Sheru Chowdhry said high-yield issuers are learning that collecting ESG data and improving outcomes can improve their cost of capital.

Investors, he said, will have to weigh whether long-term investment performance will ultimately be supported despite any short-term value loss that would come from these kinds of policy shifts. He added that engagement may not be the best way to get there because investors have driven change before without running into the conflicting investing stances that seem to plague energy investing. "Investors didn't 'engage' on tobacco," he said. "They recognized the harm, and once they did, the regulation followed."

The fluid nature of the energy transition is likely to make it difficult for allocators and policymakers to make straightforward determinations for a number of years. The war in Ukraine has already forced some European countries to momentarily change their energy policies.

For instance, the European Commission voted this summer to include nuclear energy and natural gas as environmentally sustainable investments in a new green taxonomy scheduled to take effect Jan. 1.

None of this comes as a surprise to Mark Carhart, chief investment officer and founding partner of the $1.9 billion New York-based systematic investment firm Kepos Capital LP. "We take the position that the transition is inevitable. But the timing of the transition is not yet known and policymakers are only just now beginning to realize that the social cost is going to be higher than they initially thought," he said.

Mr. Carhart argues that decarbonization is still in the early stages and measuring emissions may not end up being a comprehensive metric for determining overall impact. Kepos takes a more opportunistic view of decarbonization and includes carbon-related factors, such as whether they are trading offsets to evaluate both legacy companies and assets, as well as to identify companies that are likely to lead the transition. That approach resonates with investors, he said.

"Investors we talk to are thinking of climate in terms of risks to the portfolio and how to hedge those risks. They also want to know what opportunities they can take part in as the transition happens. And so our focus on carbon transition gives us a view into both of those issues," Mr. Carhart said.

Kepos currently trades in the carbon markets — where emitters like airlines, utilities and other companies can trade carbon credits and offsets. "One of the most interesting markets is the carbon market," Mr. Carhart said. "Allowances are really the key area where there's actually a tremendous amount of liquidity. There are interesting structural features, which generate a tailwind for performance."

Cap and trade emissions trading systems are designed to reduce carbon dioxide emissions by placing a cap on total emissions and lowering the cap each year while allowing market participants to trade carbon, thereby setting the market price. There are a number of government-required and voluntary carbon markets that can be traded throughout the world, with more slated to come online over the next decade.

Index provider MSCI Inc. places the total value of the U.S. carbon market at about $270 billion.

### Fixed income

While engagement is proving to be a little tricky within equities portfolios, on the fixed-income side it may be more straightforward.

DSC Meridian Capital, a New York-based opportunistic credit-focused hedge fund, has been able to

SEE ESG HEDGING ON PAGE 18

## Hedge fund stats at a glance

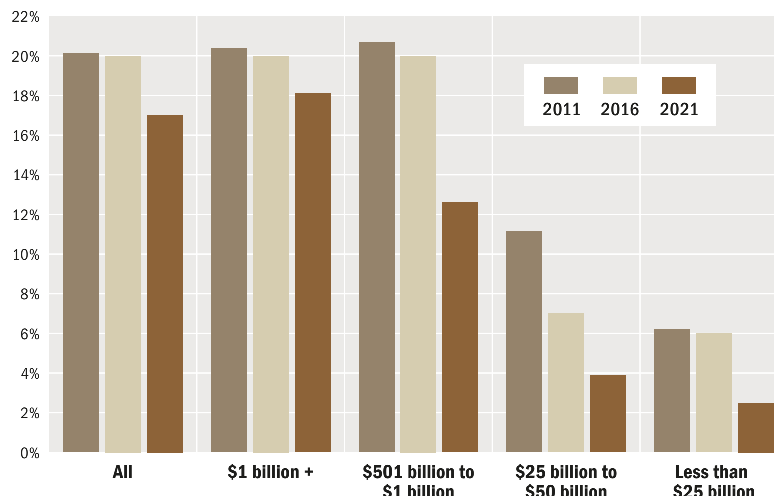
### Return vs. risk

Return data are through Aug. 31.

| Index | 10-year annualized return | 10-year beta |
|---|---|---|
| HFRI Equity Market Neutral | 3.1% | 0.09 |
| HFRI Event-Driven | 5.3% | 0.37 |
| HFRI Credit Arbitrage | 4.8% | 0.26 |
| HFRI Macro | 3.0% | 0.10 |
| HFRI Commodity | 4.0% | 0.08 |
| HFRI Relative Value | 4.4% | 0.21 |
| HFRI Fund of Funds Composite | 3.8% | 0.28 |
| S&P Risk Parity - 10% target volatility | 6.3% | 0.43 |
| HFR Risk Parity Vol 10 Institutional | 3.7% | 0.47 |
| S&P 500 | 13.1% | 1.00 |
| Bloomberg U.S. Aggregate Bond | 1.4% | 0.02 |

### Endowments' hedge fund allocation

By asset size, as of fiscal year ended June 30.




Sources: Bloomberg LP, National Association of College and University Business Officers

### How the 2022 P&I survey was conducted

*Pensions & Investments* annually surveys institutionally oriented managers to collect data about their worldwide and institutional assets managed in hedge funds as of June 30.

The 2022 survey marks the 13th year *P&I* has gathered data from hedge fund firms for its September hedge fund special report, which is one of *P&I's* most popular annual manager features.

In a small number of cases, *P&I* obtains hedge fund assets under management worldwide from a company source such as a spokesman, website or financial report. ■

# INTERESTED IN SUSTAINABLE EQUITY?

## START WITH OUR FREE ESG RESEARCH HUB

If you are an institutional asset owner searching for sustainable/ESG-driven investment strategies, Global Fund Search is the place to start.

- Browse the leading investment strategies
- Download white papers
- Register for upcoming webinars

### Featured leaders in sustainable equity investing

Learn more
**www.globalfundsearch.com/ESG**

In Partnership with Pensions&Investments

## The most institutional hedge fund managers

Ranked by percentage of total discretionary assets managed in hedge funds worldwide for institutions as of June 30.

| Manager | % inst'l |
|---|---|
| Acadian Asset Mgmt. | 100.0% |
| AQR Capital Mgmt. | 100.0% |
| Aristeia Capital | 100.0% |
| AS Birch Grove | 100.0% |
| Brevan Howard Asset Mgmt. | 100.0% |
| Cheyne Capital | 100.0% |
| GoldenTree Asset Mgmt. | 100.0% |
| Versor Investments | 100.0% |
| Wexford Capital | 100.0% |
| Massar Capital Mgmt. | 98.9% |
| Nephila Capital | 98.2% |
| Garda Capital Partners | 98.1% |
| Gramercy Funds Mgmt. | 97.8% |
| Crabel Capital Mgmt. | 97.6% |
| Magnetar Capital | 93.0% |
| Capstone Investment Advisors | 91.2% |
| Napier Park Global Capital | 90.1% |
| Capital Fund Mgmt. | 89.0% |
| Systematica Investments | 88.7% |
| PIMCO | 86.1% |
| Weiss Multi-Strategy Advisers | 84.4% |
| Waterfall Asset Mgmt. | 83.6% |
| Canyon Capital | 81.1% |
| Wellington Mgmt. | 79.3% |
| Man Group | 78.5% |
| Two Sigma Investments/ Advisers | 78.1% |
| Aspect Capital | 77.7% |
| J.P. Morgan Asset and Wealth Mgmt. | 75.8% |
| Marshall Wace | 74.5% |
| BlackRock | 73.8% |
| Taconic Capital Advisors | 72.7% |
| Lighthouse Partners | 72.5% |
| Schonfeld Strategic Advisors | 72.5% |
| Farallon Capital Mgmt. | 71.4% |
| D. E. Shaw Group | 66.2% |
| King Street Capital Mgmt. | 63.8% |
| Graham Capital Mgmt. | 60.0% |
| Citadel | 58.9% |
| Abbey Capital | 55.2% |
| Owl Creek Asset Mgmt. | 54.9% |
| Quest Partners | 51.7% |
| Ruffer | 51.0% |
| Tudor Investment | 49.6% |
| Universa Investments | 47.2% |
| Indus Capital Partners | 44.7% |
| Lone Pine Capital | 44.5% |
| Winton Group | 43.8% |
| Millennium Mgmt. | 36.4% |
| SPX Capital | 36.3% |
| Third Point | 33.0% |
| Senvest Mgmt. | 15.9% |
| Pictet Asset Mgmt. | 10.3% |

# Growth

CONTINUED FROM PAGE 1

A significant newcomer to the 2022 hedge fund survey was London-based absolute-return and macro manager Ruffer LLP, London, which had $31.7 billion in AUM, placing the firm in the 12th slot on *P&I's* manager ranking.

Investors appreciate the consistency of Ruffer's macro strategies, especially given that they can make money in down markets and provide "reasonable returns in benign markets and in both deflationary and inflationary environments," said Omar Kodmani, head of international and institutional, in an interview.

The firm is seeing broad institutional interest in its strategies globally, with the most active inquiries from the U.S., Mr. Kodmani said. While Ruffer's home territory is in Europe, he said Asian and Middle Eastern institutional investors also are exploring macro strategies.

Ruffer's investment team is monitoring global markets with a very careful eye.

"We are in a significant regime change from low and falling inflation to rising inflation. There will be changes in the correlations that have been in place for at least three to four decades," said Alex Lennard, Ruffer's investment director, who was on the call with Mr. Kodmani.

**GROWING:** Ryan Tolkin said Schonfeld added 20 partners as it looks to expand its investor base.

Mr. Lennard stressed "we think liquidity in financial markets will tighten and the impact is underappreciated. Investors need to be cautious about complacency regarding currency to see how markets will tolerate it."

Bridgewater Associates LP, Westport, Conn., the largest manager on *P&I's* list, reported $126.4 billion in worldwide hedge fund assets as of June 30, up 19.6% from the same date a year earlier.

Unlike some hedge fund managers, Bridgewater has found that current market conditions have been "a great alpha-generation environment. It's been a great macro environment with a lot of volatility across most currencies, interest rates, and equities in 200 liquid markets," said Kyle Delaney, president and chief commercial officer, referring to the firm's flagship fund Pure Alpha Fund II, which is mostly closed to new investors.

Given inflationary impacts not seen since the 1970s, Mr. Delaney said "the traditional 60/40 diversification approach isn't working. In an environment where there's a shift from growth to inflation, you're much better off diversifying broadly across assets, geographies and currencies."

He added that the firm's institutional investors are seeking advice from the firm about navigating current conditions. Most of Pure Alpha's growth is from performance, he said.

Bridgewater's Pure Alpha (18 volatility) offering returned 32.1% year to date through June 30, according to a source who asked not to be identified.

### 'Tale of two halves'

Paul Kreiselmaier, Seattle-based director, hedge funds at consultant Verus Advisory Inc., noted that there was a strong bifurcation between the two six-month periods. "The year ended June 30 was really a tale of two halves," he said.

In the second half of 2021, hedge fund strategies that did well included long-biased approaches and long/short equity, he said, adding that "the wind was at their backs."

In contrast, Mr. Kreiselmaier stressed that "at end of 2021 when inflation began to rise and from January 2022 onward when the Federal Reserve Bank began to raise interest rates, investors became more worried."

He said asset owners began to look for fixed-income substitutes within hedge fund strategies, including short equity strategies as well as long-biased funds, absolute return, global macro and commodity trading advisers.

Institutional investors are "on a quest for diversification given market conditions, but it will be harder going forward in the 2020s, post COVID, especially if inflation is higher," Mr. Kreiselmaier said.

The same factors that sent the HFRI Fund Weighed Composite index down 5.8% in the year ended June 30 also likely contributed to the AUM declines for various hedge fund firms that participated in *P&I's* survey, said Kenneth J. Heinz, president of HFR Inc., Chicago.

In contrast, the HFRI Composite index was up 27.5% in the year ended June 30, 2021.

### 71% growth

Among the hedge fund firms with at least $10 billion in assets in *P&I's* 2022 hedge fund manager universe, New York-based Schonfeld Strategic Advisors LLC had the largest growth in AUM at 71%, to total $13.8 billion as of June 30.

The growth propelled the firm to the 32nd spot in the hedge fund rankings from 51 in 2021 when the firm's growth was up 46.1% to $8.1 billion.

Ryan Tolkin, the firm's CEO and CIO, said the multistrategy firm in the past year has expanded its organic capacity by adding 20 new partners and dozens of fund analysts, technologists and operations experts as well as developing long-term partnerships with external trading teams.

The firm's employee base now totals 820 people in multiple offices around the world to accommodate 110 portfolio management teams and other employees.

"Our strong growth has been fueled by opportunity across markets over the year ended June 30," Mr. Tolkin said.

The firm manages multiple hedge fund strategies within four broad categories — quantitative, fundamental equity, tactical trading, and combined discretionary macro and fixed income.

Within the broad strategy areas, Schonfeld's strategies range from long/short equity, tactical trading, systematic, event-driven, risk and volatility arbitrage, discretionary macro, commodities and other approaches.

The firm continues to "increase the strategies it offers seeking diversity across regions and markets from offices in the U.S., Asia, Australia, the Middle East, Europe and the Americas," Mr. Tolkin said.

The firm also is increasing its institutional investor base, said Mr. Tolkin, noting that the company works closely with clients offering transparent relationships because "we want our clients to understand what we do."

About three-quarters of Schonfeld's AUM is institutional.

Other $10 billion-plus hedge fund firms with strong asset growth in *P&I's* universe includes Balyasny Asset Management LLC, Chicago, up 60% in the year ended June 30. That pushed the multistrategy firm to the 27th spot in *P&I's* ranking with $16 billion in assets from the 39th spot a year ago.

In written comments, Anita Nassar, partner and senior managing director, said "Balyasny's goal is to empower our LPs to be the best investors they can be. We partner with our investors in a way that ensures transparency, alignment of interest and long-term objectives which has contributed to our growth."

She added "to this end, we encourage a lengthy due diligence process and investors are given access to our risk analytics, investment process and data intelligence."

Miami-based tail-risk specialist Universa Investments LP, moved up to No. 24 in the ranking with AUM of $19.1 billion, up 54.4% from the 32nd spot in 2021.

Brandon Yarckin, chief operating officer, said in an interview that the firm's growth was driven by a "significant majority of new investors," noting that "Universa shines when markets get really bad. Pension funds get really

# ESG hedging

CONTINUED FROM PAGE 16

make progress with companies on ESG through the high-yield market. The firm manages $800 million, half of which is in climate-focused strategies.

"High yield is only 3% of the fixed-income market, but these companies represent almost a third of U.S. emissions," said Sheru Chowdhry, founder and CIO at DSC Meridian Capital. Many high-yield companies are in resource-intensive industries such as energy, construction, light manufacturing and logistics.

"We spent a lot of time looking at how to approach ESG in an authentic way and with an approach that would lead to outperformance," he said. "We settled on climate as a key driver, and what we have found is that when you show issuers that collecting ESG data and improving outcomes can improve their overall cost of capital, they do listen."

Mr. Chowdhry noted that many high-yield issuers the firm evaluates are only in the early stages of collecting and reporting ESG data such as emissions or overall carbon footprint. But once they start, they may find new doors open in terms of financing as more investors are considering this data in their evaluation of securities. That means that companies can see a lower cost of capital, even if they aren't yet making moves to improve ESG outcomes but are merely reporting impact.

"We are creditors, so that does give us a bit more credibility in the conversation," added Paula Luff, director of ESG research and engagement at DSC Meridian Capital. "High-yield issuers are very sensitive to factors that can change their cost of capital. What we have found is that they are willing to have conversations and make change. That creates value for investors as well."

### Quiet ESG

Other, classic hedge fund strategies are emerging as a sort of quiet ESG. These strategies aren't necessarily being deployed through a purely ESG lens, but the ways in which they can be used to manage risk in a portfolio can have significant ESG-positive benefits as well. In May, the Institutional Investors Group on Climate Change issued a paper designed to start a discussion around the use of derivatives and shorting in ESG strategies. The paper argues that both of these tools — commonly used in hedge fund strategies — can support net-zero commitments by separating financial risk management from net-zero alignment.

This theory of portfolio construction could help solve the fiduciary issues that come from engagement campaigns but it's not definitive. The findings also create an opening for opportunistic strategies to be included more readily within ESG-oriented portfolios.

But some remain wary of finding more use cases for shorting and derivatives, which some consider to be controversial investment tools. MSCI published a report in April voicing skepticism of shorting and ESG. The investment research firm said without careful and fully transparent reporting, it will be challenging to fully understand the intent of long/short ESG portfolios and whether they are effectively meeting their stated goals.

Still, HITE's Mr. Jampel noted that long-only ESG would limit the investment strategies available to allocators. Shorting could support investors' ability to make change through investment, Mr. Jampel said, because it removes the conflict of interest involved in holding on to high emitters and hoping engagement will work. What's more, it also provides a more authentic picture of the emissions in a portfolio. A short position would indicate that a company isn't expected to ma-

nervous when markets are like this. We give them more security and we help investors put a higher focus on risk and drawdowns."

London-based Man Group PLC saw its worldwide AUM managed in hedge funds rise 15.9% to $73.5 billion as of June 30.

"Institutional investor demand focused on a mix of strong strategies, especially quantitative macro and equity market-neutral strategies, which did well in tough markets," said Mark Jones, deputy CEO, in an interview. "Net inflows also went into absolute strategies. There were big moves into commodities and currencies in the face of rising inflation."

On the bright side, Mr. Jones said market conditions are creating more dispersion between companies, which provides more investment opportunities for hedge fund managers.

### Overweight value

Worldwide assets managed in hedge funds by AQR Capital Management LLC, Greenwich, Conn. as of June 30 totaled $28.2 billion, up 8% from June 30 the prior year.

While AQR's hedge fund AUM growth was comparatively modest, the company's "multistrategy and stock selection strategies saw very strong performance with our overweight of the value factor in equities a significant contributor to their outperformance over peers and traditional markets," said Suzanne Escousse, principal and chief marketing officer, in written comments.

"Our trend-following and global macro strategies also performed strongly thanks to an overall environment of trends across asset classes, increased inflation concerns and a rapid shift to tightening monetary policy," she added.

With equities in a sustained downturn and bonds currently offering little to no diversification, Ms. Escousse said "we've seen renewed interest from institutions in strategies offering diversifying sources of return," especially for multistrategy, value-oriented equity market-neutral, long-short equity and trend-following approaches like managed futures.

Year to date through June 30, AQR's Managed Futures Full Volatility strategy returned a net 53.3%; Equity Market Neutral Global Value, 35.4%; and Absolute Return, 29.4%, according to data from AQR.

None of the $10 billion-plus hedge fund managers in *P&I's* hedge fund manager ranking for 2022 that experienced the largest asset declines responded to requests for comment.

Lone Pine Capital LLC, Greenwich, Conn., experienced a precipitous decline of 50.9% to $5.4 billion in the year ended June 30. The firm declined to comment, but in a July letter to clients obtained by Bloomberg, the firm said "while this phase of latest period of underperformance has been difficult, we believe the work we are doing today will set us up to reap the rewards in the months and years to come."

The letter said the hedge fund's AUM declined 41.1% between September 2021 and June 2022. ■

Bloomberg contributed to this story.

# Global macro

CONTINUED FROM PAGE 14

about the pros and cons of individual offerings and how they fit in overall portfolio strategy — individual manager quality is more important than the size of the allocation in this space," Mr. Li said.

Another pension fund CIO, who asked not to be named, said their fund has invested in macro strategies for decades and that the funds have performed well, including this year. "If anything, we are taking profits since the returns have been so good. I can understand why those who didn't have exposure to the strategy might feel like they are missing out," the CIO said.

### Time is right

In a survey of 87 endowments, foundations and healthcare systems by BlackRock Inc. and Coalition Greenwich, a division of S&P Global's CRISIL analytics business, between February and early April, just 10% of those institutions planned to increase their hedge fund allocations this year. Still, many institutional investors are already invested in hedge funds, like MassPRIM and others.

Graham Capital's Mr. Tropin candidly explained that he doesn't talk to clients as much as his investor relations employees. But he's friends with hedge fund managers and other investors and "everybody is talking about macro because if you've been around investments for a while, you know that this is a good environment for macro."

Global macro strategies can perform especially well during some periods, but years can pass between those phases, making returns "feast or famine," said Sean McGould, CEO and chief investment officer at Lighthouse Investment Partners LLC, a $14.4 billion firm in Palm Beach Gardens, Fla., that spun out of a multifamily office in 1999.

Once it became an independent firm and began taking outside capital, Lighthouse was able to grow, create a multimanager platform and recruit more portfolio managers and traders. It has 12 distinct teams right now that specialize in fundamental or systemic strategies focused on things like inflation, emerging markets and currencies, and it expects to have as many as 16 teams before the end of the year. The new hires were years in the making.

The lead times for the new hires at Lighthouse began well before this year, but the company's rolling search for managers and strategies has nonetheless helped it perform and attract investors. Having many types of global macro strategies can smooth returns and make a global macro offering even more alluring, Mr. McGould said.

"If you can get it right, for institutional investors or individual investors, if you can produce a nice return stream that's uncorrelated to other things they have in their portfolio, then that's a home run," Mr. McGould said.

Inflows to the Trium Larissa Global Macro Fund, part of the €750 million ($746 million) multimanager firm Trium Capital in London, have more than doubled this year to €90 million. The new money has come primarily from institutional investors "who believe the opportunity set, in this more volatile market environment, will be good for global macro funds. We agree," Donald Pepper, co-CEO at Trium Capital, said. ■

terially improve its sustainability rather than holding on to an ESG laggard and hoping for the best.

"We contend that if you're looking to measure the carbon intensity of a portfolio, shorts should be counted as a negative against other positive metrics you might have in your long book," Mr. Jampel said.

Another classic strategy — merger arbitrage — is emerging as a way to improve ESG scores in a portfolio.

New York-based quantitative investment firm Versor Investments has analyzed the impact of mergers on ESG scores and come away with some notable findings.

**NO CONFLICT:** James Jampel thinks shorts should be counted as part of an ESG strategy.

"The standard approach is to invest with the goal of picking the highest ESG scores or finding significant improvements in ESG scores," said Deepak Gurnani, founder and managing partner of Versor Investments, which had $3.4 billion in AUM as of June 30. "There is a lot of debate about whether that actually works or not. Our approach uses merger arbitrage. We have been able to show that merger arbitrage improved ESG scores in a statistically significant way. So we have been able to incorporate that in our quantitative and risk models as a consideration."

Typically, Mr. Gurnani said, the target of a merger has a lower ESG score than the acquirer. Once the deal is complete and the company is absorbed, their ESG practices tend to improve as does the total score of the combined entity.

"We typically measure over a two-year period — one year before the announcement and one year after the completion," he said. "A typical deal takes about four to five months. So within a 30-month period, we typically see that the improvement in scores is better than the sector average."

That finding points to an ESG improvement many allocators may not even realize they have in their portfolio because merger arbitrage as a strategy doesn't have to be done through an ESG-specific lens. Mr. Gurnani added that over time, merger arbitrage may take on more of an ESG tilt naturally because more companies are including discussion of ESG factors in their M&A plans.

Mr. Gurnani said this could be broadly beneficial for ESG because it can move the transition ahead without some of the issues and inertia embedded in other approaches. "From our perspective, the focus should be on strategies that improve the ESG scores rather than maintain the status quo," he said. ■

# Hedge funds serving as an odd pairing with ETFs

By ARI I. WEINBERG

Hedge funds and exchange-traded funds have a complicated relationship.

Some hedge funds use ETFs — sparingly — within their strategies, others are taking advantage of the products popularity by serving as market makers, but few are actually trying to get a foothold with new investors by offering absolute-return ETFs of their own.

For example, Bridgewater Associates LP, Millennium Management LLC and Citadel Advisors LLC are among the largest hedge fund operators in the world and occasionally report ETF and ETF option holdings in their 13-F regulatory filings with the U.S. Securities and Exchange Commission. Citadel's market-making unit, Citadel Securities, has also evolved over the past few years into one of the largest ETF market makers, arbitraging small discrepancies between ETF prices and their underlying securities. The willingness of market makers like Citadel to step into volatile markets is a key part of the ETF ecosystem.

But few hedge funds have jumped the shark to offering their own strategies within an ETF. In fact, the absolute-return category of ETFs — products aiming to produce consistent uncorrelated returns to major asset classes — has accrued just $6.7 billion in total assets across 43 products, the first of which was launched in early 2009. That's just a drop in the bucket of the nearly $7 trillion U.S. ETF market.

"ETFs that aim to deliver consistent positive performance across market conditions have overwhelmingly disappointed," said Elisabeth Kashner, vice president and director of global fund analytics at FactSet Research Systems in San Francisco. "Nearly every ETF in FactSet's absolute returns category has delivered decidedly mixed performance," she said.

Ms. Kashner adds that many absolute-return ETFs are highly correlated to global equities or to a 60/40 portfolio of global stocks and investment-grade U.S. bonds, running counter to asset managers' claims of uncorrelated returns. Only three of the 25 hedge-fund-mimicking ETFs have produced higher Sharpe ratios than a simple 60/40 portfolio from the end of 2018 to September 2022, she said.

According to FactSet, absolute-return ETFs include long/short funds, merger arbitrage, tactical asset allocation, global macro and real-return products. Of the 40 ETFs with year-to-date results through Aug. 31, 27 have lost value and longer-term correlations to short-term Treasuries have been negative. "In many cases, investors haven't gotten the results they might have hoped for from products that commonly cost between 0.50% and 1%," Ms. Kashner concluded.

A challenging return environment, however, hasn't stopped investors from directing assets to these strategies. Of the forty-three ETFs tracked by FactSet, six have assets above $500 million, including the $1.3 billion RPAR Risk Parity ETF. (As of June 30, 34.4 million shares were held by wealth management firm Evoke Advisors and its affiliate, Advanced Research Investment Solutions LLC, which built the underlying index.)

"Managing assets within an active ETF is no different than other fund structures," said Daniel Gamache, Denver-based executive director with Core Alternative Capital. "We find the liquidity and transparency of the ETF to be a distinct benefit to our investors."

Mr. Gamache is part of the team running the $440 million Core Alternative ETF, which has achieved a 5.9% annualized return over the five years through Sept. 9, according to FactSet data on ETF.com. The annual expense ratio is 1.07% and the fund holds anywhere between 45 to 60 equity positions and short-dated index options. (The ETF has a blended benchmark of 60% S&P 500 index and 40% Bloomberg U.S. Aggregate Bond index.)

"Absolute-return investing can thrive in the ETF structure and its success is an outcome of the investment process implemented every day," said Mr. Gamache, "not a byproduct of the fund structure it is housed in."

Michael Green, portfolio manager and chief strategist officer at Simplify Asset Management in New York, also believes in the opportunity for ETFs to capture uncorrelated returns. "Operating within the ETF wrapper, we can execute rebalancing without incurring taxable gains in a manner that is not possible for most individuals and many institutions," Mr. Green said.

Simplify launched its "permanent portfolio" Macro Strategy ETF in May. With a gross expense ratio of 0.75%, the ETF offers "pass through pricing" that utilizes other Simplify ETFs focused on convexity, volatility and managed futures, as well as index options.

Yet, even Mr. Green admits that there are corners of the market that are slightly out of reach. "We recognize that over-the-counter positions can become risky due to the disclosure," he said, referring to the requirement that an active ETF must disclose its portfolios positions daily.

Aaron Filbeck, Philadelphia-based managing director and head of UniFi at the CAIA Association, acknowledges that "many traditional hedge funds are investing in less liquid markets and securities" and employ leverage to enhance returns. "In a wrapper that doesn't mandate daily liquidity, leverage is easier to apply," Mr. Filbeck said.

While absolute-return ETFs tend to have higher fees than the rest of the ETF market, they are still not as high as the management and incentive fees charged by most hedge funds today.

"High fees are considered a barrier to success for the end investor," said Simplify's Mr. Green, but in the hedge fund world, they are a sign of exclusivity. "From my perspective, I'd rather offer investors a great deal and the right structure, especially tax efficiency, and let the numbers speak for themselves." ■

ESG ROUNDUP

# BlackRock responds to ESG backlash, 'disturbed' by trend

BlackRock defended its policies regarding climate risk in a response to a letter from 19 U.S. state attorneys general, and expressed concern over the politicization of public pension plans.

The world's largest money manager released the letter Sept. 7 from Dalia Blass, senior managing director, head of external affairs, addressed to the 19 Republican attorneys general who had signed an Aug. 4 letter to CEO Laurence D. Fink accusing BlackRock of using "the hard-earned money of our states' citizens to circumvent the best possible return on investment" in its position on energy investments.

Ms. Blass said in the letter the manager's motives for participating in various ESG-related initiatives is the result of its efforts to "realize the best long-term financial results consistent with each client's investment guidelines," and the participation in the initiatives is consistent with their fiduciary duties.

"Given our commitment to those saving for retirement, we are disturbed by the emerging trend of political initiatives that sacrifice pension plans' access to high-quality investments – and thereby jeopardize pensioners' financial returns," Ms. Blass said. "Open competition, the free flow of information, and freedom of opinions is core to the strength of U.S. capital markets. It is precisely for these reasons that millions of people have been able to build savings during their working years, invest in the capital markets, and live comfortably in their retirement. BlackRock is proud to play our part in that process."

Ms. Blass pointed out that much of the world has already made commitments to net-zero.

"Governments representing over 90% of global GDP have committed to move to net-zero in the coming decades," Ms. Blass said in the letter. "We believe investors and companies that take a forward-looking position with respect to climate risk and its implications for the energy transition will generate better long-term financial outcomes. These opportunities cut across the political spectrum."

The following week, 13 state treasurers and New York City's comptroller signed an open letter taking aim at what they call the "political backlash" against ESG investing by public pension and related funds.

"Several states in our country have started blacklisting financial firms that don't agree with their political views," said the letter.

The letter calls out West Virginia, Idaho, Oklahoma, Texas and Florida for creating new policies and laws "that restrict who they will do business with, reducing competition and restricting access to many high-quality managers. This strategy has real costs that ultimately impact their taxpayers," the treasurers and comptroller said in the letter.

## University of Washington to divest from fossil fuels

University of Washington, Seattle, will divest from fossil fuels and has set a goal of investing at least 2.5% of its $4.7 billion consolidated endowment fund in climate-solution companies or money managers.

The university's board of regents approved a plan at its Sept. 8 meeting to divest completely from fossil fuel companies by the fiscal year ending June 30, 2027, spokesman Victor Balta confirmed in an email.

The plan also includes a commitment to achieve net-zero emissions in the consolidated endowment fund by fiscal year 2050.

The resolution approved by the board directs the University of Washington Investment Management Co., which oversees the management of the endowment fund, to begin exiting all direct investments in fossil fuel companies by the date above, engage with portfolio holdings and external managers to "encourage acknowledgment, measurement and reduction of climate impacts," according to resolution text on the university's website.

The resolution includes allowances for firms it says are "contributing to the transition to sustainable energy."

"With this resolution, the board wishes to avoid greenwashing and to take meaningful action, putting the University of Washington in the front ranks of universities addressing climate change through research, teaching, operations and investments," said David Zeeck, chairman of the board of regents, in the news release.

Mr. Balta said the university currently has a total of about 3% exposure to energy, including less than 1% in direct investments.

## Florida pension fund report shows ESG support

Florida State Board of Administration, Tallahassee, voted in favor of more than 40% of social-related shareholder resolutions and nearly 30% of environmental-related shareholder resolutions during the fiscal year ended June 30, according to a report included with materials for the board's investment advisory council on Sept. 13.

The board, which oversees $228 billion in assets including the $180 billion Florida Retirement System, supported 50.1% of shareholder-proposed ballot resolutions at Russell 3000 index companies during the fiscal year ended June 30, according to the report from Michael McCauley, senior officer – investment programs and governance.

Among the resolutions the board classified as addressing governance issues, which includes board structure, anti-takeover devices and shareowner rights, the SBA supported 57.4% of those resolutions; among resolutions in the social category, which includes human capital, lobbying activity and sanctions, the board supported 42.3%; and among environmental issues, which includes corporate water use and emissions goal-setting, the board supported 29.4%.

Data on the specific ESG-related resolutions that SBA supported was not immediately available.

The board passed a resolution on Aug. 23 that all decisions related to the investment management of the Florida Retirement System will not include ESG considerations.

Since the end of 2021, the SBA has moved much of its proxy-voting authority to its own internal proxy-voting platform from external money managers including BlackRock, and by June 30, SBA staff was directly voting about 99% of all votable assets, according to the report.

Of the 99,759 distinct voting items, SBA staff voted against 16.8% of all management-recommended-votes.

For example, it supported a resolution filed by shareholders of Exxon Mobil Corp. requesting that the oil company's "board of directors seek an audited report assessing how applying the assumptions of the International Energy Agency's Net Zero by 2050 pathway would affect the assumptions, costs, estimates and valuations underlying its financial statements, including those related to long-term commodity and carbon prices, remaining asset lives, future asset retirement obligations, capital expenditures and impairments."

SBA spokeswoman Emilie Oglesby said in an email: "As fiduciaries, the SBA and its investment managers are required to take all relevant risks into account when making investment decisions. Neither the SBA nor its managers use ESG factors as a way to screen or limit the available investment opportunity set. We do not invest to make social statements."

## NZ Super shifts $15 billion to low-carbon indexes

New Zealand Superannuation Fund, Auckland, shifted about 40% of its investment portfolio — NZ$25 billion ($15.3 billion) in passive global equities — into low-carbon indexes as part of a sustainability push.

The changes apply to the NZ$57 billion sovereign wealth fund's index-tracking reference portfolio benchmark and the corresponding allocations to passive global equities.

"In addition to alignment with climate goals, we expect these new indices to deliver better environmental, social and governance metrics across the board," CIO Stephen Gilmore said in a news release.

The fund began its changeover to the MSCI World Climate Paris Aligned index and the MSCI Emerging Markets Climate Paris Aligned index in June, with the new benchmarks taking effect July 1. The wealth fund previously tracked a customized version of the MSCI ACWI Investable Market index.

## Investors want governments to raise climate ambitions

As government officials around the world prepare for the next U.N. climate change summit, more than 500 institutional investors are urging them to "raise their climate ambitions," including addressing methane emissions, according to a statement released Sept. 13 by The Investor Agenda.

The 27th Conference of the Parties of the United Nations Framework Convention on Climate Change, or COP27, begins Nov. 6 in Sharm el-Sheikh, Egypt.

The global investor statement to the governments was signed by 532 investor signatories representing $39 trillion in assets.

One of the five policy priorities in the statement is for governments to scale up climate finance from the public and private sectors, with particular focus on emerging markets.

In addition to ensuring that countries' targets to address global warming are aligned properly, the investors want governments to mandate climate transition plans and more climate disclosure across the financial system.

"Mandatory disclosure will help investors compare companies efficiently and decide who is really moving," said Kirsten Spalding, senior program director of Ceres Investor Network, in an interview.

## Real estate managers use problematic climate tools

Real estate managers are using a grab bag full of conflicting climate models, assumptions, data and software to assess climate risk, according to a soon-to-be released report by the Urban Land Institute and LaSalle Investment Management.

It's like comparing apples with "something that isn't a fruit," Elena Alschuler, LaSalle's Americas head of sustainability and vice president who co-authored the report, said in an interview.

These findings come at a time when many investors are trying to assess the physical risks to their real estate portfolios of such weather events as floods, wildfires and excessive heat caused by climate change.

These inconsistencies have led climate analytics providers to arrive at different risk scores for the same building, said the report, which is based on interviews with U.S. and global real estate managers conducted in the second quarter of 2022.

The variation between scores range from small to great orders of magnitude, Ms. Alschuler said.

ULI and LaSalle executives are shining a light on the problem to promote the development of a consistent approach to climate-related analysis. The industry needs a "common language" to assess risk from climate change and the business impact of that climate risk, she said.

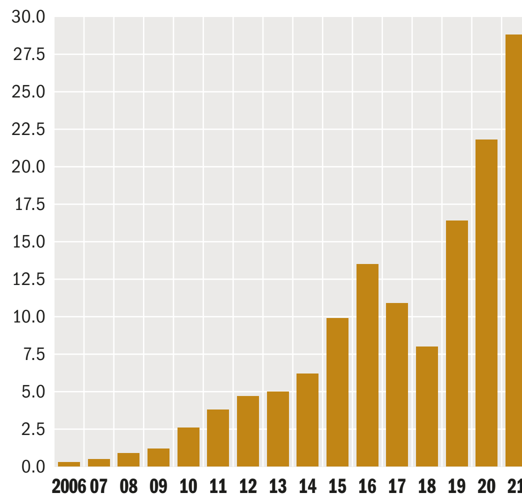
Indeed, real estate managers interviewed do not believe that physical risk from climate change is currently priced into commercial real estate values, she said.

## Solar energy really heating up

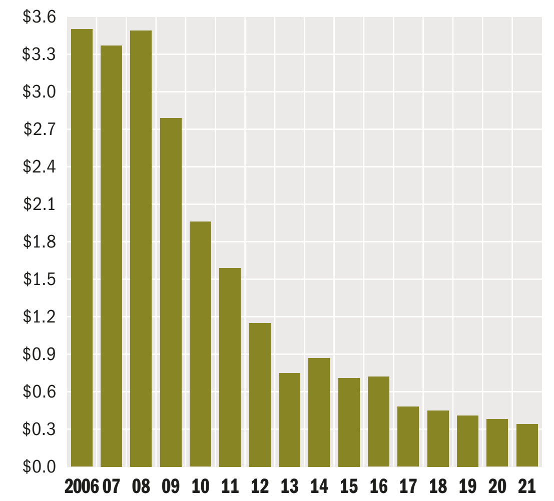
U.S. shipments of solar panels rose to a record 28.8 million peak kilowatts last year, up from 21.8 million in 2020, according to the U.S. Energy Information Administration. The majority — 80% — were imported from Asia. With the recently signed Inflation Reduction Act, which encourages renewable energy, many expect solar installations to increase over the next decade.

Using the average value of U.S. solar panel shipments as a measure, prices fell about 11% to 34 cents per peak kW last year, despite higher costs related to supply-chain issues and materials.

**U.S. solar panel shipments** (millions of peak kilowatts)




**Average value of U.S. solar panel shipments** (per peak kilowatt)




Source: U.S. Energy Information Administration

Investment
**INSIGHTS**

# DELIVERING ON SUSTAINABILITY IN THE INSTITUTIONAL MARKETS

*Clear intentions and transparent actions support ESG alignment with institutional clients*

**KEITH MCDONAGH**
Head of Institutional Solutions
MassMutual

To ensure durability and sustainability in the institutional markets, all participants — from clients to asset managers, financial professionals and solution providers — should adopt both financial and environmental, social and governance (ESG) objectives with a long-term view. With many institutional investors using an ESG lens when they select and work with asset management and financial firms, they are interested both in how their asset managers incorporate ESG investing and how the firms themselves are committed to ESG principles.

Despite the current challenges of the market environment, with rising inflation and economic uncertainty, the commitment and interest in sustainability persists among institutional clients who aim to be well positioned for the long-term, said Keith McDonagh, head of Institutional Solutions at Massachusetts Mutual Life Insurance Company, or MassMutual. "It's the connection between the long-term durability of a business and the long-term durability of the society in which we live, operate and run our businesses."

"When you think about ESG principles, you're thinking about the long-term impact for the business, whether that's related to the environment, related to equity and inclusion or all the other aspects of ESG," McDonagh said. These objectives are increasingly significant for MassMutual's institutional clients who want to learn more about the firm's commitment to ESG both as a company and as a financial solutions provider, he said. Top themes include climate change and achieving net-zero carbon emissions as well as diversity, equity and inclusion.

> *There's an inherent alignment between mutuality and sustainability because both are focused on excellence over the long-term.*

### MUTUALITY AT THE CORE

For MassMutual, a 171-year-old life insurance company that has customers, members and participating policyowners, mutuality is a core value, McDonagh said. "When you have relationships that can last decades into the future, you want to ensure that your company and the promises you provide last not only today and tomorrow but well into the future."

"The other element of mutuality is collectively pooling together to help each other for long-term financial well-being," he said. "There's an inherent alignment between mutuality and sustainability because both are focused on excellence over the long-term."

This mindset informs the firm's approach to sustainability, McDonagh said, which includes goals related to environmental stewardship, social responsibility and good governance. MassMutual has embraced these tenets of ESG within its investment portfolio and throughout its operations.

Many institutional clients today are seeking an alignment of shared interests with their industry partners, he pointed out. "Are those alignments of interests on shared ESG principles? Are they on complementary ESG goals and objectives within the investment portfolio? And do they deliver long-term value creation?"

### TAKING A SUSTAINABLE PATH

While MassMutual has long focused on ways to decrease its environmental impact, it recently accelerated its actions by committing to net zero greenhouse gas emissions in its operations by 2030. To that end, a new Boston office that opened last year is certified as LEED Platinum® under the U.S. Green Building Council's Leadership in Energy and Environmental Design program. More than 90% of the company's corporate facilities (by square footage) have LEED certification, including its 1927-built Springfield headquarters, which has had major retrofitting, McDonagh said.

In addition, MassMutual is a signatory of the United Nations-supported Principles of Responsible Investing, and 97% of the general investment account that it runs for clients is managed by PRI signatories[1]. In 2021, the firm made a commitment to achieve net zero greenhouse gas emissions in its portfolio by 2050, McDonagh noted. "Those are some of the ways that we have not only demonstrated our commitment, but have also made progress toward our goals," he said.

"All of these steps align with our core intentions of how we think about having a positive impact on the environment," McDonagh said.

For its overall investment portfolio, MassMutual follows a framework that its portfolio managers use to evaluate opportunities across the investment portfolio. The framework takes an engagement-centered approach in which MassMutual actively engages with companies and investment partners on their ESG-related activities and policies.

On the aspect of social responsibility, MassMutual committed $100 million of impact investment capital aimed at advancing racial equity and economic opportunity: $50 million of that commitment is allocated to the MM Catalyst Fund[2], which supports entrepreneurs in Massachusetts, including Black-owned, founded or managed businesses as well as technology and sustainability-focused companies.

### TRANSPARENT GOALS AND ACTION

Institutional investors who prioritize a mutual commitment to ESG objectives with their industry partners need to do the necessary due diligence to evaluate their partners' ESG processes and outcomes, McDonagh said. "That requires seeing whether a company's actions are consistent with the goals that they've publicly shared."

"By having that conversation and doing that research, you can understand whether there is an alignment of interests," he said. "You want partners with whom you not only have alignment of interests on business and financial goals, but on sustainability and ESG principles as well."

As institutional clients look more closely at how industry providers are meeting stated ESG objectives, transparency is key. "Companies need to be clear about what their intentions and goals are. But it's not just about the statements that companies make. What are the actions they are taking?" he said.

MassMutual published its first sustainability report earlier this year. "We've continued to try to evolve how we provide the market and our customers with information on where we stand on ESG and the actions we're taking," McDonagh said. "Our evolution has been about continually looking at ways that we can have more positive impact and how to get that information into the hands of those who care about it in the most effective manner."

> *It's the connection between the long-term durability of a business and the long-term durability of the society in which we live, operate and run our businesses.*

### IT'S A JOURNEY

Increasingly, interests overlap. Thinking sustainably is an essential part of operating a successful business — or finding investment opportunities — in today's market environment, McDonagh said. "ESG principles, to my mind, are not something distinct from how you operate a business. They are embedded in how you operate a business."

"It's a journey — it's not a destination." It's matter of how companies move "toward those goals," he said. "For a company to be really successful, it is about stewardship of its assets, its mission, its relationships with customers [and] its ESG principles."

Part of that is inclusion, "to ensure, as an organization, that we serve all our diverse customers and our communities as well as we can," he said, adding that this sustainable approach across different dimensions will drive long-term value creation in the industry.

Looking ahead, MassMutual will continue to evolve its approach toward ESG, just as it has done over the years, McDonagh said. "You're never finished with sustainability, because you can always have an increasingly positive impact on the societies where you are and on the environment. And the solutions that are available to make a positive impact continue to evolve as well." ■

*sponsored by:*

MassMutual

pionline.com/mm-ESG2022

1. As of December 31, 2021
2. As of February 2021

P&I CONTENT SOLUTIONS GROUP

This sponsored Investment Insights is published by the P&I Content Solutions Group, a division of *Pensions & Investments*. The content was not produced by the editors of *Pensions & Investments* and *www.pionline.com* and does not represent the views of the publication or its parent company, Crain Communications Inc.

# HIRINGS

■ **Alaska Retirement Management Board**, Juneau, completed two new commitments totaling $80 million.

The board's investment staff in July completed commitments of $40 million each to Glendon Opportunities Fund III, a credit and special situations fund managed by **Glendon Capital Management**, and middle-market buyout fund **Sentinel Capital Partners** VII, according to a report from CIO Zachary A. Hanna included with board materials for its upcoming meeting Sept. 15-16.

The board oversees the management of a total of $40.4 billion in defined benefit and defined contribution plan assets, including the $23.4 billion Public Employees' Retirement System and $10.9 billion Teachers' Retirement System.

■ **Arlington County (Va.) Employees Retirement System** approved three new commitments totaling $60 million. The $3.1 billion pension fund's board at its Sept. 1 meeting approved commitments of $25 million to JFL Equity Investors VI, a middle-market buyout fund managed by **J.F. Lehman & Co.**, $20 million to Franklin Park Co-Investment Fund V and $15 million to Franklin Park Venture Capital Fund XIV, a venture capital fund of funds, both managed by **Franklin Park Associates**, said Susie Ardeshir, executive director and chief investment officer, in an email.

**HAVE SOME NEWS?**

Please submit news of changes to John Fuller, news editor, at john.fuller@pionline.com.

■ **Cambridge (Mass.) Retirement System** hired **Acadian Asset Management** to run about $50 million in active international equities, and also rehired **abrdn** and hired **RBC Global Asset Management** to run about $42 million each in active emerging markets equities. The $1.8 billion pension fund's board approved the hirings at its Aug. 3 meeting, recently released meeting minutes show.

The other international equity finalists were Aristotle Capital Management, Marathon Asset Management and Trinity Street Asset Management. RBC Global Asset Management was the incumbent international equity manager; the minutes did not say whether the manager bid for those services.

For the emerging markets equity portfolio, abrdn was the incumbent active manager. Its portfolio will be reduced to $42 million from $79 million, while the remaining funding will come from a reduction in the portfolio of passive emerging markets equity manager Mellon Investments, leaving it with about $68 million.

■ **Centrica**, Windsor, England, appointed **Redington** as strategic investment consultant for its £10 billion ($11.5 billion) in defined benefit assets, including oversight of its recently adopted OCIO agreement with Schroders Solutions.

The energy services provider runs three pension funds with more than 36,000 participants. The move to an OCIO model was announced in April, with Centrica's seven-person investment team led by CIO Chetan Ghosh joining Schroders Solutions as part of the deal.

Redington will oversee the implementation of the agreed strategy under the OCIO arrangement and will provide oversight and recommendations relating to how that relationship develops.

■ **Colorado Fire & Police Pension Association**, Greenwood Village, disclosed two new alternative fund commitments totaling $45 million.

The $6.2 billion pension fund's investment staff committed $30 million to Banner Ridge DSCO Fund II, a secondary distressed debt fund managed by **Banner Ridge Partners**, and $15 million to Clean Growth Fund VI, an impact-oriented venture capital and growth equity fund of funds managed by **North Sky Capital**, according to an investment report included with Aug. 31 board meeting materials.

■ **Constitutional Reserve Fund of Monaco** committed €10 million ($10 million) to **Ocean 14 Capital** Fund 1, which aims to improve ocean health.

The impact fund focuses on the so-called blue economy, which is forecast by the Organization for Economic Cooperation and Development to be worth $3 trillion by 2030. It aims to invest in eight companies this year and grow its portfolio to between 20 and 25 businesses within three years, said a news release posted on Ocean 14's website.

Following the commitment from the sovereign wealth fund, which has $6 billion in assets according to data firm Global SWF, the private equity firm has raised €100 million since launching its fund in December.

■ **Dallas-Fort Worth International Airport Board** hired **Causeway Capital Management** to run about $32 million in active international equities.

The $828 million pension fund's board approved the hiring at its Sept. 1 meeting, spokesman Brian A. Brooks said in an email.

Funding comes from the termination of Ivy Investments due to underperformance, according to a memo included with board meeting materials. The firm was acquired by Macquarie Asset Management in 2021. Macquarie spokesman Lee Lubarsky declined to comment.

Separately, the board also approved a commitment of $8 million to AG Realty Value Fund XI, a value-added real estate fund managed by **Angelo, Gordon & Co.**

■ **Fort Lauderdale (Fla.) Police & Firefighters' Retirement System** hired **Waycross Partners** to manage about $25 million in active domestic large-cap growth equities.

The $1.2 billion pension fund's board approved the hiring at its Aug. 10 meeting, spokesman Fred Nesbitt said. Funding comes from the termination of INTECH Investment Management from its active domestic large-cap core equity portfolio.

Mr. Nesbitt said the termination was not for performance reasons, but because the board wanted to give its overall domestic equity portfolio more of a growth tilt.

■ **Illinois State Treasurer's Office**, Springfield, rehired **Marquette Associates** as investment consultant for the $86 million Illinois Secure Choice Savings Program, said Christopher Flynn, chief procurement officer for the treasurer's office, in an email.

Mr. Flynn said Goelzer Investment Management and Meketa Investment Group also submitted proposals. Marquette was the sole finalist.

Ascensus is the program manager of the Illinois Secure Choice Savings Program, which is an auto-enrollment, payroll-deducted retirement savings account for certain private-sector employees whose employers do not offer retirement plans.

## CALPERS PUTS $7.4 BILLION TOWARD ALTS

CalPERS committed approximately up to $7.4 billion to 16 alternative investment strategies, the $444.4 billion pension plan reported.

The California Public Employees' Retirement System, Sacramento, committed up to $1.2 billion to Redwood Lane Capital, a new technology private equity limited partnership managed by **Veritas Capital Fund Management**.

CalPERS also committed $750 million each to Blackstone Mileway Logistics, a European last-mile logistics fund managed by **Blackstone**; IFM Global Infrastructure Fund, an open-end infrastructure fund managed by **IFM Investors**; and Advent International GPE X, a buyout fund managed by **Advent International**.

CalPERS also committed a total of $1.4 billion to three buyout funds: $600 million to **Thoma Bravo** Fund XV, up to €500 million ($497 million) to **Rubicon Partners**, and $300 million to **Arlington Capital Partners** VI.

The pension fund committed $350 million to Silver Lake Partners VII and $75 million to SLP Emblem Co-Invest, a co-investment fund, both managed by **Silver Lake**.

Pension fund officials also made commitments to two **Bessemer Venture Partners** funds: $115 million to Bessemer Venture Partners XII Institutional, a technology-focused venture capital fund, and $35 million to BVP Forge Institutional, a buyout fund.

CalPERS also made about $2 billion in additional commitments to five existing alternative investment strategies: up to $500 million to Nordic Bear, a European private equity strategy managed by **EQT**; $400 million to CalEast Solstice, a real estate joint venture between CalPERS and **GI Partners**; $400 million to Institutional Logistics Partners, a real estate partnership investing in logistics with **Bentall GreenOak**; $380 million to a core office separate account managed by **CommonWealth Partners**; and $285 million to TechCore 2019, a technology-related real estate partnership with GI Partners.

■ **Kommunal Landspensjonskasse**, Oslo, committed 2 billion Norwegian kroner ($199 million) to **Quinbrook Infrastructure Partners** III – Net Zero Power Fund, as part of an annual goal to invest in climate-friendly investments, spokesman Glenn Slydal Johansen said in an email.

The fund invests in solar power with battery systems and in green data centers in the U.S., U.K. and Australia. U.S. companies Primergy Solar and Rowan Digital Infrastructure will represent at least two-thirds of the fund's investments, according to KLP's website. In the first phase, KLP bought into an existing portfolio, and future money will go to new capacity.

As of March 31, KLP had 710.5 billion Norwegian kroner in assets, while the parent company KLP Group, including five subsidiaries, had total assets of 902.9 billion kroner, according to its latest report.

The annual goal of investing 6 billion kroner each year in climate-related investments was set in 2017, and now accounts for 8% of KLP Group's total investments. The Quinbrook Net Zero Power Fund allocation will contribute to the annual goal "and be part of the transition to a net zero society," said Harald Koch-Hagen, director of risk management and allocation at KLP, in an article on the KLP website.

■ **Louisiana Teachers' Retirement System**, Baton Rouge, rehired **T. Rowe Price Group** to manage about $250 million in active domestic small-cap growth equities and committed $425 million to several alternatives funds.

The $25.4 billion pension fund's board approved the hiring at its meeting Sept. 8, said Dana T. Brown, director of public markets, in an email.

The pension fund had issued a solicitation for proposals in June for two small-cap growth equity managers to run about $250 million each, due to the upcoming expirations of T. Rowe Price and AllianceBernstein's contracts on Nov. 29.

The board on Sept. 8 eschewed finalist presentations for T. Rowe Price's portfolio and approved **AllianceBernstein** as a finalist for the other portfolio along with **Driehaus Capital Management**. Those two managers will make presentations at the board's Oct. 7 meeting, and a selection is expected shortly thereafter.

Separately, the pension fund's board approved six new alternative fund commitments totaling up to $425 million.

The board approved commitments of up to $125 million to HPS Special Situations Opportunity Fund II, a distressed debt fund managed by **HPS Investment Partners**; $75 million each to value-added real estate fund **EQT Exeter** Industrial Value Fund VI, Harbert European Real Estate Fund VI, a value-added real estate fund managed by **Harbert Management**, and opportunistic real estate fund **Henderson Park** Real Estate Fund II; up to $50 million to ECP V, an energy fund managed by **Energy Capital Partners Management**; and up to $25 million to Ares Special Opportunities Fund II, a middle-market distressed credit fund managed by **Ares Management**.

■ **Marlborough (Mass.) Contributory Retirement System** hired **People's Bank** as custodian.

The $198 million pension fund's board approved the hiring of the bank at its July 26 meeting, recently released meeting minutes show.

The pension fund issued an RFP in May. Current custodian Comerica was eligible to rebid, but the firm did not do so, according to the minutes.

■ **Miami Firefighters' and Police Officers' Retirement Trust** hired **Waycross Partners** to run about $50 million in active domestic large-cap core equities.

The $1.6 billion pension fund's board approved the hiring at its meeting on Sept. 15, said Dania L. Orta, administrator, in an email.

The pension fund conducted a shortlist search because investment consultant Meketa Investment Group recommended adding an additional active large-cap manager with a consolidated portfolio with significant tracking error vs. the index. This strategy "has a good opportunity to produce strong performance if their positions outperform the few large positions driving index returns," according to a presentation included with Sept. 15 meeting materials.

The other finalist was Parnassus Investments.

Funding will come from a reduction of the passive domestic large-cap equity portfolio managed by Northern Trust Asset Management, previously the pension fund's sole large-cap manager, leaving it with about $300 million in assets.

■ **Michigan Department of Treasury**, Bureau of Investments, disclosed just over $2.3 billion in alternative fund commitments completed in the second quarter on behalf of the $93.4 billion Michigan Retirement Systems, East Lansing, according to materials for the upcoming Sept. 22 investment board meeting.

In absolute return, the bureau committed $500 million to senior direct lending fund **Sixth Street** Lending Partners; $300 million to Apollo Accord+, a multiasset-class opportunistic credit fund managed by **Apollo Global Management**; $250 million to Irradiant Solutions Fund II, a buyout fund managed by **Irradiant Partners**; and $225 million to Owl Rock Technology Finance Corp. II, a direct lending fund managed by **Blue Owl Capital**.

In private equity, the bureau committed $150 million to Apax XI, a middle-market buyout fund managed by **Apax Partners**; $113 million to buyout fund **TPG** Partners IX and $38 million to health-care-focused private equity fund TPG Healthcare Partners II; $100 million to growth equity fund **Blackstone** Growth II; $50 million to venture capital fund **Accel** Leaders Fund 4; $48 million to Meritech Capital Partners VIII and $12 million to Meritech Capital Sidecar III, both venture capital funds managed by **Meritech Capital Partners**; $35 million to multistage health-care venture capital fund **Arboretum Ventures** VI; $35 million each to FirstMark Capital VI and FirstMark Capital OF IV, both venture capital funds managed by **FirstMark Capital Partners**; and $8 million to Lightspeed India Partners IV, a venture capital fund managed by **Lightspeed Venture Partners** targeting India-based technology firms.

In its real estate and infrastructure asset class, the bureau committed $200 million to global real estate fund Blackstone Real Estate Partners X; $100 million to ASF VIII Infrastructure B, an infrastructure secondaries fund managed by **Ardian**; $75 million to Ridgewood Water & Strategic Infrastructure Fund II, an infrastructure fund managed by **Ridgewood Infrastructure**; and $50 million to Warwick UK Real Estate Fund I, an opportunistic real estate fund managed by **Warwick Investment Group**.

## HIRINGS

■ **Nebraska Investment Council**, Lincoln, approved a $50 million commitment to Dover Street XI.

The council, which oversees $35.6 billion, made the commitment to the secondary private equity fund managed by **HarbourVest Partners** at its Sept. 8 meeting, Michael Walden-Newman, state investment officer, said in an email.

The commitment was on behalf of the council's five defined benefit plans, which have a total of $14.8 billion in assets, and its cash balance benefit plans totaling $2.6 billion.

■ **New Castle County (Del.) Employees' Pension Program** approved two new commitments totaling $14 million.

The $565 million pension fund's board at its July 20 meeting approved commitments of $9 million to real estate fund **TA Realty** Value-Add Fund XIII and $5 million to Backcast Credit Opportunities Fund II, a private credit fund managed by **Backcast Partners**, recently released meeting minutes show.

■ **North Carolina Retirement Systems**, Raleigh, disclosed two new alternative fund commitments totaling $602 million.

The $111 billion retirement system committed $500 million to global real estate fund **Blackstone** Real Estate Partners X and $102 million to Hg Genesis 10, a European upper-middle-market buyout fund managed by **Hg Capital**, according to a report included with Aug. 24 investment advisory committee meeting materials on the website of Dale R. Folwell, state treasurer and sole trustee of the retirement system.

■ **Oregon Investment Council**, Tigard committed $150 million to Sculptor Diversified Real Estate Income Trust.

The council, which oversees the $93.3 billion Oregon Public Employees Retirement Fund, Salem, has invested with **Sculptor Capital Management** in the past, including a $150 million commitment to Sculptor Real Estate Fund IV, an opportunistic real estate fund, in 2020.

■ **Pinellas Park, Fla.**, hired **SageView Advisory Group** as the first investment consultant for its $21 million 457 plan, said Kelly Schrader, city finance administrator, in an email.

The city issued an RFP in April for its first investment consultant to assist in the ongoing evaluation of investment options provided by record keepers MissionSquare Retirement and Nationwide Financial.

■ **San Francisco City & County Employees' Retirement System** disclosed four new commitments totaling $245 million in a report from CEO/CIO Alison Romano ahead of its Sept. 15 board meeting.

It also made a $300 million follow-on commitment.

Within real assets, the $33.6 billion pension fund committed $70 million to JEN 8, a U.S. residential land development fund managed by **JEN Partners**; $65 million to GCP Secure-Space Property Partners, a real estate fund managed by **GLP Capital Partners**; and $40 million to SAF Annex Fund, an infrastructure fund managed by **Vision Ridge Partners**.

Within private credit, SFERS committed $70 million to Arrow Credit Opportunities II, a private credit fund managed by **Arrow Global**, a new manager for the pension fund.

The pension fund also made a follow-on commitment of $300 million to Presidio Loan Fund, a customized global senior debt "fund of one" managed by **HPS Investment Partners**. SFERS originally committed up to $275 million to the fund in 2020.

■ **San Jose (Calif.) Federated City Employees Retirement System** committed $9 million to Octagon CLO Opportunity Fund IV, said Ron Kumar, investment operations supervisor, in an email.

The $2.7 billion pension fund's commitment to the private credit fund managed by **Octagon Credit Investors** was disclosed in a private markets report from investment consultant Meketa Investment Group included with materials for its upcoming Sept. 15 board meeting.

■ **South Carolina Retirement System Investment Commission**, Columbia, disclosed $400 million in commitments for the $38.3 billion South Carolina Retirement Systems' investment portfolio, according to documents from the commission's meeting Sept. 8.

The commitments were made from June through August.

The commission committed $100 million to global real estate fund **Blackstone** Real Estate Partners X and $100 million to **EQT Exeter** Industrial Value Fund VI, a value-added industrial real estate fund.

The commission also made a $100 million commitment to Brookfield Infrastructure Fund V, a core and core-plus infrastructure fund managed by **Brookfield Asset Management** that invests in North America, Latin America and Asia.

Lastly, the commission committed €50 million ($50 million) to Eighth **Cinven** Fund, a European buyout fund and $50 million to Eagle Point Defensive Income Fund II, which invests in certain types of senior unsecured debt or preferred equity securities and is managed by **Eagle Point Credit Management**.

■ **Southfield (Mich.) Employee Retirement System** committed $2 million to Sturbridge Diversified Private Equity III.

The $112 million pension fund's board approved the commitment to the secondary private equity fund at its July 19 meeting, recently released meeting minutes show.

It is the pension fund's first commitment to a **Stubridge Capital** fund.

■ **Tacoma (Wash.) Employees' Retirement System** approved a commitment of $50 million to American Rivers Fund.

The $2 billion pension fund's board approved the commitment to the private real assets fund managed by **Maritime Partners** at its Aug. 11 meeting, said Tim Atwill, deputy chief investment officer, in an email.

As of June 30, the pension fund's actual allocation to real assets was 5.6%.

■ **Texas Teacher Retirement System**, Austin, completed a total of $685 million in private equity and energy commitments in August, according to a transaction report emailed by spokesman Rob Maxwell.

Within private equity, the $199.9 billion pension fund committed $400 million to Apollo Investment Fund X, a buyout fund managed by **Apollo Global Management**; $200 million to Eighth **Cinven** Fund, a European buyout fund; and $20 million to CoinFund Ventures I Onshore, a venture capital fund focused on crypto assets that is managed by **CoinFund Management**.

Within its energy, natural resources and infrastructure asset class, TRS committed $65 million to Greenbelt Capital Partners TRP, an energy-focused private equity fund managed by **Greenbelt Capital Management**.

Greenbelt Capital, a new manager for the pension fund, was spun out in January by the energy team from growth-focused private equity manager Trilantic North America.

■ **State of Wisconsin Investment Board**, Madison, disclosed private equity and real estate commitments during the second quarter totaling $1.5 billion in materials for its upcoming board meeting Sept. 14.

In real estate, the board, which manages $145.8 billion in assets, including the $124.9 billion Wisconsin Retirement System, committed $300 million to global real estate fund **Blackstone** Real Estate Partners X; $150 million to RREEF Core Plus Industrial Fund, an open-end real estate fund managed by **DWS Group**; $50 million to AG Asia Realty Fund V, a value-added real estate fund managed by **Angelo, Gordon & Co.**; and $50 million each to Gateway Real Estate Fund VII and Gateway VII Co-Investment Account (SWIB), both China-focused real estate funds managed by **Gaw Capital**.

The board also made follow-on commitments of $100 million to Rockwood Multifamily Partners, a real estate fund managed by **Rockwood Capital**; $26 million to open-end industrial real estate fund Realterm Airport Logistics Properties; and $25 million to Wilson HCF Wisconsin Holdings 8, a customized real estate fund managed by **Heitman**.

SWIB originally committed $150 million to the Rockwood fund in 2021 and $26 million to the Realterm fund in 2020, and has made multiple commitments to the Wilson fund totaling $225 million.

In private equity, the board committed €150 million ($149 million) to EQT X, a buyout fund managed by **EQT Partners**; $100 million to **Blackstone** Tactical Opportunities Fund IV, an opportunistic global multistrategy alternatives fund; $100 million to Glendon Opportunities Fund III, a credit and special situations fund managed by **Glendon Capital Management**; €65 million to Hg Genesis 10, a buyout fund managed by **Hg Capital**; $50 million to Ares Special Opportunities Fund II, a middle-market distressed credit fund managed by **Ares Management**; $50 million to buyout fund **Sterling Group** Foundation Fund; $50 million to middle-market buyout fund **Varsity Healthcare Partners** IV; $40 million to Centerbridge Seaport Acquisition Fund, a buyout fund managed by **Centerbridge Partners**; and $37 million to buyout fund **Water Street Healthcare Partners** V.

Also during the second quarter, the board completed a total of $76 million in three information technology private equity co-investments, one financials co-investment and one health-care co-investment.

**Defined Contribution**

# Morningstar decries suits focused on past performance of TDFs

By ROBERT STEYER

The recent filings of 11 ERISA lawsuits against 401(k) sponsors offering a BlackRock Inc. target-date fund series have prompted Morningstar Inc. to warn that evaluating an investment based on historical returns and on "a hand-picked group of peers could set a dangerous precedent" for plan fiduciaries.

"There's more to picking a target-date strategy than past performance," said a Sept. 7 Morningstar report referring to the lawsuits that argued sponsors should have replaced the BlackRock LifePath Index series due to alleged poor performance when compared with several competitors. The lawsuits, all filed by Miller Shah LLP, accused the sponsors of failing to find a better choice and of pursuing a lower-fee investment option over investments with better returns.

"If plan sponsors have to worry that they will face a lawsuit for periods when a series isn't a top performer, it can potentially lead them to performance-chasing and swapping out the target-date funds more often than they should," said the report, called "New 401(k) Lawsuits Go Too Far," by Megan Pacholok, a Morningstar research manager analyst. "If the lawsuits are successful, this can lead plan sponsors facing similar questions on every fund offered in their 401(k) lineups."

Lawyers for Miller Shah did not return requests for comment.

The lawsuits, filed in late July and August, compared the passively managed BlackRock LifePath Index series to those of four competitors.

However, the Morningstar report questioned the evaluating of the investments not only by past performance but also by comparing BlackRock's target-date series to a handful of the 54 other target-date mutual funds available during the period covered by the lawsuits.

Among the comparisons in the lawsuits are quarterly net returns from the second quarter of 2016 through the second quarter of 2022 assessing American Funds Target Date Retirement (managed by Capital Group) and T. Rowe Price Retirement, both of which are actively managed, plus Fidelity Freedom Index and Vanguard Target Retirement, both of which are passively managed by Fidelity Investments and Vanguard Group. The lawsuits also cited the actively managed Fidelity Freedom target-date series but excluded it from the comparisons, saying it exhibited "myriad quantitative and qualitative red flags."

Each quarterly return was analyzed for three-year annualized results and for five-year annualized results for the mutual fund-based target-date series. "Virtually all competent investment advisors emphasize that fiduciaries should focus on three-year and five-year returns to evaluate performance of an investment over periods most approximating a market cycle," the lawsuits said.

BlackRock isn't a defendant, and its response via email has been identical for each complaint. The company's investment process "takes into account multiple factors, including return objectives, market cycles, time horizon, and risk management," the email said. The BlackRock LifePath Index series is "highly regarded by many fiduciary decision-makers and independent evaluators of investment products," it added.

### Selective comparisons

The Morningstar report showed how selective comparisons of different target-date series over different periods of time can affect performance evaluations. In each comparison, Morningstar selected the cheapest share classes of target-date funds.

For example, Morningstar reviewed total returns for the first seven months of this year for the 2025 vintage funds.

The Morningstar total return for the 2025 vintage category, covering 55 funds, was -11.13%. Among the target-date families cited in the lawsuits, the total return for the BlackRock LifePath Index Fund's 2025 vintage was -10.74%, placing second behind American Funds Target Retirement at -10.08%.

The total returns for the 2025 vintage funds for the other target-date families cited in the lawsuits ranged from -11.36% to -12.38%, according to Morningstar Direct.

"BlackRock's more conservative approach has benefited shareholders" this year, the Morningstar report said.

Morningstar also looked at the various 2025 vintage target-date series, from May 2011, when the BlackRock series was launched, through July 2022.

Comparing annualized returns, Morningstar Direct found that the BlackRock series outperformed the category average (6.12% vs. 5.74%), but lagged each of the other target-date families named in the lawsuits, whose 2025 vintage funds' annualized returns ranged from 6.21% to 7.66%. The BlackRock results "can largely be attributed to its lower allocation to stocks," the report said.

Morningstar also looked at total returns of 2060 vintage funds – those with the highest allocation to equities – annualized for the five years ended July 31.

The category average was 7.41%, according to Morningstar Direct. The BlackRock LifePath Index total return was 8.14%, second best among the target-date competitors named in the lawsuits. American Funds Target Retirement was first at 8.17%. The others' returns ranged from 7.68% to 7.87%.

"Looking at the past five years, if a plan sponsor switched target-date series to one of the proposed series (cited in the lawsuits), younger investors would have been worse off," the Morningstar report concluded. "BlackRock's larger equity allocation further from retirement helped boost returns." ■

P&I | CAREERS AND RFPs

To place your ad contact
**Thomas Markley**
**(603) 305-1967**
thomas.markley@pionline.com

## RFP

**PUBLIC NOTICE**

**New York City Deferred Compensation Plan**

The New York City Deferred Compensation Plan (the "Plan") is seeking qualified vendors to provide Discretionary Investment Management of Traditional Guaranteed Investment Contracts in a separate account format for the Plan's Stable Income Fund ("the Fund"). To be considered, vendors must submit their Traditional GIC separate account composite information to Milliman Investment Consulting at the following e-mail address: investment.search@milliman.com. Please complete the submission of Traditional GIC separate account composite information no later than 4:30 P.M. Eastern Time on October 11, 2022.

**Consistent with the policies expressed by the City, proposals from certified minority-owned and/or women-owned businesses or proposals that include partnering arrangements with certified minority-owned and/or women-owned firms are encouraged. Additionally, proposals from small and New York City-based businesses are also encouraged.**

## RFP

**New York State Insurance Fund (NYSIF)**
**Investment Accounting Services and Software**
**RFP NYSIF 2022-53-INV**

NYSIF is seeking proposals from qualified firms capable of providing Investment Accounting Services and Software, as further described in the Request for Proposals (found www.nysif.com/procurement). NYSIF is seeking investment accounting services, along with access to such service provider's deliverables via website or cloud-based software, for its approximately $22 billion in investments from qualified firms. Services also include providing required schedules for financial and regulatory reporting, including but not limited to Schedule D and Schedule BA, monthly general ledger entries and annual SOC-1 Report Controls. Proposals from responsible bidders are due 10/24/22.

## RFP

**Ohio Retirement Study Council Requests Proposals for Fiduciary Audit Services for HPRS**

The Ohio Retirement Study Council has issued an RFP seeking proposals from qualified firms interested in providing independent fiduciary audit services of the Ohio State Highway Patrol Retirement System.

The RFP is available at www.orsc.org. Responses must be submitted no later than 5:00 pm EST on October 26, 2022.

Questions may be submitted via email to Bethany Rhodes, Director and General Counsel, at Bethany.Rhodes@orsc.org.

Alert the top investment managers and service providers about your next RFP.

**Let's get started**
Contact Thomas Markley at thomas.markely@pionline.com or 603.305.1967 today.

P&I | RFP

## CAREERS

### ONLINE CAREER POSTINGS

To view these job opportunities and more go to www.pionline.com/careers

| Job Title | Company | Location | Date Posted |
|---|---|---|---|
| Chief Investment Officer | North Dakota Department of Trust Lands | ND | 9/5/2022 |
| Chief Risk Officer | North Dakota Retirement and Investment Office | ND | 8/29/2022 |
| Analyst (Arbitrage Investment) | Farallon Capital Management, L.L.C. | PA | 8/29/2022 |
| Senior Investment Director, Private Markets | California State Teachers' Retirement System | CA | 8/24/2022 |
| Senior Investment Director, Public Markets | California State Teachers' Retirement System | CA | 8/24/2022 |
| Chief Investment Officer (CIO) | State of Hawaii Employee's Retirement System | HI | 8/19/2022 |
| Senior Investment Officer -Credit & Opportunistic/ARS | New York State Office of the Comptroller | NY | 8/11/2022 |
| Investment Officer I | West Virginia Investment Management Board | WV | 8/10/2022 |

Where the movers, shakers and decision makers find their next career move.

Visit **pionline.com/careers** today to find more career opportunities.

**Get started with your job posting**
Contact Thomas Markley at thomas.markely@pionline.com or 603.305.1967 today.

P&I | CAREERS

# Forgiveness

CONTINUED FROM PAGE 1

or $250,000 for married couples and heads of household.

Though the relief only impacts a portion of Americans with student loan debt, "younger workers, in particular, are going to have more money available to save now that they don't have to use it to pay down their student loans," which could allow for an increase in retirement savings, said Craig Copeland, director of wealth benefits research at the Employee Benefit Research Institute, based in Washington.

For workers under 40, 70% of those with student loans said that debt significantly or somewhat impacted their ability to save for the future, according to Alight Solutions' 2021 Employee Wellbeing Mindset Study.

Young people have several other expenses to worry about, Mr. Copeland added, so it's difficult to determine how much of their newfound savings will be diverted into retirement accounts.

"I think the younger generation has definitely wanted to be able to save for retirement, they just, in our experience, have felt very burdened with student loan debt," said Heather Kessler, Seattle-based team lead and wealth manager at Coldstream Wealth Management, which manages $7.2 billion in assets and works with individuals as well as institutions, including retirement plans.

### Generational divide

Student loan debt is often associated with younger generations. According to an EBRI study published in January 2021, 66.7% of families with student loan debt in 2019 had family heads younger than 45, and 40.5% had heads younger than 35.

But, as Ms. Hunter Peterson said, "people of all ages, all generations, all demographics, struggle with student debt." A Fidelity Investments case study from June found that while millennials are the most likely generation to have student debt, baby boomers pay the most amount of student loan debt, on average.

"Even though people have student loans, that hasn't totally prevented them from participating in retirement plan benefits, because in many cases, they are — particularly those that finish their education — in higher-paying jobs," EBRI's Mr. Copeland said.

Mr. Copeland's research report from December shows millennials had higher median balances in their defined contribution plans than Generation X did, when comparing balances from when both generations were ages 25-36. He said this could be because millennials had immediate access to defined contribution plans, whereas Generation X may have only participated in defined benefit plans when they first entered the workforce.

Regardless of age, Mr. Copeland said the new student loan forgiveness plan will likely be most impactful for those who never completed their bachelor's degree but are still paying off student loans.

"That's the one group that we can really change in the loan forgiveness issue is those that didn't really get the full benefit of their education debt that they took on," he said. "And now that they don't have to pay it, then they could certainly be the ones that would have the ability to really change what their retirement savings is."

The EBRI study from January 2021 found that those with student loans who did not finish their degree are less likely to participate in a defined contribution plan, and when they do, their plan balance is smaller than those with loans who did complete their degree.

ENCUMBRANCE: Heather Kessler believes the younger generation wants to save for retirement, but they've felt burdened with student loan debt.

### 'Financial and emotional weight'

As student loan debt remains a major issue for Americans, research shows that parents are increasingly focused on saving for their children's college education. In Fidelity Investments' 2022 College Savings Indicator study, 27% of parents ranked saving for college as their top priority, compared with 22% that ranked saving for retirement as their top priority.

"I think—this statistic—it speaks to both the financial and emotional weight of student debt and parents not necessarily wanting their children to have to bear that burden of student debt if they don't have to," said Fidelity's Ms. Hunter Peterson.

Even with a potential $20,000 in student debt relief, many Americans will still have loans to pay off in the future. According to The Institute for College Access and Success, a non-profit organization advocating for college affordability, 2019 graduates of public and private non-profit colleges owed an average of $28,950 in student loan debt.

"There still could be a role for employers, looking at how they can incorporate student loan debt reimbursement programs into their benefits programs," Mr. Copeland said.

In 2018, Abbott Laboratories started a first-of-its-kind program, allowing employees who put 2% of their annual salary toward student loan payments to receive a 401(k) contribution of 5% of their salary, the equivalent of the company match. This came after the company received a private letter ruling from the IRS, allowing them to do so. Starbucks just announced this month that it will start a student loan management benefit program to help employees optimize student loan repayments.

In Washington, both the House and Senate are working to put together a retirement security package that would allow for employers to make matching contributions to a 401(k) plan, 403(b) plan or SIMPLE IRA based on qualified student loan payments.

### Taking steps to engage

In light of the upcoming student debt relief, plan sponsors can take a three-pronged approach to encourage increased retirement savings from plan participants, said Virginia Maguire, Atlanta-based vice president of wealth solutions at Alight Solutions.

Ms. Maguire recommends personalized messaging and engagement, whether that takes place through an app, email or website. She said having those messages specifically tied to loan forgiveness could encourage participants to invest more in their retirement, especially if there's an example tied to it, such as how saving an extra $100 a month could help build their retirement savings.

The other thing plan sponsors can offer is a paycheck savings planner so that they can help participants determine how to divide up their paycheck each month, Ms. Maguire said. Finally, offering access to live, unbiased advisers via phone could help plan participants save more, as that person "also can be the touch point that they speak to repeatedly," she added.

"It's an opportune time for plan sponsors to engage their participants," said Fidelity's Ms. Hunter Peterson. "Maybe it's a communication strategy, maybe it's something else, but make sure that participants are aware of some of these changes that might impact their cash flow." ■

# 401(K) plans

CONTINUED FROM PAGE 4

for the first time or dusting off old ones to make sure they're still competitive. Many are venturing outside their industries in their search for talent, making non-qualified plans a requirement if sourcing from industries where such plans are the norm, according to industry experts.

### Consolidated plans

AVANGRID Inc., an energy services and delivery company, in June 2020 consolidated its multiple non-qualified plans into one "harmonized" plan to be more competitive and have a better program for its executives, said Paul Visconti, the company's Orange, Conn.-based director of retirement programs and investments.

"It makes things easier for participants if it's a consolidated centralized plan and everybody has the same eligibility criteria," Mr. Visconti said of the move.

The plan is open to directors making $200,000 or more and currently has 50 executives participating in it, or 25% of the 200 eligible to participate. The plan has $23 million in assets.

Mr. Visconti sees non-qualified plans as "absolutely crucial" in recruiting and retaining senior executives. "It's the best financial vehicle on earth for executives," he said. "With a 401(k), you can only put $20,500 in. With a deferred compensation plan, you can put your whole salary in there."

AVANGRID will make the non-qualified plan even more competitive by adding an annual company contribution ranging from 5% to 15% of an executive's total compensation beginning in April 2023. The company's 401(k) plan matches 150% of an employee's contribution up to 8%.

Employers that make contributions to non-qualified plans have a "huge competitive edge" in the war for talent, Mr. Visconti said.

Employers often get creative in designing company matches for their non-qualified plans. Some, for example, will use the plans to make sure that executives receive the full match they would get in their 401(k) plans were it not for caps on 401(k) company matches. Under ERISA law, 401(k) plan sponsors can only provide a match on up to $305,000 of compensation. If an executive makes $400,000 and the employer matches 3% of compensation, that executive can receive only a 3% match on $305,000, Voya's Mr. Penland explained.

What some employers will do is match the 3% on the remaining $95,000 of compensation in the non-qualified plan, Mr. Penland said.

BOOST: Elena Zanussi said organizations are looking for talent outside their industries.

### Tight labor market

Chris West, a Dallas-based senior director in the benefits advisory and compliance group at Willis Towers Watson PLC and the firm's non-qualified specialty solutions leader, attributes the significant spike that her firm has seen in plan sponsor interest in non-qualified plans to what the tight labor market is pushing employers to do: recruit people outside their industries where non-qualified plans are often expected.

"They're not just looking for and hiring individuals within their own industry, but they're hiring and recruiting people across industries," she said.

An employer looking to recruit someone whose organization already has a non-qualified plan will have little luck in attracting that person because he or she will by law have to cash out their plan before they leave. Unlike 401(k) plans, employees cannot roll over their non-qualified plan balances to their new employers, Ms. West said.

Executives who expect to receive a distribution from their current employers will often ask their potential new employers whether they have a non-qualified plan. This way the new executive recruits would be able to increase their salary deferrals into the new non-qualified plan to offset the additional compensation on which they're going to pay taxes, Ms. West said.

The deferred compensation plan remains a "wonderful resource and tool" for companies to provide higher-income earners who need to continue to find avenues to defer tax on a pretax basis, she said.

As a result of the recruiting dynamics, Willis Towers Watson has helped clients implement more new non-qualified plans in the past 12 to 18 months than it has in the past six years, Ms. West said.

TIAA-CREF, too, has experienced a strong surge in new plan implementations, a fact that Elena Zanussi, TIAA's Chicago-based director of executive benefit solutions, attributes to "an incredibly competitive and tight market for recruiting and retaining top talent."

"It's a really different hiring environment than what we've seen in 30 years," Ms. Zanussi said.

Ms. Zanussi reports an 80% year-over-year increase in new plan implementations.

Like Willis Towers Watson's Ms. West, Ms. Zanussi is seeing organizations look for talent outside their industries. TIAA's not-for-profit clients, for example, are recruiting outside of educational institutions and hospitals, where they have traditionally looked for talent, Ms. Zanussi said.

Not-for-profits now are competing with corporate employers for top talent, a difficult feat given the stock options and other perks corporations give their executives, she said.

Fidelity Investments, another record keeper that has seen a robust upswing in the number of new plan implementations, also cites competition as the key driver of the trend.

"We're seeing increased competition for key talent across all industries and companies of all sizes," said Andrew Eldredge, Fidelity's Orlando, Fla.-based product area leader of non-qualified strategy.

### New plans

About half of Fidelity's new business so far this year in non-qualified plans has come from new plans, up from about 40% in 2021 and 30% in the years prior to that, he said.

Mr. Eldredge reports that the greatest demand for new plans comes from small and midsize businesses though there is some demand even among large employers, where non-qualified plans are already prevalent.

In 2021, roughly 82% of companies with more than 5,000 employees offered non-qualified deferred compensation plans, according to the Plan Sponsor Council of America's latest annual survey of profit-sharing and 401(k) plans. Among smaller employers with less than 1,000 employees, the percentage was 26.1%, and among those with fewer than 200 employees, the percentage was 13.4%.

While still the province of the largest of companies, non-qualified plans are going down market, Voya's Mr. Penland said.

"It used to be non-qualified plans were only for the very largest of companies, but that mentality has really changed," he said. ■

UPCOMING WEBINARS | REGISTER TODAY

P&I | WEBINARS

## ESG: Multi-Asset Investing

Live, Wednesday, September 21 • 2:00 p.m. - 3:00 p.m. ET

As institutional investors continue to explore and adopt environmental, social and governance integration, the evolution of the field has expanded to take a total portfolio view on sustainability across all asset classes. This audio webinar shares the different paths and approaches to ESG investing, how asset owners today are taking a multi-asset approach, and how they can develop a sustainability framework to meet their portfolio objectives. Our panel of experts shares the top ESG themes today as well as developments in data, benchmarks and regulation that are powering continued inflows into ESG investing across both public and private assets.

Register now: pionline.com/ESGMultiAsset-Webinar

Sponsored by:

Bloomberg PineBridge INVESTMENTS

## Global Equity Market Outlook

Live, Wednesday, September 28 • 2:00 p.m. - 3:00 p.m. ET

During this webinar, Aaron Anderson, Fisher Investments' Investment Policy Committee Member (Portfolio Manager) will review macro factors effecting global equities, as well as where Fisher believes we are in the market cycle and what that means for portfolio positioning. Leveraging insights from our global research platform, we believe this webinar will offer useful perspective on global equity markets. Some topics include:

- How investor sentiment is shaping our outlook Inflation should moderate in the back half of 2022, easing pressure on central bankers
- Expectations for global equities against a backdrop of slowing global growth
- Political gridlock is prominent globally, reducing political risk

Register now: pionline.com/FisherWebinar-2022

Sponsored by: FISHER INVESTMENTS® INSTITUTIONAL GROUP

## Bonds, Down but Not Out

T. Rowe Price's Chris Brown and Anna Dreyer, co-portfolio managers of the US Total Return Bond strategy, explore why now may be the wrong time to abandon fixed income but the right time to rethink how your portfolio is constructed. They will share their views on the evolving market environment and their insights on innovative portfolio construction, including:

- Why the historical negative correlation between stocks and bonds should reemerge as the Fed's focus shifts from inflation to growth.
- Why the fixed income markets, including the representative benchmarks, remain rife with inefficiencies that can be exploited through thoughtful active management.
- How investors can generate alpha from a portfolio construction approach that broadens the opportunity set, emphasizes more efficient bond sectors, and incorporates high-conviction security selection.

Replay available: pionline.com/TRPWebinar-2022

Sponsored by: T.RowePrice

For a full list of webinars, go to pionline.com/webinars

# Truss

CONTINUED FROM PAGE 3

things you're promising?" Fixed-income specialist TwentyFour has £20.3 billion ($23.4 billion) in assets under management.

U.K. government bonds had already been punished over the weeks leading up to Ms. Truss' emergence as the lead candidate to take over as leader of the Conservatives, sources said, in large part in anticipation of uncertainty under how she would govern.

U.K. gilt yields rose 94 basis points in August, adding a further 35 basis points between Aug. 31 and Sept. 8, when Ms. Truss' energy package was revealed. At close of markets on Sept. 8, the U.K. 10-year gilt yield was 3.15%.

Sources cited her reputation for changing her mind — for example, she had voted in the June 2016 referendum to remain in the European Union, then altered her stance to be a so-called Brexiteer — as one area of uncertainty that may have impacted bond markets.

Sources highlighted that there are other, less extreme changes she's made in terms of her views, as well as some inconsistencies in her economy-related explanations — such as highlighting the need for the Bank of England to fight inflation but also stating the importance of not penalizing homeowners and pensions, which sources said are at odds because hiking interest rates to fight inflation would hurt homeowners. Uncertainty, sources warned, is not something bond markets like.

However, John Roe, head of multiasset funds at Legal & General Investment Management Ltd. in London, said it's better to be "pragmatic" than "dogmatic" — "people are too quick to say changing your mind is a bad thing. I think being dogmatic can be equally bad. But it just means it's very difficult to know where she'd really land on things because it seems to be that, as she gets new information, she sometimes changes that perspective. And that, of course, brings a risk premium with it," Mr. Roe said. LGIM has $1.6 trillion in assets under management.

### Gilt reactions

But there was enough detail in her energy package to garner a negative reaction out of bond markets.

"Gilt and currency markets have not reacted well to the government's energy package," said Silvia Dall'Angelo, London-based senior economist at Federated Hermes Inc. "Gilts have sold off quite significantly since the prospect of large public borrowings emerged, due to concerns about the sustainability of public finances," which has led to higher risk premiums, she said. "While markets tend to overreact, sustainability concerns are not going to disappear," Ms. Dall'Angelo said.

ECONOMY: Gordon Shannon thinks a U.K. recession will be long and the recovery slow.

Regarding fiscal intervention and government spending, "the trouble is, the bar has been lowered for these kinds of interventions," TwentyFour's Mr. Shannon said. "I'm not arguing against that, but now you're going to spend over £100 billion on gas — so what is next year's once-in-a-generation (problem that needs spending) — the market is not going to tolerate that."

The fiscal measures outlined by Ms. Truss will temporarily boost growth and put "a lid on inflation," Ms. Dall'Angelo said. Federated Hermes runs $632 billion in assets under management.

But that impact may be short-lived.

If fully enacted, the fiscal measures "will likely have a substantial impact on inflation, reducing it now but limiting its downward trend later," Matteo Cominetta, London-based senior economist at the Barings Investment Institute, said in an email. The institute is money manager Barings' proprietary research unit. Barings has $349 billion in assets under management.

Ms. Truss said the energy cap could reduce peak inflation by 5 percentage points in the coming

## Managers warn U.K.'s new Prime Minister Liz Truss still faces fallout of Brexit

Liz Truss stepped into her role as prime minister at a time when the U.K. is still battling uncertainty caused by its exit from the European Union.

While a complete breakdown in the relationship between the EU and the U.K. is unlikely — since it is not convenient for either party — "brinkmanship and grand-standing will likely continue, from both sides, which perpetuates the uncertainty hurting investment," Matteo Cominetta, London-based senior investment economist at the Barings Investment Institute — money manager Barings' proprietary research unit, said in an email.

Brexit has already had an impact on the U.K.'s standing in the wider financial markets, and Europe will continue to use "a combination of regulation, coercion and general anti-Brexit sentiment" — albeit justified — to move bits of financial services back to Europe. "Liz Truss taking over isn't going to change that," said John Roe, head of multiasset funds at Legal & General Investment Management Ltd. in London, citing the need for euro-denominated contracts to be cleared in Europe as an example.

But while there's "huge uncertainty over the role of the U.K. in wider financial markets" because of Brexit, one school of thought that might support the U.K.'s future position could be akin to Adam Smith's concept of the invisible hand, Mr. Roe said — the idea that, no matter the roadblocks, markets will find the most efficient way of functioning. It may be, he said, that "removal from all the red tape of Europe makes doing business via the U.K. in financial services the most efficient way."

Ms. Truss has also highlighted potential changes to financial regulation, which could be

# Texas

CONTINUED FROM PAGE 2

A 13F report wasn't available for the roughly $45 billion Texas County and District Retirement System, which is also among entities subject to the divestment requirements. Asked why a 13F report wasn't available, a TCDRS spokesman said it doesn't hold a lot of direct investments and consequently doesn't meet the threshold for reporting.

Regarding Mr. Hegar's list, "TCDRS has no direct holdings in the companies identified in the comptroller's letter of August 24, 2022, concerning financial companies that boycott energy companies pursuant to Chapter 809 of the Texas Government Code," the spokesman said.

In a statement, BlackRock disagreed with the comptroller's opinion, saying it wasn't based on fact.

"BlackRock does not boycott fossil fuels — investing over $100 billion in Texas energy companies on behalf of our clients proves that," the money manager said in its statement, which also said elected and appointed public officials have a duty to act in the best interests of the people they serve. "Politicizing state pension funds, restricting access to investments, and impacting the financial returns of retirees, is not consistent with that duty."

### Initial list

While Mr. Hegar's initial list included 10 financial companies, the news release also said that comptroller's office staff researched individual investment funds and generated a list of nearly 350 funds that are subject to the same provisions. The 10 companies listed are referred to on the comptroller's website as Annex I, while the funds are under the tab Annex II.

None of the iShares ETFs reflected in the 13F reports TRS and ERS filed were among the funds listed in Annex II. Asked for clarification on whether that meant that TRS and ERS would be able continue to hold an ETF not listed in Annex II, a spokesman for Mr. Hegar's office said the statute's divestment requirements only apply to listed financial companies.

"As such, if a fund or company is not listed, the divestment requirements do not apply," the spokesman said. "Of course, nothing precludes an investing entity from taking a broader view of Annex I and divesting from other related financial entities by way of its own policies and procedures. Those decisions are left

Alex Griffiths

**EFFECTS:** John Roe said Brexit has had impacts Liz Truss' appointment won't change.

interesting given her pro-growth and pro-U.K. stance, Mr. Roe added.

"There have been murmurings in recent years of the greater holistic benefits to U.K. pension fund members, for example, if they were investing in a way that improves their own communities, their own productivity and their own capital, and there are external benefits to those members and the U.K. generally that then go well beyond the pure investment returns," Mr. Roe said. "So, her argument, which I think is not unreasonable, is if you can get similar returns inside or outside U.K., shouldn't we be changing regulation to make it as efficient and effective as possible for U.K. investors to actually be supporting the U.K. economy?"

It makes sense also, Mr. Roe said, given that "we know foreign direct investment into the U.K. is likely to be reduced because of Brexit."

— SOPHIE BAKER

months. But a fiscal package worth roughly £200 billion — equivalent to 8.6% of U.K. GDP — "fully financed by additional borrowing, will support spending in the next two years. In a context of still-constrained supply, the additional push should be inflationary, or at least limit the medium-term slowdown in inflation," Mr. Cominetta said in an email.

The limited impact of the energy cap on inflation is down to the fact that U.K. inflation is "very broad-based, driven by many factors beyond energy, as shown by core inflation, which nets-out energy and food and it currently runs at 6.2%" — the highest rate in 32 years, he added.

In the medium term, the inflationary environment will need to be combated by "more aggressive policy tightening. Higher inflation and policy rates, together with above-trend budget deficits for years to come all conjure a mix that is rather unpleasant for U.K. gilts," Mr. Cominetta said.

Mr. Cominetta added that the pound sterling is likely to remain under "intense pressure, as the highest rate of inflation in (Group of Seven) countries mixed with slowing growth and persisting Brexit uncertainties all should keep sterling volatility high."

While bond and currency markets will reflect reactions to Ms. Truss' leadership and policies, "it's less obvious what it means in equities, because in reality U.K. equities are global," LGIM's Mr. Roe said. If companies have a dollar exposure on their earnings, a weaker pound sterling means higher shares, he said. Therefore, when it comes to equities "everyone's first thought should be what's happening to the pound and commodity sectors, because we have quite high commodity-sector weights in the U.K.," Mr. Roe said.

### Recession risk

Money managers also highlighted that Ms. Truss has come into the role as a recession looms over the U.K. The Bank of England itself warned in its August update — as it delivered a 50-basis-point rate hike to 1.75% — that the U.K. is set to enter a recession starting in the fourth quarter.

TwentyFour's Mr. Shannon said that "what worries me the most is the fact that avoiding recession has become the center point of (Ms. Truss') policy. I think a recession is painful but when you're trying to fight against an economic force, defeat is just inevitable."

Regarding the impact of potentially lower inflation and the energy price cap, Charles Hepworth, London-based investment director in GAM's managed fund solutions team, said: "Consumers and businesses were already struggling with the cost-of-living crisis and energy bills are still capped at three times the price than they were this time last year, so this cap doesn't instantly translate into a consumer-led boom that would have been otherwise. If anything, it could mean the recession is slightly shallower but with a Bank of England still committed to hiking rates, future consumer pain on borrowing is still obvious."

Mr. Shannon agreed that the U.K. will go into a recession, and said that while the consensus is that contractions in the economy are coming, "I think people aren't properly pricing in that a recession will go on for quite a while, and that a recovery will be much slower than the recessions" of recent years, when quantitative easing came to the rescue. "But you've got to think about how policymakers will respond when QE isn't an option — because it's not when inflation is an issue. And inflation might be peaking but it's still high, so huge amounts of monetary stimulus, I think, aren't an option," he said.

For Mr. Shannon, staying out of high-yield bonds, "for me as an investment-grade guy, is an easy choice. But within that (investment-grade exposure), you can go for U.K. but make sure it's non-cyclical." Buying debt of blue-chip U.K. companies, where a lot of the earnings are derived overseas, could be a good spot, he said. "You won't make a quick capital gain on that trade, but you will collect carry for less risk. So the market is paying you a premium because they think you are taking a big risk, but in actuality you're not. So you can try to buy things that are immunized from the bad news — it pays better than trying to predict what the news is," Mr. Shannon added. ■

# T+1

CONTINUED FROM PAGE 2

the official T+1 transition date.

Under the SEC proposal, the T+1 transition would be implemented by March 31, 2024. Several groups and individuals who submitted comments to the SEC requested that the implementation date be pushed back until Sept. 3, 2024, which is the Tuesday after Labor Day weekend.

Mr. Price, one of the proponents of pushing the implementation date to Sept. 3, said the three-day holiday weekend would give the industry the time needed to ensure the transition goes smoothly. "We expect it to be flawless, but we'd like the proper amount of time to make sure that we get there," he said.

Moreover, Canada also has plans to transition to T+1 in 2024 and has a similar three-day weekend at the same time, which makes pushing the implementation date back advantageous, Mr. Price said. In its comment letter, the Canadian Capital Markets Association noted the Tuesday after Labor Day would work well.

**TRANSITION:** Thomas F. Price said an implementation date over a three-day weekend would be helpful.

Stakeholders would prefer to get clarification from the SEC on this matter soon, Ms. Kane said. "Funds and intermediaries are spread very thin between all the different regulations and proposals out there, so without a final date you lose the ability to focus the industry, but you also can't plan the testing window until you know the date it has to close," she said.

The SEC did not respond to a request for comment.

### 'Every day lost is a day lost'

The playbook published by the industry trade groups outlines a road map for market participants to identify the implementation activities, timelines, dependencies and risk impacts that could arise when planning for the transition to T+1.

Bob Walley, a New York-based principal at Deloitte & Touche LLP who assisted in crafting the playbook, said firms need to start preparing for the transition now. "Every day lost is a day lost," he said. "Waiting for the SEC's rule, while it'd be nice to have certainty … in my anticipation, (it) won't change (things) dramatically."

He added, "Right now, there's so much work to be done to understand what the impacts are, to get your resources in place, get your budgets in place now so you can progress the work. If you wait until the rule comes out, you'll have lost six more months and then you'll probably be under budget, you won't have your teams organized, you'll really be behind the eight ball and at risk of not meeting the transition dates."

Added Ms. Kane, "There's a lot (to do) and I think it's important that funds and firms begin their planning now and start looking at things because 2024 is going to be here before you know it."

The settlement cycle in the U.S. was shortened to T+2 from T+3 in 2017, a process sources said went smoothly and benefited all market participants.

Mr. Price said testing was crucial in the transition to T+2 and will be important to resolve any issues before a T+1 environment goes live. But while there are lessons the industry learned in transitioning to T+2 five years ago, this time will be different.

"It's not a Y2K moment or even a (T+3) to (T+2) moment where so much planning and preparation went into that and when you look back you say, 'That wasn't so hard; that was pretty easy,'" Mr. Price said. "This is a little bit more complex because you're really taking 24 hours out of the system. Things like errors and corrections, you're going to have to expedite that."

Automation will be key in a T+1 environment, Mr. Walley said. "There are tremendous opportunities to take the friction out of the settlement system and modernize it," he said. "I think that those who are preparing for T+1 need to look at the manual activities (where) people put their hands on keyboards and have to manually fix a broken data element or issues, that basically needs to be eliminated."

Most industry participants will be affected by the change, including broker-dealers, Depository Trust and Clearing Corp. participants, custodians and asset managers, Ms. Kane said. "In short, all industry stakeholders will need to ensure that they have appropriate budgets and resources to enhance systems, update processes and procedures, and participate in the industrywide testing scheduled for 2023," she added.

### Same-day settlement

But while the industry is focused on the T+1 transition, calls for T+0, or same-day settlement, may not be far behind.

The SEC proposal asked stakeholders for feedback on the potential for T+0, while the SEC ostensibly endorsed the idea.

"The commission preliminarily believes that implementing a T+0 standard settlement cycle would have similar benefits of market, credit and liquidity risk reduction that were realized in the shortening of the settlement cycle from T+3 to T+2 and are expected in moving from a T+2 to a T+1 standard settlement cycle," it said in the proposal.

SEC Chairman Gary Gensler has also backed T+0 in public comments.

But industry leaders aren't optimistic about the idea.

"T+0, in our view right now, increases risk because it would be a fundamental rewrite of the distribution system," Ms. Kane said. "You'd be essentially settling in real time, which the industry is not set up or designed to do at this time. And if you do that you also remove any recovery time so there's no time to address fails, there's no time to address issues that come up."

Mr. Price said T+0 would put "more risk into the system" because there won't be sufficient time to process and confirm trade details.

Added Mr. Walley, "To me, T+0 is, 'Just because you can doesn't mean you should.'" ■

**'This won't make one bit of difference in the valuation of any energy company, and it won't put one more well in the ground, but I'm sure it makes for great fundraising.'**

VETTAFI'S **DAVE NADIG**

to the investing entities."

Mr. Nadig said that, based on their 13F holdings reports, the impact on TRS and ERS following Mr. Hegar's Aug. 24 announcement is likely to be negligible. Still, "the right answer here is to have boards for these pensions who act in the best interests of the plan," he said.

"I'm quite certain those people exist, and I wonder how they feel about being sidelined by legislators," Mr. Nadig said.

A TRS spokesman declined to comment on whether it continued to hold the iShares ETF investments and BlackRock shares reflected in its 13F. The TRS spokesman, however, provided a statement from Executive Director Brian Guthrie.

"The Teacher Retirement System of Texas continues to review the comptroller's list of companies that boycott the fossil fuel sector to identify and evaluate the scope of impact," Mr. Guthrie's statement said. "As outlined in statute, we will report on our holdings in these companies to the state comptroller within 30 days of the list's release."

Until then, "it would be premature to offer any definitive information on potential impact," Mr. Guthrie's statement said.

TRS' 13F report shows it held about $354.7 million worth of investments in iShares ETFs as well as BlackRock shares valued at about $24.7 million.

A spokeswoman for ERS did not respond to an emailed request seeking comment regarding Mr. Hegar's list. BlackRock's iShares is the provider of ETFs with assets totaling $2.78 trillion as of June 30. ■

## AT DEADLINE

### WSIB commits $1.8B

Washington State Investment Board disclosed new and follow-on alternative fund commitments totaling up to $1.8 billion, spokeswoman Tish Day said.

The board, which oversees $182.3 billion in assets, including $150 billion in defined benefit plan assets, was informed at its meeting Sept. 16 of staff-delegated private equity commitments of up to $450 million to TowerBrook Investors VI, a buyout fund managed by TowerBrook Capital Partners; up to $300 million to Apax XI, a middle-market buyout fund managed by Apax Partners; and up to €300 million ($298 million) to Eighth Cinven Fund, a European buyout fund.

Within real estate, the board made a follow-on commitment of $500 million to real estate fund Crane Capital.

Within its tangible assets asset class, the board made a follow-on commitment of up to $250 million to Arable Capital Partners.

### Crypto framework unveiled

The Biden administration on Sept. 16 unveiled its first framework on managing digital assets in the U.S., offering recommendations on how to support the use of cryptocurrencies while also reducing fraud in the space.

The framework comes after President Joe Biden signed an executive order in March outlining a national strategy for oversight of the cryptocurrency industry. This included calling on federal agencies to advance the executive order's six key priorities: consumer and investor protection; promoting financial stability; countering illicit finance; U.S. leadership in the global financial system and economic competitiveness; financial inclusion; and responsible innovation.

In an effort to fight illicit finance such as money laundering and terrorist funding, the president is also considering calling upon Congress to update the Bank Secrecy Act, the fact sheet states.

Aside from fighting bad actors, Mr. Biden's framework calls for the Office of Science and Technology Policy and the National Science Foundation to develop a digital assets research and development agenda that will research topics such as transaction programmability, cybersecurity and privacy, next-generation cryptography and ways to mitigate crypto's impact on climate change.

### $11.2 billion fund closes

Baring Private Equity Asia has closed its eighth private equity fund, Baring Asia Private Equity Fund VIII, at its hard cap of $11.2 billion, one of the largest private equity funds raised by an Asia-based manager, a news release said.

The fund had an $8.5 billion target and is larger than its predecessor — the $6.5 billion Baring Asia Private Equity Fund VII.

The firm is currently being acquired by Stockholm-based private markets investment firm EQT in a deal that is set to close in the fourth quarter.

The buyout fund will invest in health care, technology services, business services, education, financial services, consumer and advanced manufacturing companies in the Asia-Pacific region.

### Inclusive initiative upped

The Connecticut Retirement Plans & Trust Funds made new commitments totaling $400 million to its emerging and diverse managers initiative.

In a Sept. 15 news release following a Sept. 14 meeting of the state's investment advisory council, the office of Shawn T. Wooden, state treasurer and principal fiduciary of the $42.2 billion state pension system, announced a $300 million commitment within the private markets portfolio to GCM Grosvenor for a "custom mandate to invest in small and emerging or diverse managers" as part of its Connecticut Inclusive Investment Initiative or Ci3.

The Ci3 initiative, which was launched by Mr. Wooden in 2020, increased "target allocations to emerging and diverse managers across all asset classes, providing a pathway for growth and expanding outreach in the emerging and diverse manager community," the release noted.

GCM Grosvenor will invest the allocation equally among private equity and real estate managers over three years, the release added.

### Lori Lucas to retire

Lori Lucas will retire by year-end as president and CEO of the Employee Benefit Research Institute, the organization announced.

Ms. Lucas, who assumed the roles in 2018, is "actively involved" in the organization's search for a successor, an EBRI news release said Sept. 16.

"I told the team that this isn't goodbye, just the start of a new chapter for EBRI and for me, personally," Ms. Lucas said in the news release. "It has been a great honor to lead this mission-focused organization, to build relationships with our members, and to have the opportunity to work alongside a team of professionals whose expertise, dedication and work product is truly unparalleled."

Ms. Lucas could not be reached for additional comment. Ron Dresner, a EBRI spokesman, declined to discuss the details or timetable of the search for her successor.

# Alternatives

CONTINUED FROM PAGE 1

happened in the public markets "because they are not immune to what happens in the general economy or to the capital markets at large, and that has not yet been reflected in the portfolio," he said.

And alternatives are a big part of CalSTRS' portfolio, with 16.3% invested in real estate, 15.7% in private equity and 5.4% in inflation sensitive, which includes infrastructure, as of June 30.

The June 30 numbers for alternative investment portfolios will be included in the pension fund's financial statements, said Christopher J. Ailman, CIO of the $311.7 billion California State Teachers' Retirement System, West Sacramento, during the same meeting. Staff will bring the first draft of the full financial statements to the board in November.

CalSTRS earned a net -1.3% for the fiscal year ended June 30, outperforming its -2.2% benchmark. The three best-performing sectors for the fiscal year were private market asset classes: real estate returned 26.2%, underperforming its benchmark of 27.3%; private equity at 23.7% internal rate of return, slightly outperforming its 23% benchmark; and inflation sensitive at 17.5%, well above its 12.9% benchmark. The returns for all three asset classes are as of March 31.

"We know the assets are going to be written down, but by how much?" Mr. Ailman said.

#### 2 sets of numbers

Endowments and some pension plans will go back and restate their June 30 private markets performance with a "trued up" figure for June 30 later in the year, he said.

"It's confusing because there are two sets of numbers," Mr. Ailman said. But those June 30 numbers will be captured in next year's returns, he added.

The difference between the reported fiscal-year returns for a pension fund's private market asset classes and when those returns are "trued up" later in the year can vary, said Mindy Selby, CalSTRS spokeswoman, in a Sept. 13 email in response to questions.

The private market returns are "derived from the estimated projections performed using a public market index," she said.

CalSTRS' investment book of record is closed by early July, a standard practice for private assets that report on a lag, Ms. Selby said.

"To be consistent, we ensure that four quarters' valuation are captured over a reporting period," Ms. Selby said.

However, CalSTRS' financial statements — its comprehensive annual financial report — "capture the best estimate for the June 30 values," she added.

For the $444.4 billion California Public Employees' Retirement System, Sacramento, the annual comprehensive financial report to be released sometime later this year will include private market performance figures through June 30, said spokesman Joe D'Anda in an email. "If this leads to a material difference in the fiscal year returns, it will be noted," he said.

The fiscal-year returns reported by CalPERS in July are preliminary, he said. But the returns in the financial statements are official and used as the basis of employer valuations and contribution rates, Mr. D'Anda said.

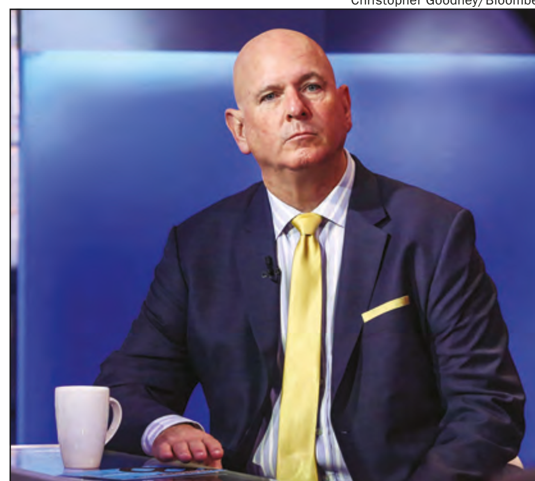
As of June 30, CalPERS had 15.8% invested in real assets, 2.8 percentage points above its target allocation, and 12% in private equity, 4 percentage points above its target.

CalPERS returned -6.1% in the fiscal year ended June 30, exceeding its -7% benchmark.

#### Overweight private equity

The Oregon Investment Council, which oversees the $93.3 billion Oregon Public Employees Retirement Fund, Salem, was also overweight private equity — 8 percentage points over its 20% target as of June 30, boosting its returns, said Paola Nealon, managing principal at the council's general investment consultant Meketa, at the council's Sept. 7 meeting. However, she cautioned that OPERF's returns do not reflect potential write-downs in the private markets given the quarter lag. The pension fund earned a net 6.3% return for the fiscal year ended June 30, outpacing its -0.7% benchmark. It is the highest public pension fund return Pensions & Investments has reported out of 70 plans.

Christopher Goodney/Bloomberg



**HANDLING THE LAG:** Christopher J. Ailman said there will be write-downs for June 30 that will impact next year's returns.

Greg MacKinnon, director of research of the Pension Real Estate Association, said he wasn't surprised that real estate market participants in the most recent consensus forecast survey "are expecting something of a drop-off in performance next year."

"Multifamily and, especially, industrial, had stellar years in 2021 and continued to be strong through the first half of 2022," he said in an email. "It would be hard to repeat that performance for another year, especially given macro conditions."

With the Federal Reserve raising interest rates at a quick pace to combat inflation, the economy is in worse shape than it was at the beginning of 2022, he said.

And real estate, across all sectors, is tied to economic growth, Mr. MacKinnon said.

"So, one should expect returns to be more muted than they have been over the last 18 months," he said. On top of that, the outlook for office usage is uncertain, which is gradually being reflected in market valuations, Mr. MacKinnon said.

The result is "you get lower overall return forecast for 2023 than for this year," he said. Although he added total returns are expected to start to pick up a bit in 2024, Mr. MacKinnon noted.

Even so, the annual return for the four years ended 2026 are expected to be more than 2 percentage points below the 2022 return, PREA's survey shows.

"Real estate as well as the broader capital markets have been on quite a ride," said Scott Dennis, Dallas-based CEO of Invesco Real Estate, a division of Invesco Ltd.

The real estate industry is coming off a period where the NCREIF Open-End Diversified Core Equity index returns were running in the high 20% range, Mr. Dennis said.

"That's been great … from a return perspective, but that is not sustainable," he said.

While the real estate investment trust market had dropped 20% right away this year, the private real estate side has not yet reflected the markdowns due to a lag in valuations, which are done by third parties, Mr. Dennis said. If the markets continue as they are with rising interest rates, there will be valuation markdowns in the third and fourth quarter of 2022, going into the first quarter of 2023, he said.

#### Private equity to drop

Private equity returns are also expected to be lower when the June 30 numbers are revealed, consultants say.

"Private equity valuations tend to follow the public markets," because one method for valuing private investments are public market comparisons, said Adam Bragar, New York-based head of the U.S. private equity practice of Willis Towers Watson PLC.

But not all sectors will fare the same, he said. Greater declines are expected in certain areas such as venture capital, particularly later-stage venture capital in which managers depend on initial public offerings for exits. With public markets softening, there is less likelihood venture capital-backed companies will go public. This will negatively affect valuations because if a company cannot go public, it will have to raise another round of financing, which is likely to value the company at flat or lower than past financing rounds, Mr. Bragar said.

Mega buyout investments will likewise be more negatively affected because there are few alternatives to an IPO exit for these very large companies, he said.

Potential buyers for mega companies are more limited than for smaller companies, Mr. Bragar said. There's a lower likelihood of another private equity firm having the capital required to acquire the company, he said. What's more, other large companies that might have been potential buyers in the past may not want to make the acquisition when their own valuation is down, Mr. Bragar said.

However, Willis Towers Watson focuses on the lower end of the middle market and "companies in our portfolio continue to perform relatively well," Mr. Bragar said.

That is not to say that private equity valuations won't go down.

"I don't think any of our clients are … not expecting markdowns across their (private equity) portfolios," Mr. Bragar said. "Those adjustments in valuations will be more muted than the public markets … none of the market write-downs have been greater than what has happened in the public markets." ■

# Fed funds

CONTINUED FROM PAGE 2

bonds, and a setback to thoughts that the Fed would soon be able to stop its cycle of rate hikes."

Ms. Smith added that "we expect that the Fed will not only hike by 75 basis points in September, but will do at least 50 basis points in November, and possibly consider a 75-basis-point increase in November."

Trillium has $5.9 billion in assets under management.

Experts who spoke to *Pensions & Investments* all concurred that a 75-basis-point hike in September is a certainty, but they generally think that investor reaction will be largely muted as the central bank has already telegraphed its intentions.

But after the government reported on Tuesday that inflation jumped 8.3% on a year-over-year basis in August, stock markets tanked — with the S&P 500 down more than 4% — as investors feared higher rate increases from the Fed.

**'Appropriate and consistent'**

Jonathan M. Duensing, Durham, N.C.-based senior managing director, head of fixed income-U.S., director of multisector fixed income and portfolio manager at Amundi U.S., said he views a third consecutive 75-point rate hike as "appropriate and consistent with the hawkish Fed messaging that has dominated the airwaves over the past month."

Amundi U.S. is the U.S. arm of Paris-based Amundi Asset Management, which has $2.3 trillion in assets under management.

Stephen Hooker, Hartford, Conn.-based managing director and portfolio manager at Newfleet Asset Management, noted that "most of the recent Fed speakers have generally favored the idea of front-loading the tightening of monetary policy," suggesting another 75-basis-point hike in September.

Newfleet has $8.5 billion in AUM.

Christopher Shipley, Chicago-based chief investment strategist-North America at Northern Trust Asset Management, said he finds "reasonable" the market consensus that the Fed will hike by 75 basis points at the September meeting, and that 75 basis points is "on the table again in November," with the pace of rate hikes moderating thereafter.

"I think these rate hikes reflect the Fed's prioritization of tamping down on inflation," he added.

Northern Trust Asset Management had AUM of $1 trillion as of June 30.

In a speech delivered Aug. 26 at Jackson Hole, Wyo., Fed Chairman Jerome H. Powell warned of continuing tightening and "some pain to households and businesses," but said that "at some point … it likely will become appropriate to slow the pace of increases."

Anders S. Persson, Charlotte, N.C.-based CIO for global fixed income at Nuveen, said Mr. Powell's language "suggests that it is not yet time to slow the pace of increases." Fed Vice Chairwoman Lael Brainard, who is usually dovish, Mr. Persson noted, corroborated this view by saying in a Sept. 7 speech "it will be necessary to see several months of low monthly inflation readings to be confident that inflation is moving back down to 2%."

Nuveen's AUM totaled $1.1 trillion as of June 30.

**Not a surprise**

The expected hike "is not necessarily good news for investors, but it will not shock them either," said Jason R. Vaillancourt, Boston-based global macro strategist at Putnam Investments. "They are very aware that the Fed wants to avoid an entrenched inflation. We no longer have an accommodative Fed."

Amundi's Mr. Duensing said given that fixed-income markets are largely discounting a 75-basis-points rate hike, "it's unlikely the FOMC's action would have much impact on markets." Any information that moves the markets, he noted, will likely come from the Fed's updated quarterly projections and Mr. Powell's post-meeting news conference.

With respect to how higher interest rates will impact institutional investors, Newfleet's Mr. Hooker said investors who are adding fixed-income assets at these higher yields are positioned for better future returns. "I would think the institutional investors with long-time horizons and long-term liabilities would be favorably disposed to taking advantage of the higher yields in the market and be dollar-cost averaging into increased exposures," he said.

Similarly, Mr. Duensing added: "Higher discount rates should be helpful for the funded status of pension plans. If so, it's possible that plan sponsors rebalance the asset allocation more in favor of long-duration high quality fixed income."

Mr. Vaillancourt of Putnam noted that, historically, institutional investors have thought of bonds as their "volatility dampener" and "diversifier" to the risky assets in their portfolio. "The rapid increase in short rates this year and uncertainty over when the Fed will take their foot off the brake has caused a rapid increase in the ratio of bond (market) volatility relative to equity (market) volatility at a time when we have also observed a strong positive correlation between stock and bond prices — a double whammy in portfolios for what you thought was your 'safe' asset."

**PREDICT:** Stephen Hooker thinks the U.S. could avoid a recession or, if it happens, it would be mild.

Year-to-date through Sept. 15, the S&P 500 index has dropped 17.2%, the Russell 3000 has tumbled 17.8%; and the Russell 2000 has declined 18%. The Bloomberg U.S. Aggregate Bond index has lost 12.3%, and the Bloomberg U.S. Corporate High Yield index has slipped 11.6%.

**More increases coming**

Most sources think the Fed will continue raising rates for the remainder of the year.

"We have only had one month of low inflation in July," Mr. Persson said. "So Brainard's framework (from her recent speech) suggests that it is too soon for the Fed to change course."

On Aug. 10, the Bureau of Labor Statistics reported that consumer price index rose 8.5% in July year-over-year, just below the 8.6% figure for May, but far above the Fed's 2% target.

Mr. Duensing expects rates to finish the year at 3.75% to 4% given current expectations for future economic growth and inflation. "As is the case with the Fed, the fed funds rate path into 2023 will be data dependent," he added.

Blerina Uruci, Baltimore-based U.S. economist at T. Rowe Price Group Inc., expects the central bank will probably finish the year with the rate at a range of 3.75% to 4%.

"However, I think after the new year the Fed might pause further tightening in order to evaluate how these rate hikes impact the overall economy," she added.

Ms. Uruci also noted that while there has been some "synchronization" among the major western central banks — the Fed, European Central Bank and Bank of England — in recent years in terms of monetary policy, their actions have not been "coordinated."

"Inflation has surged on both sides of the Atlantic, but I think the Fed has acted faster and more decisively to bring monetary policy into a restrictive stance to tamp down inflation," she added.

T. Rowe Price Group had $1.39 trillion in assets under management as of July 31.

Some market participants fret about the likelihood of a recession as the Fed continues to hike rates.

But Mr. Hooker thinks the U.S. economy could avoid a recession. "Companies and consumers were in good fundamental shape as the Fed began raising rates and that has supported (economic) activity," he said. "The Fed has communicated that it would like a period of below-trend growth to help bring supply and demand back into balance. It's our base case that a recession, if it happens, would be mild … The nature of the inflation fight will go a long way to determine the probability of recession, its severity and duration."

While potentially contentious midterm elections will occur around the same time as the November Fed meeting, Northern Trust's Mr. Shipley does not expect the central bank to be in any way influenced by political motivations.

Curbing inflation is one thing that both Democrats and Republicans can agree upon, Putnam's Mr. Vaillancourt said. "High inflation is politically undesirable, so I don't think the election will influence the Fed to be less aggressive in tightening," he said. Putnam had $176 billion in assets under management at the end of July. ■

Regulation

# Wells Fargo settles DOL investigation

By BRIAN CROCE

Wells Fargo & Co. agreed to settle a Department of Labor investigation that found the company, from 2013 through 2018, overpaid for company stock purchased for its 401(k) plan, the Labor Department announced Sept. 12.

Wells Fargo, which did not admit to or deny the Labor Department's allegations, will pay about $145 million — roughly $131.8 million to the plan's eligible current and former participants and a $13.2 million penalty — to settle the matter.

The company said in a statement that though it disagrees with the Labor Department's allegations and has not conducted these transactions since 2018, it believes "resolving this legacy matter is in the best interest of the company."

The investigation by the Labor Department's Employee Benefits Security Administration determined Wells Fargo and GreatBanc Trust Co. — plan trustee for the Wells Fargo & Co. 401(k) Plan, San Francisco — caused the plan to pay between $1,033 and $1,090 per share for Wells Fargo preferred stock. Specifically designed for the plan, the stock converted to a set value of $1,000 in Wells Fargo common stock when allocated to participants, according to the DOL. In transactions between 2013 and 2018, the plan borrowed money from Wells Fargo to purchase the preferred stock, the department noted.

Moreover, EBSA investigators learned Wells Fargo used the dividends paid on the preferred shares to defray its obligation to make contributions to the $55.7 billion 401(k) plan, by using the dividends to repay the stock purchase loans, according to the Labor Department. "The investigation revealed the transaction was designed to cause the 401(k) plan to pay more for each share of stock than plan participants would ever receive," the department said in a news release. ■

# ERISA

CONTINUED FROM PAGE 6

ERISA cases in 1991, 1996 and 2000.

These decisions allowed ERISA claims "to be the subject of enforceable arbitration agreements … without regard to whether the plan is a party to the agreement," the Cintas petition said. "The participants' agreement to arbitrate ERISA claims is sufficient."

These three decisions didn't discuss "whether the plan had consented to the arbitration agreement or not in a case where a participant brings (on behalf of an ERISA) claim to seek relief on behalf of the plan," said Mr. Mamorsky, who is based in Chicago. "These cases hold generally that arbitration agreements that cover legal rights to bring claims pursuant to alleged statutory violations of ERISA are enforceable. This is not in dispute in Cintas or in other similar cases."

In Mr. Mamorsky's opinion, "on its face, the (Cintas) petition does not appear to address any obvious circuit splits."

**SMALL CHANCE:** Joseph J. Torres thinks there's a low likelihood the high court will review Cintas.

Joseph J. Torres, a Chicago-based partner at Jenner & Block, said the "likelihood is low" the Supreme Court will review the Cintas case.

"Everyone agrees that as a general matter ERISA claims can be arbitrated," he said. "The question is what vehicle can be extended to cover claims for the plan."

One way to "sidestep" a Cintas-like dispute, is for sponsors to make sure an arbitration agreement is written into the plan document, he said.

Putting an arbitration agreement in an employee handbook "leads to a greater risk of it not being enforced" in an ERISA complaint, given court rulings on placing arbitration provisions in plan documents, said Nancy Ross, a Chicago-based partner at Mayer Brown LLP.

Ms. Ross, describing federal courts' differing views as "exceptionally confusing," isn't sure if the Supreme Court justices will review the Cintas case. If they are on the fence, they will most likely ask the Department of Labor for its opinion, Ms. Ross said. Justices periodically request opinions from government agencies.

The Labor Department has commented only once in a dispute between a sponsor and a plaintiff over arbitrating an ERISA complaint.

"The Secretary (of Labor) has a substantial interest in ensuring that participants are not forced to arbitrate under agreements that prohibit the plan-wide remedies that ERISA provides," said a DOL amicus brief filed in June in the case of Cedeno vs. Argent Trust Co. et al. now before the 2nd U.S. Circuit Court of Appeals in New York.

The DOL "is not here contending that ERISA claims are categorically non-arbitrable," said the amicus brief, which supported the plaintiff.

However, "a participant cannot be compelled to arbitrate if they are deprived of the full range of ERISA remedies that would be available had they brought the same claim in federal court," the DOL said.

In this case, a U.S. District Court in New York issued a pro-plaintiff ruling in November 2021 saying an employee stock ownership plan's arbitration clause was unenforceable because it didn't protect participants' ERISA rights. A participant in an ESOP run by Strategic Financial Solutions LLC, New York, sued Argent Trust Co., Atlanta, and other fiduciary defendants in November 2020, alleging ERISA violations by purchasing ESOP shares at higher than a fair-market price, thus harming participants' investments.

ERISA attorney Carol I. Buckmann agreed with Ms. Ross that if the justices are interested in the Cintas case, they will first ask for guidance from the DOL.

"The arbitrability of ERISA fiduciary breach claims is a really important federal issue," said Ms. Buckmann, founding partner of the New York law firm Cohen & Buckmann PC. "The court may well decide it is important to clarify the rules and have one nationwide standard."

Ms. Buckmann predicted that if the Supreme Court agrees to hear the Cintas case, " it will end up ruling that ERISA arbitration is permissible and then clarify who must consent."

In the meantime, Ms. Buckmann tells clients who want to compel arbitration of ERISA complaints to put a carefully-worded provision in a retirement plan document. ■

# Water

CONTINUED FROM PAGE 1

Pension Fund of South Africa, Pretoria. Others, including New York City Comptroller Brad Lander, fiduciary for the five pension funds in the $239.5 billion New York City Retirement Systems, serve on an advisory council guiding the initiative.

With global water demand projected by a United Nations resource panel to exceed supply by 56% by 2030, water scarcity and quality issues will only get tougher for all types of companies, and in turn, their investors. Currently, Ceres estimates that 50% of companies in the four largest indexes have medium to high water risk.

That is a lot to tackle. There is also a lot at stake for investors that cannot meet their fiduciary obligations without factoring in water, coalition members said. "If these risks are not mitigated, the potential financial impact on companies and their shareholders are huge," said John Anzani, an executive committee member of the Local Authority Pension Fund Forum in London, which represents 85 public-sector pension funds and their six pool companies who together have more than £350 billion ($402.6 billion) in combined assets.

Initiative members will begin by engaging with 72 portfolio companies in four sectors — food, beverages, apparel and high technology — using a methodology developed by Ceres that shows companies with the greatest water use and impact. The list includes McDonalds Corp., Coca-Cola Co., ConAgra Brands Inc., Adidas AG, Microsoft Corp, Amazon.com Inc. and Sony Group Corp.

As the investors engage with those companies as shareholders, they will raise six expectations that apply to each company's value chains where:

- They do not negatively impact water availability in water-scarce areas.
- They do not negatively impact water quality.
- They do not contribute to the conversion of natural ecosystems critical to freshwater supplies and aquatic biodiversity but do actively work to restore degraded habitats their businesses depend upon.
- They contribute to the social, economic and ecological resilience of communities they interact with.
- Corporate boards and senior management oversee water management efforts.
- Their public policy engagement and lobbying activities are aligned with sustainable water resource management outcomes.

The initiative will also track how the companies' activities and practices align with the United Nations' 2030 Sustainable Development Goal for water, SDG6, to "ensure availability and sustainable management of water and sanitation for all."

Having investors "strive to drive large-scale practice changes" will be meaningful, said Kirsten James, senior program director for water at Ceres in Boston.

### Companies not prepared

Morningstar Sustainalytics analyzed 122 companies in the tech and telecom sectors that rely on water-intensive data centers to see how prepared they are to mitigate water-related risks. It found that just 16% disclosed elements of a management program to mitigate risks posed by water scarcity. By contrast, 64% of companies had some elements of a physical climate risk management program.

When it comes to minimizing the overall reliance on water in their business activities, nearly 50% of the companies disclosed some elements of a formal water management program, although 61% rated their program as weak.

One of the biggest challenges for investors is inconsistent — and often missing — disclosure of corporate water practices. Sustainalytics offers some useful metrics, including how much companies rely on water for operations, location and water intensity, and how much they need to generate a dollar of revenue.

**WATER RISKS:** Kirsten James noted investors can finally hold companies accountable with Ceres' evaluation tool.

### New investor tools

The good news, investor advocates say, is that there is growing awareness of the interconnectedness of water issues with other environmental issues like climate change and supply chain risk, and new tools for investors.

The World Wildlife Fund's Water Risk Filter online tool helps companies and investors assess, value and respond to water risks in operations, supply chain and investments. It aggregates three water risk types: physical, regulatory and reputational. It allows them to integrate climate and other scenarios of water risks to perform scenario analysis across portfolios or even by asset class.

The Ceres Investor Water Toolkit helps investors evaluate and act on water risks in investment portfolios with concrete engagement advice.

"Investors finally have at our fingertips what we need to hold companies accountable," said Ms. James of Ceres.

Still, the lack of data on corporate water exposure "does hamper engagement," said Kris Nelson, director of investment research for Russell Investments' global equities team in Seattle. "It makes it a much more case-by-case exercise. You have to do some digging," she said.

While there are relatively few water-related strategies to invest in today, "there are thematic strategies that you can invest in with (water) solutions," Ms. Nelson said. "I do think there will be more if the effects of climate change continue to grow, which they will."

Matthew Diserio, co-founder and president of Water Asset Management LLC, a New York water industry-focused firm managing $500 million in public and private equity investments, couldn't agree more. His firm invests exclusively in companies and assets that ensure water quality and supply, and shorts companies that are at water risk from drought, wildfires and supply issues.

"We are seeing more interest from institutional investors. People are mostly still focused on risk. We are focused on investing in the solutions," he said.

It's not altruistic. "The entire water industry has a revenue growth tailwind from more and more spending" and growing recognition of water as an asset class. "We know that all these problems are solvable. These issues get solved by committing capital," Mr. Diserio said.

Recent headlines add a sense of urgency to the investors' mission. A drinking water crisis in Jackson, Miss., caused by poor maintenance and oversight has triggered a federal investigation and will require substantial infrastructure investment.

Record-low water levels in the Colorado River after a 22-year drought are even more ominous. According to the multiagency U.S. Drought Monitor, the Colorado River provides water to almost 40 million people in two countries, seven states, 29 federally recognized Native American tribes, and four million acres of farmland. According to a study by the University of Arizona, the river supports $1.4 trillion in annual economic activity—equivalent to one-twelfth of total U.S. gross domestic product.

Massive challenges like those, along with the energy transition push, could also create new opportunities for institutional investors through private and public partnerships, said Bill Green, managing partner of Climate Adaptive Infrastructure in Mill Valley, Calif. The infrastructure investment firm specializes in low-carbon real assets. Its investment mandate in the water sector includes integrated water and wastewater systems, industrial pretreatment and water recycling and potable reuse.

When it comes to drinking water and industrial uses, "we believe that as the historic supply models break down, you will see increasing demands for water partnerships," Mr. Green said. "The demand is being created by acute shortages resulting from climate-related drought."

The firm did not provide its AUM. ■

# Exec comp

CONTINUED FROM PAGE 3

"currently there is a substantial disconnect," said Marcie Frost, CEO of the $444.4 billion California Public Employees' Retirement System, Sacramento, in a March 4 comment letter on the SEC's rule proposal.

More meaningful disclosures addressed by the new rule should bring better alignment of corporate pay and performance practices, "or at least better explanations regarding pay decisions," Ms. Frost said.

Mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the new pay-for-performance disclosure rule was first proposed in 2015 by the SEC, where it languished until Mr. Gensler took over.

The goal of the new rule is to provide shareholders with more information in proxy statements used for voting on executive compensation plans and director elections.

In a key change from existing standards for executive compensation disclosure, the new one focuses on what is actually paid to executives and calls for companies to be more descriptive of their executive compensation process, particularly the relationship between pay and company performance.

Companies must now report total shareholder return for themselves as well as their peer group, along with net income and up to seven financial performance measures relevant to the company. They also have to describe the relationship between those performance measures and the compensation paid to a CEO, as well as other executive officers. It all has to be provided in tables and narratives. After a multiyear phase-in period, the disclosures will eventually cover the five most recently completed fiscal years.

Companies also get to choose a financial performance measure that they consider relevant to their company or industry. That is "an elegant approach of getting a company to actually disclose the information it uses to determine executive compensation," said Ms. Frost of CalPERS in her comment letter. Companies are free to add other metrics, including those related to environmental, social and governance issues, that could be relevant to performance.

Having more metrics disclosed in the context of executive pay is also "another cross-check" on a company's true priorities, said Mr. Mozumder of LGIM America.

### ESG portion

ESG metrics are becoming more common in the executive pay-vs.-performance calculation. A review by consulting firm Semler Brossy Consulting Group LLC of public disclosures made between March 2020 and March 2021 found that 57% of S&P 500 companies included an ESG metric in either the annual or long-term incentive plan.

An April 2021 report from Willis Towers Watson PLC found that most of the largest companies in North America and Europe already incorporate ESG metrics into executive pay plans, and their board members see ESG issues as a business risk, the report said, citing pressure from stakeholders on issues ranging from climate change to diversity, equity and inclusion. "There is ample evidence suggesting that companies with a strong ESG profile outperform their competitors," the report said.

The option of adding ESG metrics to the disclosure of executive pay calculations "I think will be a real test of how serious companies are about ESG," Mr. Mozumder said.

### Next steps

Pushback against the new rule began simultaneously with its approval. Opponents raised the prospect of legal challenges for several reasons, including the use of outdated economic analysis from the 2015 proposal. Groups like the Business Roundtable want the SEC to go back to the drawing board.

Marc Hodak, a partner at executive compensation and corporate governance consultancy Farient Advisors LLC, based in Dallas, cautions that the new rule could potentially mislead investors or disguise a lack of alignment between management and shareholders.

That is because the required disclosure ignores equity gains before vesting, which represent real value to the executive, and are important to investors. If managers are granted equity each year, that vesting equity could increase "actual pay" regardless of performance, he said. "The best way to value pay is to look at the value of options over time. That 'realizable value of the equity' is difficult to measure. It's really very complicated to do it right," Mr. Hodak said.

**STEWARDSHIP:** Neaaz Mozumder wants to see how pay is aligned with performance.

Even if the new SEC rule gets held up, shareholders are not likely to stop pushing for companies to make it clearer how they connect pay and performance, which would also make it easier for investors to compare companies.

A 2022 proxy season preview by ISS Corporate Solutions, a division of International Shareholder Services Inc., found CEOs in the S&P 500 and Russell 3000 received record-high pay increases, but also record levels of shareholder opposition to pay proposals. Median say-on-pay vote support that started declining in 2018 hit an all-time low in 2022. The percentage of companies with failed say-on-pay votes increased to 3.2%, up from 2.6% in 2021 — the highest failure rate since say-on-pay votes became mandatory in the U.S. in 2011.

"Existing disclosures can otherwise often be unnecessarily complex and verbose, without painting the full picture of pay outcomes and how they relate to company performance," said John Hoeppner, Chicago-based head of U.S. stewardship and sustainable investments, and Alexander Burr, ESG policy lead, in LGIM America's SEC comment letter.

They cite an Economic Policy Institute study from August 2020 that found that the average compensation of CEOs of the 350 largest U.S. firms increased 35.7% from 2009 to 2019, based on numbers provided under current standards. Measuring by what is actually paid, that same cohort of CEOs experienced a pay growth of 105.1%, the study found.

"This aligns with our experience as shareholders where we have evaluated compensation plans at public companies that often have material differences between what's disclosed and what's taken home. The intricacies of pay plans, which involve vesting periods, a range of performance targets, as well as board discretion, make it difficult for investors to make cross-company comparisons and time series analysis," the LGIM America letter said. "Executive compensation practices at U.S. public companies still have much room for improvement."

As Jeffrey P. Mahoney, general counsel for the Council of Institutional Investors, an association of employee benefit funds, public investment officials, foundations and endowments with $4 trillion in combined assets, commented to the SEC, "directors' decisions about executive pay speak volumes about the board's accountability to shareowners." ■

## CHANGES AHEAD

**Cecil County Public Schools**, Elkton, Md., is searching for a record keeper for its 403(b) and 457 plans. The school district is seeking a firm to provide investment administration, communication services and a record-keeping platform for the plans, which have a combined $68 million in assets, according to a notice to proposers posted on the district's website. The current record keeper is Lincoln Financial; the notice does not disclose whether the firm is eligible to rebid. The notice is on the district' website. Proposals are due at 3 p.m. EDT on Sept. 26. Investment consultant Bolton Partners is assisting.

**HAVE SOME NEWS?**

Please submit news of changes to John Fuller, news editor, at **john.fuller@pionline.com**

**Boston Retirement System** is looking to commit a total of $100 million to diverse private equity funds of funds, co-investment funds and energy/infrastructure funds. The $6.4 billion system is searching for diverse managers that offer private equity fund of funds, and managers that offer private equity co-investments and energy/infrastructure funds, according to a search notice posted on the website of NEPC, the pension fund's investment consultant, which is assisting in the search. As of Dec. 31, the pension fund's actual allocation to private equity was 9.9%. Investment consultant NEPC is assisting. The search notice and accompanying materials are posted on NEPC's website. Proposals will be due by 2 p.m. EDT on Sept. 27, according to the notice.

**Santa Clara Valley Transportation Authority**, San Jose, Calif., is searching for a record keeper for its $297 million 457 plan and $11 million 401(a) plan, said Vincent Galindo, senior consultant at investment consultant Hyas Group, which is assisting with the search, in an email. The authority issued an RFP due to the expiration of the contract of current record keeper MissionSquare Retirement. In October 2021, VTA spokeswoman Stacey Hendler Ross said in an email the firm would be eligible to rebid. The RFP is available on the VTA's procurement website, and registration is required. Proposals are due at 4 p.m. PDT on Sept. 30.

**Westmoreland County Employees' Retirement System**, Greensburg, Pa., is searching for an investment consultant. The $639 million pension fund issued a request for information as a due diligence measure, said Regis Garris, the county's deputy controller. Current consultant Gallagher Fiduciary Advisors is eligible to rebid, Mr. Garris said. The RFI is available on the county's website. Responses are due at 2 p.m. EDT on Oct. 4.

**State of Wisconsin Investment Board**, Madison, is searching for one or more board governance consultants. The board, which manages $145.8 billion in assets, including the $124.9 billion Wisconsin Retirement System, is seeking one or more firms to facilitate the annual evaluation of the board of trustees, according to an RFP posted on its procurement website. The selected consultant will also facilitate the annual evaluation of Edwin Denson, executive director and chief investment officer, as well as complete other board governance projects, including the review of board policies and procedures, according to the RFP. The RFP does not disclose the name of the current firm providing the services or whether the firm is eligible to rebid. The RFP is available on the board's procurement website. Registration is required. Proposals are due at 5 p.m. CDT on Oct. 7.

**Erie County Deferred Compensation Committee**, Buffalo, N.Y., is searching for a record keeper, said Vincent Galindo, senior consultant at investment consultant Hyas Group, in an email. The $298 million 457 plan's committee is seeking a firm to "provide retirement plan administration, record keeping, education, communications, investment-related, and other related services," Mr. Galindo said. The RFP is available on the county's website. Proposals are due at 2 p.m. EDT on Oct. 14. Finalist interviews are scheduled for Jan. 26-27, 2023, with a selection expected shortly thereafter. Hyas Group is assisting with the search.

**Pittsburgh Comprehensive Municipal Pension Trust Fund** will launch a search within the next month for an active domestic small-cap core equity manager to run about $46 million. The $1 billion pension fund will issue an RFP because existing manager Guyasuta Investment Advisors is discontinuing its small-cap strategy, said James R. Wesner, managing director at Marquette Associates, in an email. Marquette, the pension fund's investment consultant, will assist in the search. Mr. Wesner said the RFP should be posted within the next month, but a specific timeline has yet to be determined. The pension fund posts RFPs on its website.

For a comprehensive database of search and hiring activity, visit P&IQ at **PIonline.com/piq.**

# Crypto

CONTINUED FROM PAGE 3

volatility," said Andrew Spellar, the chief investment officer of the $5.1 billion Fairfax County Employees' Retirement System. "As to whether regulation in the grand scheme of things is a good or bad thing, we have no comment."

Starting in 2019, Mr. Spellar said the retirement system has made six different investments totaling $85 million in the digital-asset space, mostly through venture capital vehicles with expected life cycles of 10 to 12 years. Among them are two investments in "yield farming," in which crypto investors are willing to lock up their cryptocurrency for a period of time in exchange for more cryptocurrency.

### Custody needed

Ajit Singh, chief investment officer for Houston Firefighters, thinks crypto and related investments will gain added legitimacy when major custodians launch custody services for digital assets. He also said "regulation clarity is certainly important and opens the door for various investment vehicles designs suitable for investment objectives and risk tolerance."

Currently, the crypto industry comes under the oversight of a patchwork of agencies including the Securities and Exchange Commission and the Commodities Futures Trading Commission. But it's clear that regulators, the White House, and some lawmakers on Capitol Hill feel that regulation needs to be expanded and clarified to keep pace with the industry's expected growth.

An executive order from President Joe Biden in March outlined a national policy for overseeing digital assets across six areas including consumer and investor protection, financial stability and illicit finance. And members of Congress have introduced various bills designed to regulate digital assets such as bitcoin, though these measures have differing views about which agency should take the lead.

SEC Chairman Gary Gensler has argued that the majority of cryptocurrency tokens are securities and thus should be regulated by his agency, but he said recently that he is open to expanding the role the CFTC plays. The commission also announced Sept 12 the addition of a new office to review filings that involve crypto assets.

Still, much of the sector's growth as an bona-fide investment class will be tied not to regulation but to expanding technological applications for digital assets. "Our fund's investment in digital assets is motivated by taking a foothold exposure in upcoming disruptive (Web3)," added Mr. Singh in an email, a reference to the next iteration of the internet in which blockchain technology will play a role in creating a more decentralized medium. Currently, all of the fund's investments are in bitcoin and ether, the two leading cryptocurrencies.

### Bullish on digital assets

Jase Auby, CIO of Texas Teachers, also believes that a bullish case for digital assets such as crypto and the blockchain is tied to progress toward what he refers to as a "true" Web3.

"Credibility will be built over time as investment successes pile up and the market for end user cases expands tangibly." Thus far, Mr. Auby says his pension plan has made some initial venture capital commitments to digital assets-focused managers, though he refrained from discussing specific amounts.

Ryan Skinner

**NAYSAYERS:** Cambridge Associates' Joe Marenda said cryptocurrency doubters may be missing opportunities.

As the New York-based CIO of digital assets at the Forest Road Co., an asset manager with institutional clients, Chris Solarz is an admitted crypto bull. But Mr. Solarz concedes that a number of conditions need to take place before this sector can gain true acceptance among investors.

"There are currently over 300 million crypto users globally, and the three things we need to see before we add the next 300 million users are increased regulatory clarity, more user-friendly front-end interfaces for trading digital assets, and more security," Mr. Solarz said. "The number of hacks and frozen accounts have adversely affected the trust users place in the security of the overall crypto ecosystem, and trust will ultimately be restored through increased security."

Speculation about the future of digital assets comes at a time when investment sentiment regarding this sector has been decidedly bearish. After jumping more than tenfold in market value in a three-year period to an all-time high of over $68,000 last November, bitcoin has since fallen by more than 70%. Even a more diversified crypto play, the actively managed Amplify Transformation Data Sharing ETF, has also fallen by close to 70% since its November high. By contrast, the Invesco QQQ Trust, a proxy for tech stocks, has fallen by 28% from its all-time-high reached in late December.

As prices of digital assets have fallen, the criticism of these investments has accelerated. Once lauded for being relatively uncorrelated to the U.S. stock and bond markets, crypto investments like bitcoin and even stocks like crypto-trading platform Coinbase Global Inc. have become more closely correlated with speculative technology stocks. Even the process by which units of bitcoin are created has come under attack by environmentalists and sustainable investing advocates because of added demand on fossil fuels used in the electricity that powers "mining" efforts.

All these concerns make it easy for most public pension funds to sit on the sidelines — at least for now.

"For pension funds to commit to an asset class, they would need more of a track record of performance and a greater level of assurance about future performance," said Keith Brainard, the Georgetown, Texas-based research director for the National Association of State Retirement Administrators.

### Missed opportunity

Crypto naysayers, however, may be missing an opportunity to gain exposure to technology that transforms the way business and finance is conducted, said Joe Marenda, San Francisco-based partner and global head of digital assets investing at investment consultant Cambridge Associates LLC.

Mr. Marenda has a simple counterargument to the criticism that crypto investing has become highly correlated with the speculative technology stocks.

"Blockchain is a disruptive technology and if you have that view, you never bought into the uncorrelated asset argument in the first place," he said. He also contends that environmental arguments against crypto mining will subside over time as the process becomes more energy efficient, thanks to the increasing use of renewable sources such as wind, solar and hydroelectric power.

Mr. Marenda said most crypto-related investments are best suited for investors that have the patience to watch a new financial-system paradigm play out over the next decade or longer. "Like the internet, this is a transformation that will take many years to come to full fruition," he said. "We're still early in the second inning." ■


# P&I Events Calendar

Mark your calendar and join us at these upcoming P&I events.

| Retirement Income Conference | Managing Pension Risk & Liabilities | Defined Contribution West |
|---|---|---|
| SEPTEMBER 20, 2022 \| SAN FRANCISCO<br>SEPTEMBER 22, 2022 \| NEW YORK<br>SEPTEMBER 29, 2022 \| VIRTUAL | OCTOBER 11, 2022 \| DALLAS<br>OCTOBER 13, 2022 \| NEW YORK<br>OCTOBER 20, 2022 \| VIRTUAL | OCTOBER 23-25, 2022 \| CARLSBAD |
| WWW.PIONLINE.COM/RI2022 | WWW.PIONLINE.COM/MPRL2022 | WWW.PIONLINE.COM/DCW2022 |

CALL FOR ENTRIES

WWW.PIONLINE.COM/EDDYENTER

The Eddy Awards recognize outstanding efforts by plan sponsors and their service providers to educate employees about how to invest their defined contribution plan assets wisely for retirement.

ENTER IN THE FOLLOWING CATEGORIES:

**FINANCIAL WELLNESS**
**ONGOING INVESTMENT EDUCATION**
**SPECIAL PROJECTS**
**CONVERSIONS/403(B) CONSOLIDATIONS**
**PLAN TRANSITIONS**
**PRE-RETIREMENT PREPARATION**

PLAN SPONSORS, SERVICE PROVIDERS AND RETIREMENT PLAN ADVISERS ARE ALL ENCOURAGED TO ENTER.

FOR FULL DETAILS AND ACCESS TO THE ONLINE ENTRY SYSTEM GO TO:

WWW.PIONLINE.COM/EDDYENTER

**SUBMISSION DEADLINE: SEPTEMBER 16**