

Pension Funds

GPIF pays out record fees for fiscal year

Money managers share in big alpha gains under fund's performance-fee structure

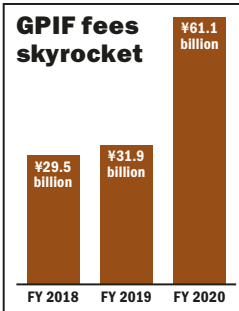
By DOUGLAS APPELL

Money managers garnered a record ¥61 billion (\$553 million) in fees managing the Government Pension Investment Fund's ¥186.2 trillion portfolio — roughly half of Japan's pension assets — for the fiscal year ended March 31.

Those outlays easily topped the previous record of ¥48.7 billion for the year ended March 31, 2018. At the April 2018 start of the following fiscal year, GPIF moved to achieve a better alignment of interests with its external managers, instituting higher performance fees but only passive payouts for managers that fail to top their benchmarks.

The year the new system went into effect, GPIF's fee payments plummeted to ¥29.5 billion before rebounding slightly to ¥31.9 billion for the year through March 31, 2020 — roughly 2 basis points of the weighted average of the portfolio's holdings.

GPIF's then-chief investment officer, Hiromichi Mizuno, insisted the world's biggest pension fund wasn't intent on lowering fees and stood willing to



SPECIAL REPORT TECHNOLOGY IN MONEY MANAGEMENT

Further digitization on the horizon for investing

More improvements in tech for investment management expected in next two years

By RICK BAERT

Institutional money management's use of technology is expected to burgeon in the next two years, with that growth driven by a better understanding of what to do with it, sources said. "The difference between people's experience with how they interface with technology

in their personal lives and their consumer lives, and the gap between how they deal with that technology in their investing lives, are quickly closing," said Sudhir Nair, managing director, global head of Aladdin business in BlackRock Inc.'s solutions unit, New York. "That is creating incredible change."

Added Thomas Kim, CEO of fintech software provider Enfusion Ltd. LLC, New York, "Today, everything is centered around data — accessing it, using it, extracting insights from it — and in the next two years, there will be much more

MORE ON TECHNOLOGY IN MONEY MANAGEMENT

- Washington board targets \$7 million for technology. **Page 16**
- Pandemic shines spotlight on benefits of tech. **Page 17**
- Data growth in industry leads to skills gap. **Page 10**

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Private Equity

Firms turn to roll-ups to find instant growth

Strategy employed to bypass paying high prices to purchase portfolio companies

By ARLEEN JACOBIOUS

Private equity firms with a record \$1.6 trillion in dry powder are leaning heavily on roll-up strategies as a way of avoiding high purchase prices for portfolio companies. Instead, they are buying smaller, cheaper companies — especially in the wealth and alternative investment management and insurance sectors — and merging them for instant growth.

Private equity-backed deals including roll-ups have been on a tear since the fourth quarter of 2020, despite a pause in transactions in the earlier part of 2020 when valuation uncertainties caused by the pandemic drove private equity players to the sidelines. So far in 2021 to July 7, there were 1,741 roll-up transactions | SEE ROLL-UPS ON PAGE 33

ESG

Panel: Investors should view diversity as a strategy

By SOPHIE BAKER

Including diverse money managers in an investment portfolio should be viewed as an alpha play, investment executives say.

Speaking at the second in a series of *Pensions & Investments* virtual roundtables on June 22, panelists discussed the benefits that hiring diverse or emerging money managers — such as those that are minority-, women- or disabled person-owned — can bring to an institutional investor's overall portfolio.

"It is about being a good fiduciary," said Angela Miller-May, CIO at the Public School Teachers' Pension & Retirement Fund of Chicago. "Diversity should be looked at as a strategy like (an) ESG

SEE DIVERSE ON PAGE 30

RELATED CONTENT

To view video from the roundtable, go to plonline.com/diversity



BE A GOOD FIDUCIARY: Angela Miller-May, clockwise from upper left, Jasmine N. Richards, Rupal J. Bhansali and Gilbert A. Garcia participated in P&I's roundtable.

SOUND BITE

Minnesota State Board of Investment's **Mansco Perry III** stressed his summer reading list has **'NOTHING about investments.'** READ MORE ON PAGE 3



AMG adds Parnassus amid slew of M&A

Affiliated Managers Group's deal for a majority stake in the ESG-dedicated manager was one of a number of recent transactions. **Page 19**

Defined Contribution

Industry: New brokerage rules are not needed

DOL seeks feedback to make sure those with DC self-directed accounts protected

By ROBERT STEYER

Self-directed brokerage accounts are the ERISA version of cicadas for defined contribution regulations — they generate a bit of buzz periodically but then go quiet.

Seven years ago, the DC industry made a lot of noise when the Department of Labor issued a 39-question request for information about whether brokerage accounts merited more federal regulation. The DOL didn't act on the RFI, and the issue disappeared from view until late last month, when the ERISA Advisory Council held a hearing in which DC industry members testified that additional regulation isn't necessary and could be expensive and counterproductive.

Another public hearing will be held Aug. 26-27, and the council will hold two public meetings later this year to discuss their findings and recommendations, which it will send to the Employee Benefit Security Administration. The council's membership includes representatives from the public, employers, unions, investment managers and other financial firms.

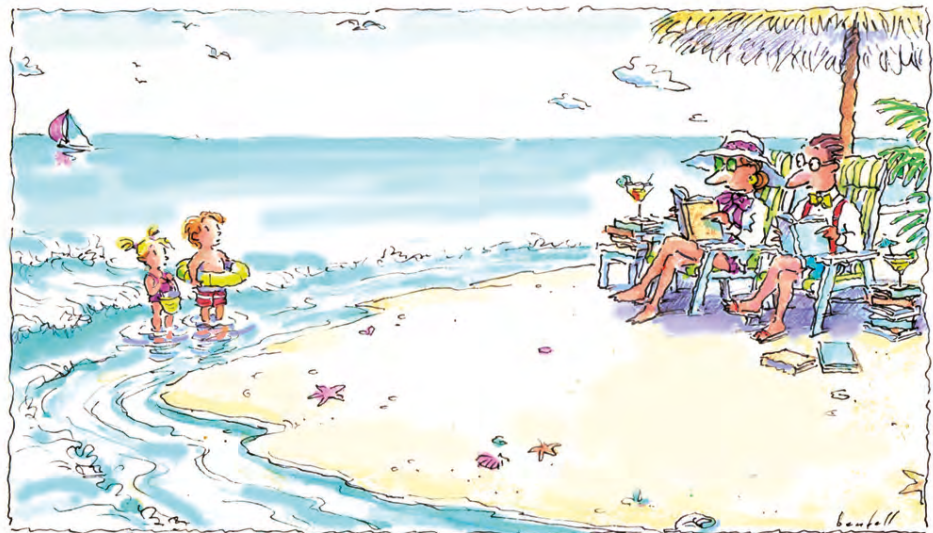
The council "will study the nature and extent of disclosures that plan participants receive, which plan participants use brokerage windows, and in what manner," says a notice on the council's website. The DOL wants to know "whether guidance would be appropriate and necessary to ensure that plan participants and beneficiaries with access to a brokerage window are adequately informed and protected under ERISA," the website says.

If it ain't broke ...

In testimony to the council and in interviews with *Pensions & Investments*, officials of DC trade groups and record keepers said the brokerage account system isn't broken, so there's no need for more regulation. SEE BROKERAGE ON PAGE 34



NOT AN ISSUE: Alison Borland insisted that "there's no problem that needs to be fixed" by the Labor Department.



Summer Reading

Grab a chair and enjoy these suggestions

Some finance-related books on tap for P&I readers this summer, but still lots of escapist fare to peruse

By JAMES COMTOIS, ARLEEN JACOBUS, ROB KOZLOWSKI and CHRISTINE WILLIAMSON

Biographies, history and escapist fare ranging from popular fiction to travel guides top the summer reading lists of readers of *Pensions & Investments*.

■ **Ashbel C. "Ash" Williams Jr.**, executive director and chief investment officer of the \$245.8 billion Florida State Board of Administration, Tallahassee, will be reading Hank and Jan Taft and Curtis Rindlaub's book "A Cruising Guide to the Maine Coast" this summer.

The book is for background research for an August trip on Downeast Charter Boat Tours based in Maine, Mr. Williams said in an email.

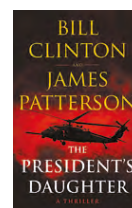
Other books on Mr. Williams' list in-

clude "Bananas: How the United Fruit Company Shaped the World" by Peter Chapman and "On Food and Cooking: The Science and Lore of the Kitchen" by Harold McGee.

Those books are, respectively, "great historical perspective on the intersection of U.S. commercial interests and Latin American geopolitics" and "the seminal cooking reference work used in CIA coursework (Culinary Institute of America, not the secret agent CIA)," Mr. Williams said.

■ **Mansco Perry III**, executive director and CIO of the Minnesota State Board of Investment, St. Paul, said in an email he is making up for lost reading time this summer "having failed at getting much reading done during the last two summers, despite having an ambitious list."

"After being distracted by pandemic TV streaming," Mr. Perry said his summer reading endeavors will be limited



to the following books: John Grisham's "The Guardians," "Camino Winds," and "A Time for Mercy," "The President's Daughter" by co-authors James Patterson and former President Bill Clinton; and David Quentin Voight's "American Baseball Volumes 2 and 3."

Mr. Perry said he also intends to reread Edward Bellamy's "Looking Backward: 2000 - 1887," a utopian novel first published in 1888 "if I can find my 50-plus year-old copy, which is stored in one of over 100 boxes."

He stressed in his email that he is reading "NOTHING about investments" this summer.

As of March 31, the Minnesota State Board of Investment managed a total of \$116.9 billion, including \$84.5 billion in defined benefit plans.

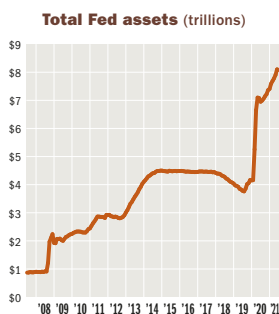
■ **Johara Farhadieh**, executive director and CIO of the \$28 billion Illinois State

SEE READING ON PAGE 30

A look at the Fed's balance sheet

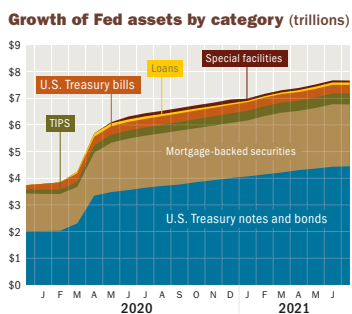
The U.S. Federal Reserve acknowledged inflationary pressures last month, although it believes they are due to transitory factors caused by the economy's reopening. Nevertheless, the central bank raised the possibility of higher short-term interest rates in late 2022 or early 2023. That makes this an opportune time to look at the central bank's greatly expanded balance sheet.

Massive growth: The Fed kicked its asset purchases into high gear after the onset of the COVID-19 pandemic in early 2020. The size of its balance sheet was at \$8.1 trillion as of June 30, nearly double the \$4.2 trillion at the end of 2019.



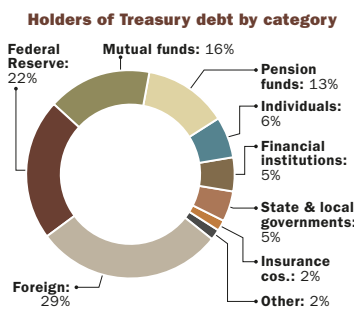
Sources: Federal Reserve; U.S. Department of the Treasury; SIFMA

Appetite for Treasuries: The Fed's U.S. Treasury holdings sat at \$5.2 trillion as of June 30 vs. \$2.3 trillion at the end of 2019. The increase was mostly driven by longer-term government securities — Treasury notes and bonds grew to \$4.4 trillion from \$2 trillion. Over the same period, mortgage-backed securities holdings increased 65% to \$2.3 trillion.



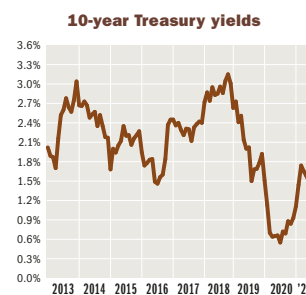
Sources: Federal Reserve; U.S. Department of the Treasury; SIFMA

Major holding: The Federal Reserve held about 22% of outstanding Treasury securities as of the end of the first quarter, according to data provided by SIFMA. In 2008, it held roughly 6%. After enacting various quantitative easing programs during the Great Recession, that figure approached 20% in 2014 before declining over the next five years.



Sources: Federal Reserve; U.S. Department of the Treasury; SIFMA

Patient approach: From 2015 through October 2017, the Fed reduced assets by a negligible \$25 billion to \$4.5 trillion and to \$3.8 trillion by August 2019. The 10-year Treasury yield peaked at more than 3% in 2018 before falling back to pre-tapering levels. As of July 9, the 10-year yield was 1.36%.



Compiled and designed by Larry Rothman and Gregg A. Runburg

Brokerage

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"There's no problem that needs to be fixed," Alison Borland, San Francisco-based executive vice president for wealth solutions and strategy at Alight Solutions Inc., said in an interview.

Comments by Ms. Borland and other DC industry representatives sounded the same in 2021 as they did in 2014, when the Labor Department issued its brokerage account RFI. After the RFI, "there was no compelling reason to make changes," Ms. Borland said.

"I was surprised it was on the list" said Kent Mason, a Washington-based partner at Davis & Harman LLP, referring to the ERISA Advisory Council's agenda for this year. "I don't think there's an issue."

Mr. Mason and Ms. Borland were among those testifying at June's virtual ERISA Advisory Council hearing as did representatives of the ERISA Industry Committee, the U.S. Chamber of Commerce and Empower Retirement.

Their unifying theme was that more regulation and more disclosure would create more problems — administrative and legal — for sponsors leading to possible reduction or even cancellation of brokerage accounts.

"We're good; we don't need more disclosure," Chantel Sheaks, vice president for retirement policy for the U.S. Chamber of Commerce, said, adding there is room for more regulatory clarity. "More disclosure isn't better disclosure."

DC industry members "are still a little leery" about the Labor Department and self-directed brokerage accounts due to a guidance document issued — and then swiftly withdrawn — nine years ago, she said.

In May 2012, the Labor Department issued a fee disclosure guidance document, including a passage that said if an investment in



Jennifer Bishop

COVERED: Aliya Robinson believes current rules provide sufficient information for participants to make informed choices on self-directed brokerage accounts.

brokerage accounts crossed a certain threshold — based on how many participants invested in it — then sponsors would have a fiduciary duty to monitor it. The guidance said such an investment would be considered a designated investment alternative, putting it on a fiduciary par with plan's core lineup.

A bigger burden

DC members accused the Labor Department of back-door regulation. They said the guidance document would have forced them to monitor all investments — hundreds or thousands — in the brokerage accounts, defeating the purpose of giving participants extra choices without requiring the fiduciary vetting of the DC plans' core lineups.

An intense industry lobbying effort led to the proposal being withdrawn in July 2012.

In August 2014, the department came back with its RFI about the cost, administration and disclosure policies of the brokerage accounts.

Once again, DC trade groups complained about regulatory overreach and the prospects of more costs and administrative headaches. The agency never acted.

In the RFI, the department expressed concern that sponsors might turn their DC plans into one self-directed brokerage account as a way to avoid or reduce fiduciary responsibilities and fee transparency.

"We never even saw that contemplated" by clients, said Ms. Borland, whose company's record keeping clients are mostly large employers.

At the smaller end of the DC market, "no client has asked us about avoiding fee disclosures," said Kevin Mahoney, the business development officer at FinDec Co., a Stockton, Calif.-based firm which provides third-party administration as well as wealth, insurance and benefits services. His company has about 400 DC plan clients with average assets of \$2 million to \$3 million and an average of about 50

employees. The firm offers a brokerage account to clients through Charles Schwab & Co.

"In my experience, that fear has never materialized," said Mr. Mason, who works primarily with large plans, large employers and DC trade groups. He suggested that the Obama administration's Labor Department put brokerage accounts on the back burner because the agency "devoted its energy" in 2015 and 2016 to developing the fiduciary rule and a rule on state-run auto-IRA programs.

The Trump administration, he added, "had a different perspective on many issues," so the brokerage accounts never surfaced as a regulatory matter. Now, with the Biden administration, "this was the next opportunity," he said.

Already covered

Self-directed brokerage accounts already are covered by ERISA rules that provide sufficient information for participants to make informed choices, Aliya Robinson, Washington-based senior vice president for retirement and compensation policy at the ERISA Industry Committee, told the ERISA Advisory Council on June 25. "Under current guidance, plan sponsors must provide participants with sufficient information to understand how the brokerage window works, explain any fees and expenses that will be charged against the participant's account and a statement of the dollar amount of fees charged," she testified.

Ms. Robinson said ERIC and its members feared that additional rules or guidance, such as those proposed in 2012, would lead to "unintended consequences" by creating onerous, expensive administrative requirements.

Faced with such rules, some sponsors could drop the brokerage account. Sponsors may say "Why bother?" she said in an interview. "It's not worth taking on the risk."

Another unintended consequence could be sponsors adding to

their core investment lineups at a time when many are trimming their menus for simplicity and using the self-directed brokerage accounts as a way for participants — often the more sophisticated investors — to pursue other investments, she said.

Room to improve

Despite their misgivings about more regulation, DC industry members said there's room for tweaks in ERISA.

Sponsors do a good job of telling participants "that the plan has not screened brokerage window investments," Mr. Mason said. "We're not opposed to strengthening that communication."

Mr. Mahoney of FinDec said he wouldn't mind seeing the Labor Department erect a few "guardrails" for brokerage accounts. The rising role of technology in plan administration and the emergence of new types of investments could require more clarification about what investments are allowed under ERISA, he said.

Another suggestion — he doesn't call it regulation — would be more "clear language" about the responsibilities of sponsors, advisers and service providers.

In her testimony, Ms. Sheaks of the Chamber of Commerce said ERISA should contain language saying the sponsor's duty to monitor covers only the activity of the brokerage account provider and not specific investments in the brokerage account.

Assuming fiduciaries follow all of ERISA's rules, she advocated language that clearly states they shouldn't be liable for a participant losing money in a brokerage account investment.

She also offered some model language that sponsors can provide to participants describing the brokerage account's terms, costs and administration as well as making clear that neither the sponsor nor the account provider is responsible for losses due to participants' investment choices.

Future Fund

CONTINUED FROM PAGE 2

ic asset allocation program, leaning more heavily into private markets and complexity and illiquidity and control premium because ... you can't simply rely on the equity premium the way many people have over the last 30 years," Ms. Brake said in the interview.

Mr. Arndt and Ms. Brake this year have contended that the pandemic crisis has — as Mr. Arndt told senators on May 26 — brought about "deep and lasting changes to economies and investment markets," making the pursuit of investment returns more complex and challenging than ever before.

There are more important drivers of return now than there have been historically, which in turn calls for more breadth in portfolios and the pursuit of more granular diversification opportunities — a backdrop that requires more investment professionals, Ms. Brake said. By way of example, she cited "geographic levers" of investment returns that had come to be ignored as globalization went from strength to strength in recent decades. Going forward, the lack of focus on geographic factors "needs to be rethought," she said.

"All those things add up to just being more active about how we think about investing and that requires more people," she said.

Expanding investment staff

Mr. Arndt told Australia's Senate the Future Fund's investment staff needs to grow to 150 from 80 at present. Without those reinforcements, he said, his team could fall short of meeting the fund's mandated return target of Australia's consumer price index plus 4 to 5 percentage points going forward.

Over the coming five years, the Future Fund will have less passive exposure in public markets, Ms. Brake said. A Future Fund spokeswoman didn't respond to requests for a current breakdown of active vs. passive exposures in the fund's equity allocations of 32.1% — with 16.8% in developed market equities, 8.3% in emerging markets equities and 7% in Australian equities.

Mr. Arndt did specifically mention the need for more staff capable of selecting managers of "skill-based" strategies in market segments such as private equity and hedge funds — areas the fund is already heavily exposed to with respective allocations of 14.6% and 14.4% of the portfolio.

There will be more private markets exposure over that period, Ms. Brake said. Private market allocations

already stand at roughly 35% of the portfolio, with that 14.6% in private equity complemented by 7.3% in infrastructure and timberland, 7% in private debt and 6% in real estate. The portfolio's remaining 18.6% weighting is parked in cash — which Ms. Brake has said should leave the Future Fund well positioned to pursue opportunities in what look to be increasingly "fragile" global capital markets.

The CIO conceded that some additions to the Future Fund's private markets staff would be useful, as managing private assets that are already in the portfolio is becoming a heavier burden on the team as the portfolio continues to expand.

The Future Fund does direct deals and even though the private markets assets it acquires are ultimately managed by an asset manager, they still require considerable ongoing oversight by the fund's investment professionals, she said. Those assets are "of decent size and we put one or two people on the boards and you get to a certain point and the whole team is busy managing the assets we already have," Ms. Brake said. "The growth in the fund and the growth in the number of mandates we've had just mean that we need to have more people ... to continue to be thoughtful about what the right deals are and what the right assets are for the



HOT PURSUIT: Sue Brake believes current drivers of return call for more breadth in portfolios — and more staff.

portfolio, given where we're heading."

There are no set targets for increasing private market allocations, Ms. Brake said.

'One team, one purpose'

Whether a near-doubling of investment staff will change the Future Fund's "one team, one purpose" culture — where there are no targeted silos and every proposed allocation has to justify itself vis-à-vis all of the portfolio's existing holdings — is an open question.

Ms. Brake said she's confident that culture will emerge intact from the fund's upsizing. "We wouldn't be doing this if we thought that this

increase in numbers was going to dilute or jeopardize that culture," she said.

"We've resisted change," striving to keep the team small due to the conviction that the Future Fund's culture is a big comparative advantage, "adding significant basis points to our performance," she said.

Nonetheless, "we've come to that inflection point (and) we do need to grow" due to the increasingly complex market environment and the handful of additional funds, with combined assets of A\$48.3 billion, the Future Fund team has been tasked with managing over recent years, she said.

Additional plans falling under the Future Fund include the A\$21.4 billion Medical Research Future Fund and the A\$15.3 billion DisabilityCare Australia Fund.

To square the circle, the fund has launched a "Future Fund Academy" to preserve the culture, providing a more formal induction and education of both new and existing staff, she said.

"I think that's going to be great for us to be able to articulate what it is to do it the Future Fund way," she added.

Meanwhile, Ms. Brake said, that increase in staff won't be rushed — taking place over a three-year period.