AGENDA

DALLAS POLICE & FIRE PENSION SYSTEM

Date: August 2, 2024

The regular meeting of the Dallas Police and Fire Pension System Board of Trustees will be held at **8:30 a.m. on Thursday, August 8, 2024, in the Second Floor Board Room at 4100 Harry Hines Boulevard, Dallas, Texas and via telephone conference for audio at 214-271-5080 access code 588694 or Toll-Free (US & CAN): 1-800-201-5203 and Zoom meeting for visual https://us02web.zoom.us/j/83364156526?pwd=OG5CbEFhajN5V0hWaUFJMlhYcHQ2Zz09 Passcode: 923237.** Items of the following agenda will be presented to the Board:

A. MOMENT OF SILENCE

B. APPROVAL OF MINUTES

Regular meeting of July 11, 2024

C. DISCUSSION AND POSSIBLE ACTION REGARDING ITEMS FOR INDIVIDUAL CONSIDERATION

1. **Independent Actuarial Analysis and Recommendations and Section 2.025 Update**

   Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

2. **Quarterly Financial Reports**

3. **2024 Mid-Year Budget Review**

4. **Financial Audit Status**

5. **Executive Director Approved Pension Ministerial Actions**

6. **Monthly Contribution Report**

7. **Board approval of Trustee Education and Travel**

   a. Future Education and Business-related Travel
   b. Future Investment-related Travel

8. **Actuarial Review Required by Texas Government Code 802.1012**

9. **Portfolio Update**

10. Lone Star Investment Advisors

Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

11. Legal issues - In accordance with Section 551.071 of the Texas Government Code, the Board will meet in executive session to seek and receive the advice of its attorneys about pending or contemplated litigation or any other legal matter in which the duty of the attorneys to DPFP and the Board under the Texas Disciplinary Rules of Professional Conduct clearly conflicts with Texas Open Meeting laws.

12. Closed Session - Board serving as Medical Committee

Discussion of the following will be closed to the public under the terms of Section 551.078 of the Texas Government Code:

a. Application for death benefits for disabled child 2024-1c
b. Disability application 2024-2d

D. BRIEFING ITEMS

1. Public Comment

2. Executive Director's Report

a. Associations' newsletters
- NCPERS Monitor (August 2024)
- NCPERS PERSist (Summer 2024)

b. Open Records

The term "possible action" in the wording of any Agenda item contained herein serves as notice that the Board may, as permitted by the Texas Government Code, Section 551, in its discretion, dispose of any item by any action in the following non-exclusive list: approval, disapproval, deferral, table, take no action, and receive and file. At the discretion of the Board, items on this agenda may be considered at times other than in the order indicated in this agenda.

At any point during the consideration of the above items, the Board may go into Closed Executive Session as per Texas Government Code, Section 551.071 for consultation with attorneys, Section 551.072 for real estate matters, Section 551.074 for personnel matters, Section 551.076 for deliberation regarding security devices or security audits, and Section 551.078 for review of medical records.

DALLAS POLICE & FIRE PENSION SYSTEM

MOMENT OF SILENCE

In memory of our Members and Pensioners who recently passed away

NAME	ACTIVE/ RETIRED	DEPARTMENT	DATE OF DEATH
Clyde Dickerson	Retired	Police	07/02/2024
William L. Johnson	Retired	Police	07/03/2024
Thomas S. Swing	Retired	Fire	07/03/2024
Richard E. Beebe	Retired	Fire	07/06/2024
Craig A. Reynerson	Retired	Police	07/07/2024
Eugene M. Walther	Retired	Fire	07/09/2024
Albert L. Hay	Retired	Police	07/10/2024
Jimmy A. Bollman	Retired	Fire	07/17/2024
David L. Goelden	Retired	Police	07/23/2024
Robert W. Foster	Retired	Fire	07/31/2024

Regular Board Meeting –Thursday, August 8, 2024

Dallas Police and Fire Pension System
Thursday, July 11, 2024
8:30 a.m.
4100 Harry Hines Blvd., Suite 100
Second Floor Board Room
Dallas, TX

Regular meeting, Nicholas A. Merrick, Chairman, presiding:

ROLL CALL

Board Members

Present at 8:32 a.m.	Nicholas Merrick, Tina Hernandez Patterson, Michael Taglienti, Anthony Scavuzzo, Tom Tull, Matthew Shomer, Marcus Smith
By telephone	Michael Brown, Mark Malveaux
Absent	Steve Idoux, Nancy Rocha
Staff	Kelly Gottschalk, Josh Mond, Brenda Barnes, Ryan Wagner, Christina Wu, Akshay Patel, Kyle Schmit, John Holt, Nien Nguyen, Milissa Romero, Cynthia J. Thomas
Others	David Elliston, Robert Gassett, Jose Rivas, Farrah Ali
By telephone	Aaron Lally, Leandro Festino, Ken Haben

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The meeting was called to order at 8:32 a.m.

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A. MOMENT OF SILENCE

The Board observed a moment of silence in memory of retired police officers James F. Steen, V.A. McDaniel, Thurman A. Ross, and retired firefighters Jerald F. Pickard, Richard G. York, Carlton T. Evans, Albert W. Kirksey, Charles R. Prater, Roy C. Chapman, Donald P. Little, Stephen M. Gouse.

No motion was made.

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Regular Board Meeting
Thursday, July 11, 2024

B. APPROVAL OF MINUTES

1. Regular meeting of June 13, 2024

After discussion, Mr. Scavuzzo made a motion to approve the minutes of the Regular meeting of June 13, 2024. Mr. Shomer seconded the motion, which was unanimously approved by the Board.

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Mr. Brown and Mr. Malveaux arrived in person at 8:46 a.m.

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C. DISCUSSION AND POSSIBLE ACTION REGARDING ITEMS FOR INDIVIDUAL CONSIDERATION

1. Independent Actuarial Analysis and Recommendations and Section 2.025 Update

The Executive Director provided an update on the process involving Section 2.025 of Article 6243a-1 and the Board provided feedback.

No motion was made.

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2. Financial Audit Status

The Chief Financial Officer provided a status update on the annual financial audit.

No motion was made.

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3. Executive Director Approved Pension Ministerial Actions

The Executive Director reported on the June pension ministerial actions.

No motion was made.

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Regular Board Meeting
Thursday, July 11, 2024

4. Monthly Contribution Report

The Executive Director reviewed the Monthly Contribution Report.

No motion was made.

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5. Board approval of Trustee education and travel

a. Future Education and Business-related Travel
b. Future Investment-related Travel

The Board and staff discussed future Trustee education. There was no future Trustee business-related travel or investment-related travel scheduled.

After discussion, Ms. Hernandez Patterson made a motion to approve Mr. Taglienti's request to attend the TEXPERS Summer Educational Forum. Mr. Merrick seconded the motion, which was unanimously approved by the Board.

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6. Pension Administration Software

Staff discussed the steps taken and the information learned related to the Pension Administration Software project.

After discussion, Mr. Shomer made a motion to authorize the Executive Director, in her discretion, to take any or all of the following actions (i) after consultation with the Chairman, hire a consultant to advise DPFP on the acquisition and implementation of a pension administration software system ("PAS"), (ii) disseminate a Request for Proposal for a new PAS; and (iii) negotiate with the current PAS vendor with respect to a new PAS. Mr. Tull seconded the motion, which was unanimously approved by the Board.

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7. Portfolio Update

Investment staff briefed the Board on recent events and current developments with respect to the investment portfolio.

No motion was made.

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Regular Board Meeting
Thursday, July 11, 2024

8. Custodian Selection

Staff reviewed the search process and recommendation on the selection of a new custodian bank.

After discussion, Mr. Tull made a motion to authorize the Executive Director to negotiate and execute a custodian agreement with BNY Mellon. Mr. Taglienti seconded the motion, which was unanimously approved by the Board.

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9. Lone Star Investment Advisors

The Board went into closed executive session – Legal at 10:18 a.m.

The meeting reopened at 10:33 a.m.

Investment staff updated the Board on investments managed by Lone Star Investment Advisors.

No motion was made.

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10. Legal issues - In accordance with Section 551.071 of the Texas Government Code, the Board will meet in executive session to seek and receive the advice of its attorneys about pending or contemplated litigation or any other legal matter in which the duty of the attorneys to DPFP and the Board under the Texas Disciplinary Rules of Professional Conduct clearly conflicts with Texas Open Meeting laws.

The Board went into closed executive session – Legal at 10:18 a.m.

The meeting reopened at 10:33 a.m.

The Board and staff discussed legal issues.

No motion was made.

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Regular Board Meeting
Thursday, July 11, 2024

D. BRIEFING ITEMS

1. Public Comments

Prior to commencing items for Board discussion and deliberation, the Chairman extended an opportunity for public comment. No one requested to speak to the Board.

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2. Executive Director's Report

a. Associations' newsletters
- NCPERS Monitor (July 2024)

b. Open Records
c. Employee Service Awards

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Ms. Gottschalk stated that there was no further business to come before the Board. On a motion by Mr. Taglienti and a second by Mr. Tull, the meeting was adjourned at 10:34 a.m.

Nicholas A. Merrick,
Chairman

ATTEST:

Kelly Gottschalk,
Secretary

Regular Board Meeting
Thursday, July 11, 2024

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DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C1

Topic: **Independent Actuarial Analysis and Recommendations and Section 2.025 Update**

Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

Discussion: Section 2.025 of Article 6243a-1 requires the Texas Pension Review Board to select, and DPFP to hire, an independent actuary to perform an actuarial analysis of DPFP's most recently completed actuarial valuation to (i) determine if DPFP meets Texas statutory funding requirements and (ii) recommend changes to benefits and contribution rates for employees and the City of Dallas. This analysis is due on or before October 1, 2024.

Cheiron, Inc., was hired as the independent actuary. In November 2023, Cheiron presented the preliminary report based on DPFP's January 1, 2022 actuarial valuation. In February 2024, Cheiron presented its official report under Section 2.025 based on DPFP's January 1, 2023 actuarial valuation. Cheiron submitted their final report, which reflects their presentation from February 2024 with some refinements based on questions and feedback received after the February presentation.

Staff presented information on this topic each month beginning November 2023. Staff will provide updates on the process and recommendations.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C2

Topic: **Quarterly Financial Reports**

Discussion: The Chief Financial Officer will present the second quarter 2024 financial statements.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C3

Topic: **2024 Mid-Year Budget Review**

Discussion: Attached is a review of the 2024 Operating Expense Budget detailing expenses for the first six months of the calendar year.

Expense items with variances to the prorated budget by more than 5% and $10,000 as of June 30, 2024 are discussed in the attached review.

Supplemental Plan expenses are deducted from total expenses in arriving at total Regular Plan expenses. Expenses are allocated to the two plans on a pro-rata basis, according to the ratio of each plan's assets to the total Group Trust assets. The ratio is derived from the Unitization Report prepared by JPMorgan as of June 30, 2024. The ratio is 99.03% Regular Plan to .97% Supplemental Plan.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C4

Topic: **Financial Audit Status**

Discussion: The Chief Financial Officer will provide a status update on the annual financial audit.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C5

Topic: **Executive Director Approved Pension Ministerial Actions**

Discussion: The Executive Director approved ministerial membership actions according to the Retirement and Payments Approval Policy. Membership actions approved are summarized in the provided report.

Regular Board Meeting – Thursday, August 8, 2024

Membership Actions -2024

	January	February	March	April	May	June	July	August	September	October	November	December	YTD Totals
Refunds	23	22	21	26	16	21	13	19					161
DROP - Join	1	1	2	0	5	1	1	1					12
Estate Payments	2	1	3	5	3	1	4	5					24
Survivor Benefits	4	6	3	8	5	4	6	5					41
Retirements	10	10	16	9	13	10	9	11					88
Alternate Payees	2	0	2	1	1	1	0	0					7
Spouse Wed After Retirement	0	0	0	0	0	0	0	0					0
Service Purchases	0	2	0	1	7	2	1	2					15
Earnings Test*	0	0	0	0	0	0	10	0					10

Membership Actions -2023

	January	February	March	April	May	June	July	August	September	October	November	December	YTD Totals
Refunds	26	19	12	13	17	14	23	13	57	53	18	21	286
DROP - Join	3	3	0	2	2	2	0	0	3	0	3	0	18
Estate Payments	0	5	7	5	1	2	4	92	5	3	5	9	138
Survivor Benefits	1	6	8	6	4	3	5	6	6	2	3	6	56
Retirements	12	16	11	14	11	12	10	13	10	17	6	12	144
Alternate Payees	0	2	1	0	2	3	1	3	2	0	0	1	15
Spouse Wed After Retirement	1	0	0	0	0	0	0	0	1	1	1	0	4
Service Purchases	2	0	0	1	0	2	0	1	0	0	2	0	8
Earnings Test	0	0	0	0	0	9	0	0	0	0	0	0	9

Data is based on Agenda/Executive Approval Date
Service purchases include Military, DROP Revocation, and Previously Withdrawn Contributions
The increase in Refunds in September 2023 and October 2023 is due to the Refund Project
87 of the Estate Payments in August 2023 are approvals for the Pending Death Project
*In 2024, 9 of 10 of the Earnings Tests did not require an benefit reduction. A piece of information is still needed to determine if the last member will require a reduciton.

G:\Kelly\Executive Director Ministerial Action Approvals\Membership Actions Data 2024

DISCUSSION SHEET

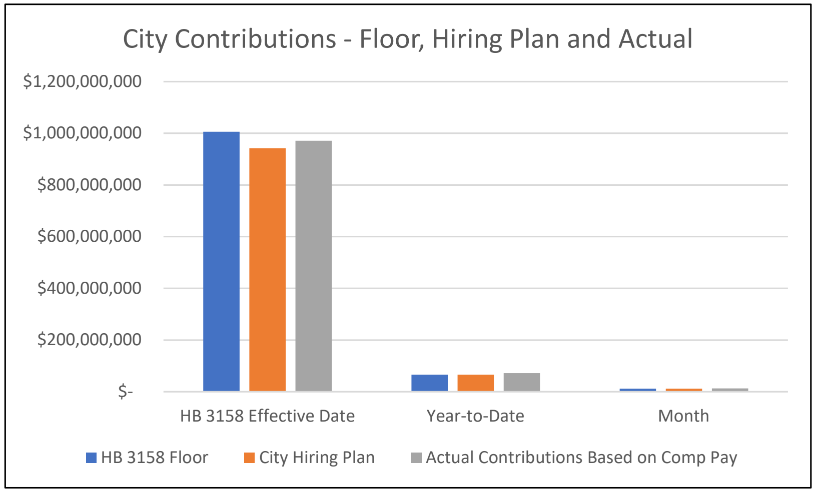
ITEM #C6

Topic: **Monthly Contribution Report**

Discussion: Staff will review the Monthly Contribution Report.

Regular Board Meeting – Thursday, August 8, 2024

Contribution Tracking Summary - July 2024 (May 2024 Data)

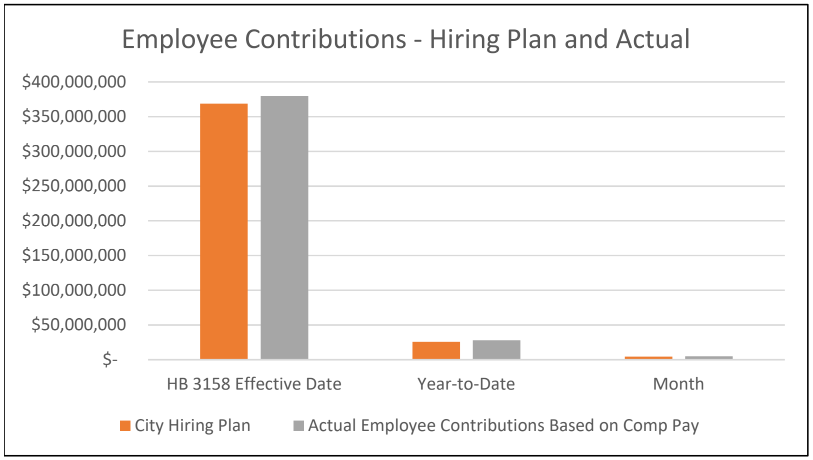


Actual Comp Pay was 103% of the Hiring Plan estimate since the effective date of HB 3158.

The Floor for 2024 is equal to the Hiring Plan estimate of $6,024,000 per pay period. The Hiring Plan increased by 3.65% in 2024. It is expected that actual contributions will exceed the Floor through 2024.

Through 2024 the HB 3158 Floor is in place so there is no City Contribution shortfall.

The combined actual employees were 31 **more** than the Hiring Plan for the pay period ending May 10, 2024. Fire was over the estimate by 280 Fire Fighters and Police was under by 249 Police Officers.



Employee contributions exceeded the Hiring Plan estimate for the month, the year and since inception.

There is no Floor on employee contributions.

Contribution Summary Data

City Contributions

May-24	Number of Pay Periods Beginning in the Month	HB 3158 Floor	City Hiring Plan	Actual Contributions Based on Comp Pay	Additional Contributions to Meet Floor Minimum	Comp Pay Contributions as a % of Floor Contributions	Comp Pay Contributions as a % of Hiring Plan Contributions
Month	2	$ 12,048,000	$ 12,048,462	$ 13,157,092	$ -	109%	109%
Year-to-Date		$ 66,264,000	$ 66,266,538	$ 72,082,033	$ -	109%	109%
HB 3158 Effective Date		$ 1,006,597,000	$ 942,486,923	$ 971,438,445	$ 48,990,866	97%	103%

Due to the Floor through 2024, there is no cumulative shortfall in City Contributions
Does not include the flat $13 million annual City Contribution payable through 2024.
Does not include Supplemental Plan Contributions.

Employee Contributions

May-24	Number of Pay Periods Beginning in the Month	City Hiring Plan	Actual Employee Contributions Based on Comp Pay	Actual Contribution Excess Compared to Hiring Plan	Actuarial Valuation Contribution Assumption	Actual Contributions as a % of Hiring Plan Contributions	Actual Contributions as a % of Actuarial Val Assumption
Month	2	$ 4,714,615	$ 5,045,058	$ 330,443	$ 4,236,924	107%	119%
Year-to-Date		$ 25,930,385	$ 28,103,029	$ 2,172,645	$ 23,303,082	108%	121%
HB 3158 Effective Date		$ 368,799,231	$ 379,842,353	$ 11,043,122	$ 355,122,760	103%	107%

Potential Earnings Loss from the Shortfall based on Assumed Rate of Return $ 626,093

Does not include Supplemental Plan Contributions.

Reference Information

City Contributions: HB 3158 Bi-weekly Floor and the City Hiring Plan Converted to Bi-weekly Contributions

	HB 3158 Bi-weekly Floor	City Hiring Plan- Bi-weekly	HB 3158 Floor Compared to the Hiring Plan	Hiring Plan as a % of the Floor	% Increase/ (decrease) in the Floor	% Increase/ (decrease) in the Hiring Plan
2017	$ 5,173,000	$ 4,936,154	$ 236,846	95%		
2018	$ 5,344,000	$ 4,830,000	$ 514,000	90%	3.31%	-2.15%
2019	$ 5,571,000	$ 5,082,115	$ 488,885	91%	4.25%	5.22%
2020	$ 5,724,000	$ 5,254,615	$ 469,385	92%	2.75%	3.39%
2021	$ 5,882,000	$ 5,413,846	$ 468,154	92%	2.76%	3.03%
2022	$ 6,043,000	$ 5,599,615	$ 443,385	93%	2.74%	3.43%
2023	$ 5,812,000	$ 5,811,923	$ 77	100%	-3.82%	3.79%
2024	$ 6,024,000	$ 6,024,231	$ (231)	100%	3.65%	3.65%

The HB 3158 Bi-weekly Floor ends after 2024

Employee Contributions: City Hiring Plan and Actuarial Val. Converted to Bi-weekly Contributions

		City Hiring Plan Converted to Bi-weekly Employee Contributions	Actuarial Valuation Assumption Converted to Bi-weekly Employee contributions	Actuarial Valuation as a % of Hiring Plan
2017		$ 1,931,538	$ 1,931,538	100%
2018		$ 1,890,000	$ 1,796,729	95%
2019		$ 1,988,654	$ 1,885,417	95%
2020		$ 2,056,154	$ 2,056,154	100%
2021		$ 2,118,462	**$ 2,118,462**	100%
2022		$ 2,191,154	**$ 2,191,154**	100%
2023		$ 2,274,231	**$ 2,274,231**	100%
2024		$ 2,357,308	**$ 2,357,308**	100%

The information on this page is for reference. The only numbers on this page that may change before 2025 are the Actuarial Valuation Employee Contributions Assumptions for the years 2020-2024 and the associated percentage.

Reference Information - Actuarial Valuation and GASB 67/68 Contribution Assumptions

Actuarial Assumptions Used in the Most Recent Actuarial Valuation - These assumptions will be reevaluated annually & may change.

City Contributions are based on the Floor through 2024, the Hiring Plan from 2025 to 2037, after 2037 an annual growth rate of 2.75% is assumed

Employee Contributions for 2018 are based on the 2017 actual employee contributions inflated by the growth rate of 2.75% and the Hiring Plan for subsequent years until 2038, when the 2037 Hiring Plan is increased by the 2.75 growth rate for the next 10 years

Actuarial/GASB Contribution Assumption Changes Since the Passage of HB 3158

	Actuarial Valuation	GASB 67/68
YE 2017 (1/1/2018 Valuation)		
2018 Employee Contributions Assumption - based on 2017 actual plus growth rate not the Hiring Plan Payroll	$ (2,425,047)	*
2019 Estimate (1/1/2019 Valuation)		
2019 Employee Contribution Assumption	$ 9,278	*

**90% of Hiring Plan was used for the Cash Flow Projection for future years in the 12/31/2017 GASB 67/68 calculation. At 12-31-17, 12-31-18 and 12-31-2019 this did not impact the pension liability or the funded percentage.*

The information on this page is for reference. It is intended to document contribution related assumptions used to prepare the Actuarial Valuation and changes to those assumptions over time, including the dollar impact of the changes. Contribution changes impacting the GASB 67/68 liability will also be included.

City Hiring Plan - Annual Computation Pay and Numbers of Employees						
	Computation Pay			Number of Employees		
Year	Hiring Plan	Actual	Difference	Hiring Plan	Actual EOY	Difference
2017	$ 372,000,000	Not Available	Not Available	5,240	4,935	(305)
2018	$ 364,000,000	$ 349,885,528	$ (14,114,472)	4,988	4,983	(5)
2019	$ 383,000,000	$ 386,017,378	$ 3,017,378	5,038	5,104	66
2020	$ 396,000,000	$ 421,529,994	$ 25,529,994	5,063	4,988	(75)
2021	$ 408,000,000	$ 429,967,675	$ 21,967,675	5,088	4,958	(130)
2022	$ 422,000,000	$ 439,104,541	$ 17,104,541	5,113	5,074	(39)
2023	$ 438,000,000	$ 460,982,051	$ 22,982,051	5,163	5,136	(27)
2024	$ 454,000,000			5,213		
2025	$ 471,000,000			5,263		
2026	$ 488,000,000			5,313		
2027	$ 507,000,000			5,363		
2028	$ 525,000,000			5,413		
2029	$ 545,000,000			5,463		
2030	$ 565,000,000			5,513		
2031	$ 581,000,000			5,523		
2032	$ 597,000,000			5,523		
2033	$ 614,000,000			5,523		
2034	$ 631,000,000			5,523		
2035	$ 648,000,000			5,523		
2036	$ 666,000,000			5,523		
2037	$ 684,000,000			5,523		

Comp Pay by Month - 2024	Annual Divided by 26 Pay Periods	Actual	Difference	2024 Cumulative Difference	Number of Employees - EOM	Difference
January	$ 52,384,615	$ 56,848,897	$ 4,464,281	$ 4,464,281	5,183	(30)
February	$ 34,923,077	$ 37,710,735	$ 2,787,658	$ 7,251,939	5,166	(47)
March	$ 34,923,077	$ 38,150,554	$ 3,227,478	$ 10,479,417	5230	17
April	$ 34,923,077	$ 38,086,745	$ 3,163,668	$ 13,643,085	5216	3
May	$ 34,923,077	$ 38,136,499	$ 3,213,422	$ 16,856,507	5244	31
June	$ 34,923,077					
July	$ 52,384,615					
August	$ 34,923,077					
September	$ 34,923,077					
October	$ 34,923,077					
November	$ 34,923,077					
December	$ 34,923,077					

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C7

Topic: **Board Approval of Trustee Education and Travel**

a. Future Education and Business-related Travel
b. Future Investment-related Travel

Discussion:

a. Per the Education and Travel Policy and Procedure, planned Trustee education and business-related travel and education which does not involve travel requires Board approval prior to attendance.

Attached is a listing of requested future education and travel noting approval status.

b. Per the Investment Policy Statement, planned Trustee travel related to investment monitoring, and in exceptional cases due diligence, requires Board approval prior to attendance.

There is no future investment-related travel for Trustees at this time.

Future Education and Business Related Travel & Webinars
Regular Board Meeting – August 8, 2024

			ATTENDING	APPROVED
1.	**Conference**	**NCPERS Public Pension Funding Forum**		
	Dates:	August 18-20, 2024		
	Location:	Boston, MA		
	Est Cost:	$745		
2.	**Conference**	**TEXPERS Summer Educational Forum**	**MT**	
	Dates:	August 18-20, 2024		
	Location:	San Antonio, TX		
	Est Cost:	$25		
3.	**Conference:**	**NCPERS Public Pension HR Summit**		
	Dates:	September 24-26, 2024		
	Location:	Denver, CO		
	Est Cost:	$750		
4.	**Conference:**	**NCPERS Accredited Fiduciary (NAF)**		
	Dates:	October 26-27, 2024		
	Location:	Palm Springs, CA		
	Est Cost:	$900		

Future Education and Business Related Travel & Webinars
Regular Board Meeting – August 8, 2024

ATTENDING APPROVED

5. **Conference** **NCPERS Program for Advanced Trustee Studies (PATS)**
   Dates: October 26-27, 2024
   Location: Palm Springs, CA
   Est Cost: $900

6. **Conference:** **NCPERS Public Safety Conference**
   Dates: October 27-30, 2024
   Location: Palm Springs, CA
   Est Cost: $775

DISCUSSION SHEET

ITEM #C8

Topic: **Actuarial Review Required by Texas Government Code 802.1012**

Discussion: Section 802.1012 of the Texas Government Code requires that the City of Dallas hire an independent actuary to audit the most recently prepared actuarial valuation every five years. Staff will provide an overview of the process and the timeline with the Board.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C9

Topic: **Portfolio Update**

Discussion: Investment Staff will brief the Board on recent events and current developments with respect to the investment portfolio.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C10

Topic: **Lone Star Investment Advisors**

Portions of the discussion under this topic may be closed to the public under the terms of Section 551.071 of the Texas Government Code.

Discussion: Investment staff will update the Board on investments with this manager.

Regular Board Meeting – Thursday, August 8, 2024

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C11

Topic: **Legal issues - In accordance with Section 551.071 of the Texas Government Code, the Board will meet in executive session to seek and receive the advice of its attorneys about pending or contemplated litigation or any other legal matter in which the duty of the attorneys to DPFP and the Board under the Texas Disciplinary Rules of Professional Conduct clearly conflicts with Texas Open Meeting laws.**

Discussion: Counsel will brief the Board on these issues.

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #C12

Topic: **Closed Session - Board serving as Medical Committee**

Discussion of the following will be closed to the public under the terms of Section 551.078 of the Texas Government Code:

a. Application for death benefits for disabled child 2024-1c
b. Disability application 2024-2d

Discussion: Staff will present applications for survivor benefits for a disabled child and a disability retirement in accordance with Sections 6.06(n) and 6.03 of Article 6243a-1 for consideration by the Board.

DISCUSSION SHEET

ITEM #D1

Topic: **Public Comment**

Discussion: Comments from the public will be received by the Board.

DALLAS POLICE & FIRE PENSION SYSTEM

DISCUSSION SHEET

ITEM #D2

Topic: **Executive Director's Report**

a. Associations' newsletters
- NCPERS Monitor (August 2024)
- NCPERS PERSist (Summer 2024)

b. Open Records

Discussion: The Executive Director will brief the Board regarding the above information.

Regular Board Meeting – Thursday, August 8, 2024

THE NCPERS MONITOR

The Latest in Legislative News August 2024

NCPERS **Executive Director's Corner**

Mid-year Member Update from NCPERS: New Resources for Public Pension Professionals

By Hank Kim, Executive Director and Counsel, NCPERS

Photo Illustration © 2024, istock.com

Reflecting back on the first half of this busy year, I am extremely proud of how much NCPERS has accomplished so far and excited about how much we have grown in 2024. We have added several new hires to our headquarters staff, increasing our bandwidth for member programs. This mid-year point offers the chance to highlight important activities to date and our big plans for the remainder of 2024. Please make sure your organization is taking advantage of these resources and services we're providing the community.

2024 ACE Hits New Highs

Thank you for making our Annual Conference & Exhibition (ACE) in Seattle such a resounding success! This year's conference saw the highest participation by pension plan staff and trustees in the last five years. The program featured more than 70 plan leaders and industry experts sharing their valuable perspectives on top-of-mind issues. View our upcoming conferences to find your next opportunity to learn from and connect with members of the public pension community.

Interested in speaking at an upcoming event? Be sure to submit a speaker proposal for our upcoming Public Safety Conference by Monday, August 5th!

New Roundtable for Member Services Leads

We launched another new Pension Professional Roundtable, this one for directors of Member Services at pension plans. Over 60 pension plans attended these Roundtable calls in April and July, sharing their day-to-day challenges and solutions with their peers. Sign up here to participate in our pension fund roundtables for CEOs, CIOs, Communications, HR, and Member Services staff. Also, if there is a class of fund professionals who would benefit from having their own Roundtable, please email me. We're always open to exploring ways to support our members!

NCPERS Research Delivering Fresh Insights

Our research shines a light on the current state of public pensions, and several new studies were released in the first half of the year. Our *2024 Public Retirement System Study*, released in January, explores pension funds' fiscal condition and their fiscal and operational integrity. Access the member-only dashboard to see how your plan stacks up.

Our newest study *The Hidden Costs of Pension Reforms: Rising Income Inequality, Lagging Economic Growth*, finds that policies that reduce pension benefits or promote transitions to defined contribution plans, which are usually implemented to save money, may end up costing more due to the dynamic interrelationship between pension reforms, income inequality, the economy, and market returns. Learn more about the key findings at our 11th annual Public Pension Funding Forum, held August 18-20 in Boston.

We are currently analyzing data from the more than 150 funds that participated in the 2024 Public Pension Compensation Survey and expect to release our most comprehensive dataset yet on public pension professional salaries and benefits in September. Participating funds will receive free access to the in-depth survey data to help them make informed decisions about compensation, benefits, and hiring strategies. Pension funds that did not participate will still be able to purchase the report for $2,500.

Educational Webinar Series

The popularity of our Center for Online Learning has encouraged us to expand our webinar series this year with more frequent events and a broader range of topics. In the just the last few months we have provided webinars to our members on key proxy votes to watch, how DEI policies can impact recruitment and retention, and new research exploring how rising income inequality impacts pension reform and GDP growth. You can find all of our past webinar recordings at the NCPERS Center for Online Learning.

With education at the core of our mission and Hunter Bryant, our new Education Manager, expanding our capacities, you will find a continued emphasis on virtual learning opportunities in the coming months.

NCPERS Resource: Best Governance Practices for Public Retirement Systems

Earlier this year, NCPERS released a newly revised version of Best Governance Practices for Public Retirement Systems. This popular resource can provide plan leaders with a better understanding of governance documents, policies, strategic planning, and many other areas of responsibility.

Developed in collaboration with Segal Marco Advisors, contributing author Julian Regan talked with NCPERS about the purpose of this guide, common governance-related challenges, and best practices for public retirement systems to consider.

Legislative Recap

Most state legislatures are winding down or finished passing legislation for this session. In November, the election and pre-filing will kick off the next round of activity, of course, both nationally and at the state level.

This current pause is a good time for members to assess what's happened to date in the legislative arena. See our 2024 Legislative Summary for the enacted legislation from calendar year 2024 that relates to pension plans and retirement systems. On this national map, states with darker blue had more pension-related activity this year. Simply click a state and then scroll down the page to see a list of enacted legislation from the 2024 session relevant to pension issues, bill titles, and links to the language.

As always, NCPERS will keep its members updated on any legislative activity impacting pension plans over the rest of 2024.

What's Next?

There's plenty more on the horizon! Later this month, we're heading to Boston for the Public Pension Funding Forum, where pension executives, industry leaders, and academics will highlight the latest research and case studies on emerging funding solutions.

In late September, we're looking forward to bringing together HR professionals in Denver for three days of networking, peer-to-peer learning, and hands-on training with industry experts during the Public Pension HR Summit. This one-of-a-kind event will equip you with the knowledge and resources needed to navigate the complexities of public sector HR. Be sure to register by September 2nd to secure the discounted early-bird rates!

We're also gearing up for the Public Safety Conference, held October 27-30 in Palm Springs, and the pre-conference NCPERS University events—the Program for Advanced Trustee Studies (PATS) and NCPERS Accredited Fiduciary (NAF) program.

Outside of our educational events, you can always find the latest research, updates on legislative and legal issues, insights into investment trends, and much more in our publications or on our blog.

Stay tuned for updates in the coming months highlighting additional opportunities to take advantage of the many resources from NCPERS. I encourage you to reach out to our membership team at membership@ncpers.org with any questions. ◆

Court Rules LACERA Can Oversee Its Own Personnel Decisions to Fulfill Fiduciary Duties

The decision from the California 2nd District Court of Appeals may be useful to other systems in supporting their independent fiduciary authority and responsibility over personnel as a key element of system administration.

By: Lizzy Lees, Director of Communications, NCPERS

Photo Illustration © 2024, istock.com

Nearly 60 percent of public pensions are struggling to attract and retain top talent, according to NCPERS 2023 Public Pension Compensation Survey. Compensation can certainly play a role, as plans are often unable to compete with private sector salaries, but some funds are struggling with the added challenge of not having oversight of their staff's employment classifications and salaries.

Los Angeles County Employees Retirement Association (LACERA) was recently facing these limitations until a June 2024 ruling from the California 2nd District Court of Appeals provided the fund with the authority to manage its personnel decisions in order to effectively fulfill its fiduciary duties.

NCPERS spoke with LACERA CEO Santos Kreimann about what led up the recent court ruling and what it means for the nearly $80 billion AUM fund going forward.

Historically, what kinds of challenges has LACERA had with recruitment and retention?

The LACERA Boards and the fund's executive leadership regularly assess staffing needs to meet the changing benefits and investment environment in which LACERA performs its fiduciary duty to our 190,000 members. LACERA's challenge, as with all public pension systems, is to build and evolve the right team with the right skills to fulfill the fund's fiduciary duty. The organizational chart that worked in the past may not be the best personnel structure for the future. The job market in which we recruit for the best talent also changes and has become more fluid and competitive. When position changes are required – such as new job classifications, a change in salary ranges for existing staff, or a change in the number of existing positions – and the Boards in their prudent judgment approve them as necessary for the required work of the association, LACERA must be able to move forward promptly to obtain final approval from the County of Los Angeles and begin recruiting.

LACERA values its relationship with the County as plan sponsor; however, LACERA's Boards must have the ability to make fiduciary decisions as to the personnel needs of the organization. Delay impacts LACERA's ability to serve members.

What led up to the 2021 lawsuit, *Los Angeles County Employees Retirement Association v. County of Los Angeles*, where LACERA sought to regain its right to manage the salaries and employment classifications of its staff?

In 2016 and 2017, LACERA conducted comprehensive personnel reviews, identifying the need for several new positions and salary adjustments to meet its strategic priorities and uphold its fiduciary duties to its members and beneficiaries. In 2018 and 2021, the County Board of Supervisors (BOS) ignored many years of its own precedent of implementing such changes without hesitation, and instead refused to adopt the necessary changes to the salary ordinance effectively blocking LACERA from implementing its personnel decisions. The County cited a decades-old case from a different Appellate District, claiming it provided them the authority to block the new classifications and salaries adopted by LACERA's independent fiduciary boards.

LACERA attempted to negotiate with the County to resolve the dispute, but these efforts were ultimately unsuccessful. After the County's 2021 action, LACERA filed a petition for writ of mandate, directing the BOS to comply with the law and adopt the LACERA approved salary ordinance. The trial court was bound to follow the decades-old case and ruled in favor of the County, but LACERA appealed the decision, which has resulted in the recent favorable ruling by the 2nd District. The opinion may be found here.

What does this ruling mean for your organization going forward?

The recent decision recognizes that, under the California Constitution and other governing law and trust principles, LACERA's independent fiduciary Boards have the authority to make final decisions as to necessary classifications and salaries, free of political influence by nonfiduciaries. The decision means that, going forward, LACERA's Boards will be able to make personnel decisions when needed and implement them promptly for the benefit of members without delay or change by the Board of Supervisors or County personnel.

What could this decision potentially mean for other public pensions across the country?

Fiduciary and trust law are similar across the country. The decision may be useful to other systems in supporting their independent fiduciary authority and responsibility over personnel as a key element of system administration. How can interested candidates apply for open roles at LACERA?

LACERA is an award-winning workplace with career opportunities for professionals in areas ranging from investments to human resources. Open LACERA positions may always be found at www.lacera.com/who-we-are/careers.

NCPERS **Feature**

Recognizing the July 2024 Class of NCPERS Accredited Fiduciaries

NCPERS would like to recognize the 13 public pension trustees and staff who most recently earned their Accredited Fiduciary designation, demonstrating their commitment to and knowledge of plan governance best practices.

By: Lizzy Lees, Director of Communications, NCPERS

The NCPERS Accredited Fiduciary (NAF) Program is an accreditation program specifically designed and tailored for individuals involved in public pension governance. Divided into two parts, NAF 1&2: Governance & Finance and NAF 3&4: Risk Management & Human Capital, trustees and staff who complete the program have the opportunity to earn their Accredited Fiduciary (AF) designation, signaling their expertise in these critical areas.

NAF is held twice per year (in the spring and the fall) allowing for small class sizes where participants can freely discuss challenges and opportunities while diving into best practices for plan governance, oversight, and administration. The fall 2024 program will be held October 26-27 in Palm Springs, immediately before the Public Safety Conference.

NAF participants who complete the program—covering governance and the board's role; investment and finance; legal, risk management, and communication; and human capital—are eligible to earn their Accredited Fiduciary designation. In order to do so, they must first demonstrate mastery of the content through an exam.

NCPERS would like to recognize the 13 public pension trustees and staff who most recently passed the exam to earn their AF designation, demonstrating their commitment to and knowledge of plan governance best practices:

- Edward Bean, Somerville Retirement Board
- Angela Budde, City of Key West General Pension Plan
- Louis Fiorino, San Bernardino County Employees' Retirement Association (SBCERA)
- Danny Gregg, District of Columbia Retirement Board
- Donald Kendig, Fresno County Employees Retirement Association
- Chad King, Louisiana Municipal Police Employees' Retirement System
- Everett Robbins, Anchorage Police & Fire Retirement System
- Anthony Ross, City of Austin Employees' Retirement System (COAERS)
- Diana Thomas, Austin Police Retirement System
- James Thompson, Denver Employees Retirement Plan (DERP)
- Grant Walker, Prince George's County Fire Pension Fund
- Belinda Weaver, Austin Fire Fighters Relief & Retirement Fund
- Lina Zapata, City of Sunrise General Employees Retirement Plan

NAF is part of NCPERS University, a suite of recurring educational programs tailored to the needs of trustees at each level of their journey. NAF is intended for trustees and public pension administrators with at least two years of experience. Learn more about the NAF Program and enroll in the fall 2024 class to start earning your Accredited Fiduciary designation. ◆

NCPERS 2024 Public Retirement Systems Study:

Trends in Fiscal, Operational, and Business Practices

NCPERS **Feature**

Defined Benefit Plan Court Rulings: NYC Pension Fossil Fuel Divestment Case Dismissed

By: Tony Roda & Kimber Y. Brewer, Williams & Jensen

Photo Illustration © 2024, istock.com

On June 1, 2020, the U.S. Supreme Court dismissed *Thole v. U.S. Bank* in a 5-4 opinion, holding that defined benefit (DB) plan participants do not have proper authority under the law to bring a breach of fiduciary duty claim where the participants do not have a "concrete" financial stake in the lawsuit.

Thole involved an ERISA plan, not a public pension plan governed by the federal Internal Revenue Code and applicable state and local law. However, on July 3, 2024, the New York State Supreme Court dismissed *Wong v. New York City Employees' Retirement System* for lack of standing, thereby providing a valuable example of how *Thole* may find practical application to public pension plans in state courts.

To establish standing, a plaintiff generally must show that the defendant's actions have caused the plaintiff to suffer a specific loss or harm to an extent requiring judicial intervention. In *Thole*, the plaintiffs brought a class action lawsuit under ERISA against several parties, including U.S. Bank, for allegedly mismanaging the DB plan in which they are participants. In this case, the plaintiffs needed to show that they suffered a concrete injury as a result of the defendants' purportedly inappropriate investment decisions, presently or in the future.

A crucial factor impacting the Court's decision was that the plan in question was not a defined contribution plan (DC) or a trust, but instead was a DB plan. The overall value of the payments distributed to participants by a DC plan or private trust typically fluctuate in direct relation to investment decisions made by the fiduciaries. Conversely, in general, participants in a DB plan receive a fixed distribution for life that does not change despite successful or ineffective investment choices.

Applied to the circumstances in *Thole*, the pension plan participants were not at risk of any current or future financial loss as a result of any alleged mismanagement on the plan fiduciary's part because they would receive the same monthly pension payments regardless of the litigation's outcome. In short, the plaintiffs were unable to show an adequate financial stake beyond their ERISA statutory right to bring a claim.

In *Wong*, the pension plans at issue were also DB plans and the plaintiffs made several standing arguments analogous to those in *Thole*. In this era of full-throated attacks on any decisions using environmental, social, or governance (ESG) factors in investment decisions, the underlying claims made by the plaintiffs were that the fiduciaries who made the investment decisions for the three New York City pension funds – the New York City Employees Retirement System, the Teachers' Retirement System of the City of New York, and the Board of Education Retirement System of New York – breached their fiduciary duties of loyalty and prudence to plan participants by divesting from oil and gas industry equities.

Primarily relying on *Thole*, the New York State Supreme Court opinion held that the *Wong* plaintiffs were not at risk of current or future monetary loss due to alleged mismanagement because they are similarly entitled to a fixed monthly DB distribution. As such, the plaintiffs in *Wong* also were unable to establish the requisite concrete loss or injury.

The *Wong* plaintiffs presented arguments to distinguish their circumstances from *Thole* in order to establish standing, but these arguments failed. Although state courts are not required to comply with federal standing requirements, New York state law has an equivalent requirement, and *Wong* did not meet that standard. Also, the New York State Supreme Court did not apply trust law to *Wong* for the same reasons as *Thole*, i.e., DB pension distributions are less like disbursements to trust beneficiaries and more like a contract. It dismissed the remaining arguments for being speculative, including that defendants would be able to avoid judicial review if the plaintiffs were not granted standing by this specific court in this lawsuit. Finally, a DB plan's theoretical inability to fulfill its payment obligations was found equally insufficient to establish a legal injury.

As I've mentioned in prior articles, ESG will continue to play out in the courts, in the halls of Congress, and in the Executive Branch agencies for years to come. The New York lawsuit at its core was motivated by anti-ESG thinking, but fiduciary breach suits are nothing new to the judicial system. I expect to see more cases in this vein brought in the state court system in the next few years, despite the strong rulings on lack of standing in the DB context thus far. ◆

Tony Roda *is a partner at the Washington, D.C. law and lobbying firm* ***Williams & Jensen****, where he specializes in legislative, regulatory, and fiduciary matters affecting state and local pension plans. He represents the National Conference on Public Employee Retirement Systems and state-wide, county, and municipal pension plans in California, Colorado, Georgia, Kentucky, Ohio, Tennessee, and Texas. Tony has an undergraduate degree in government and politics from the University of Maryland, J.D. from the Catholic University of America, and LL.M (tax law) from the Georgetown University Law Center.*

Kimber Y. Brewer is a Legal Intern at Williams & Jensen. She is currently a J.D. candidate at American University Washington College of Law.

NCPERS **Feature**

Worthwhile Canadian Initiative?

By: Neil Hrab

Photo Illustration © 2024, Pexels.com

"Worthwhile Canadian Initiative" was once, with tongue firmly in cheek, selected by the *New Republic* magazine in an informal contest as the most boring headline imaginable. The recent news that Canada's federal government has officially set itself a goal of "Encouraging Pension Funds to Invest in Canada" might be similarly greeted by deep yawns south of the border.

However, the broader issues raised by this decision will be of more than slight interest to American defined benefit (DB) plans and their stakeholders.

This effort will be brought to life through an official working group headed by a highly-respected former Bank of Canada governor, Stephen Poloz (equivalent to a US Federal Reserve chief) and aided by the federal Canadian Ministry of Finance. In typical understated Canadian style, it will likely rely more on private meetings and written submissions to gather input than large-scale public hearings.

The working group's goal is, as summarized by the government, to "explore how to catalyze greater domestic investment opportunities for Canadian pension funds. This working group will identify priority investment opportunities that will grow Canadians' pension savings – that meet Canadian pension plans' fiduciary and actuarial responsibility, spur innovation, and drive economic growth."

To put this into the American political vernacular, it sounds as if the Canadian government believes it can separate "winners and losers" when it comes to domestic investment opportunities, and wants to try to steer the pensions accordingly.

This development may come as a surprise to informed American ears. Haven't many of the large Canadian pensions for years been attributing a good degree of their consistent success in generating steady returns to the fact that they are run at arms-length from pressures coming from elected officials, or other self-interested parties?

Hasn't that long been part of the Canadian pensions' "secret sauce" – that their leaders and managers answer for the success or failure of their strategies to independent boards of directors, allowing the plans to orient themselves to making optimal asset allocations based on their projected liabilities?

What happens to that successful formula if the large Canadian pensions become answerable in some way for their investment mix to distant bureaucrats working in Ottawa, Canada's capital?

With a timely paper, the reigning academic authority on Canada's pensions, Keith Ambachtsheer has, with help from two colleagues, answered this question in precise terms.

To sum up, Ambachtsheer's paper makes the case that if the arms'-length character of the Canadian pension plans' operations and decision-making is undermined through government-directed investments, this would "compromise existing governance functions" and "expose pension plan members to potential financial losses."

The paper goes on to argue that the government would be wiser to try to foster more pension investment in the domestic market by helping these pools of capital to become more active investors in cash-generative parts of Canada's infrastructure that are currently out of the pensions' reach for a variety of reasons. This would include the country's major airports, for example.

Ambachtsheer's paper subtly makes another crucial point that Canada's government may want to consider while it awaits the working group's findings. As his paper notes in passing, the large Canadian pensions collectively serve the interests of "millions" of individuals by investing their retirement savings.

The implied warning to elected officials in the Ambachtsheer paper could be taken to mean something like: *Tread carefully here, because there are far more people watching than you may think. Especially if they stand to lose money because of government trying to "fix" something that isn't broken.*

Interestingly, shortly after the paper's appearance, Stephen Poloz, the government-announced working group's head, emphasized publicly that he is more focused on achievable and "actionable ideas" rather than proposing major changes to how the pensions currently invest at home.

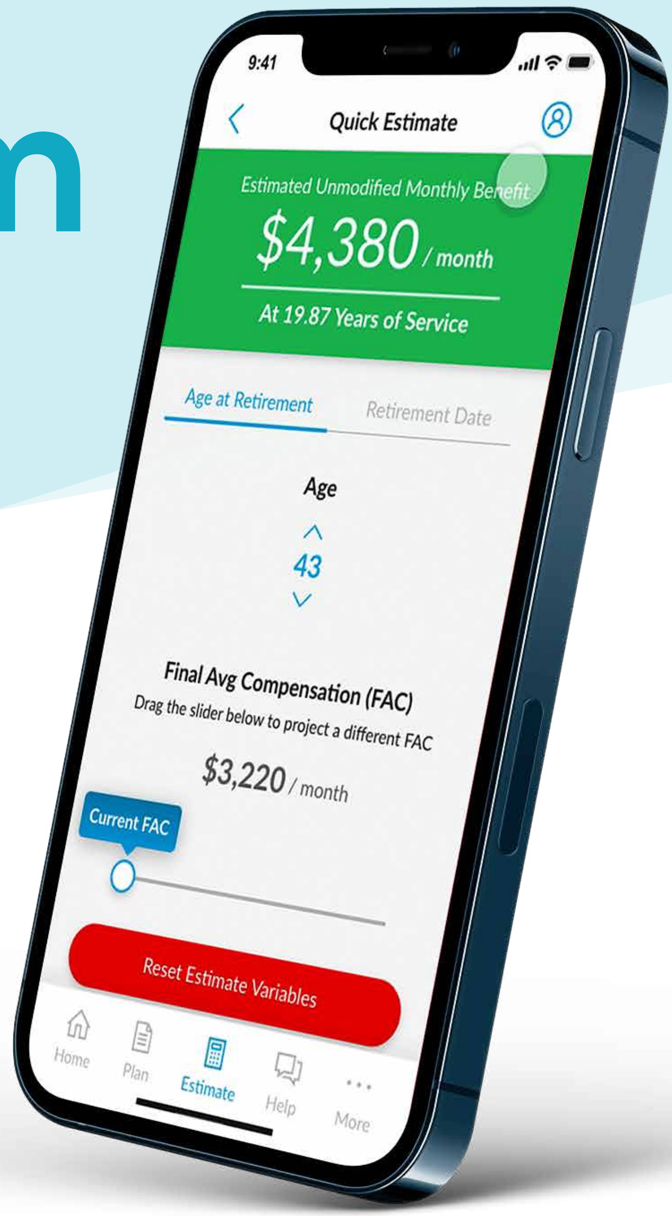
This could be taken to mean Poloz is more likely to focus in his final report on what government can do to make domestic investing more attractive and profitable for the pensions, rather than how the pensions can be muscled into following government investment diktats that could prove costly to their respective memberships.

One expression that Canadian and US politics share is that of "the third rail," in reference to policy proposals which are so controversial as to be absolutely untouchable – like the dangerous electrified third rail in a railway line.

As the government reviews Keith Ambachtsheer's paper, it may come to realize it owes him a debt of thanks. In careful and nuanced language, he's reminded elected officials to be careful and not get singed — or worse — by carelessly playing on the pension third rail. ◆

Neil Hrab worked for more than 12 years in the Canadian pension sector. This piece is written in a purely personal capacity.

NCPERS PensionX Digital Platform



NCPERS has partnered with Digital Deployment to offer its members a **10% DISCOUNT** on PensionX, the premier digital platform that securely enables pensions to engage with active and retired participants via a mobile self-service app and portal.

NCPERS 1941 | pensionX

Learn more about this new NCPERS member benefit at ncpers.org/pensionx

NCPERS Around the Regions

Oklahoma Judge Permanently Blocks Enforcement of Controversial Anti-ESG Law

Oklahoma District Court Judge Sheila Stinson issued a permanent injunction against enforcement of a controversial anti-ESG law banning public pension funds from doing business with financial firms said to be hostile to the oil and gas industry.

READ MORE *Source: Pensions & Investments*

NYC Pension Adopts 'First in Nation' Guidelines for Private Real Estate Investments

The standards were developed by the Office of the New York City Comptroller, which manages the investments of New York City pension funds, as well as For the Long Term, a nonprofit organization which advises treasurers, comptrollers, controllers and auditors at pension funds across the country.

READ MORE *Source: Chief Investment Officer*

Omaha, Nebraska Teacher Pension Fund Facing $1 Billion Shortfall; State Takeover Looms

Omaha Public Schools, the largest school district in Nebraska, is less than 50 days from handing over management of its pension fund to the state. But a new state audit widened the scope of problems Nebraska could inherit from the Omaha School Employees Retirement System, leaders of the state retirement system were told.

READ MORE *Source: Nebraska Examiner*

Should All Colorado Substitute Teachers Be Members of PERA? The Question is Headed to Court.

A group of five Colorado school districts has turned to the courts to fight a new policy that would allow substitute teachers they hire through outside staffing agencies to benefit from the state's retirement system. The policy, school districts say, could cost them millions of dollars worth of retirement contributions for substitutes and make the already difficult task of finding enough subs to cover classrooms even harder.

READ MORE *Source: The Colorado Sun*

Don't Lump Us In' — Ohio Police Reject GOP's Pension System Overhaul Due to Teachers' Controversy

Ohio police officers are urging lawmakers not to punish them and the rest of the retirees for the controversy going on inside the teachers' retirement pension fund. Statehouse Republicans proposed combining all five public systems to cut costs and stop alleged corruption.

READ MORE *Source: News 5 Cleveland*

Led by Texas Teachers, Pension Funds Press Hedge Funds to Use Cash Hurdles with Fees

Institutional investors, including some of the largest pension funds, are calling on hedge funds to adopt cash hurdles in their incentive fee arrangements as a best practice standard for the industry, arguing that hedge funds are collecting "significant incentive fees based solely on skill-less returns generated from short rebate, securities lending, unencumbered cash."

READ MORE *Source: Pensions & Investments*

UPCOMING EVENTS

August

Public Pension Funding Forum

August 18-20
Boston, MA

September

Public Pension HR Summit

September 24-26
Denver, CO

October

NCPERS Accredited Fiduciary (NAF) Program

October 26–27
Palm Springs, CA

Program for Advanced Trustee Studies (PATS)

October 26–27
Palm Springs, CA

Public Safety Conference

October 27-30
Palm Springs, CA

View all upcoming NCPERS conferences at www.ncpers.org/future-conferences.

The Voice for Public Pensions

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NCPERS Message

Which Pension Reform Initiatives Have (And Haven't) Worked?

Photo Illustration © 2024, istock.com

"Public Pension Contributions Reach Record Yet Problems Persist." "State, Municipal Retirement Systems Remain Stuck in 'Pension Debt Paralysis.'" These are just two of the headlines that appeared recently in July. Coincidentally, the same week it was quietly reported that state and local pension plan's funded status continued to rise for the third consecutive quarter.

Even when the underlying news is good, the headlines around public pensions are often riddled with negative connotations. The push for so-called pension 'reforms' remains strong, despite extensive research showing that pensions are indeed sustainable, cost-effective, and critical to recruiting and retaining employees.

The latest research from NCPERS, *The Hidden Costs of Pension Reforms: Rising Income Inequality, Lagging Economic Growth*, explores the far-reaching effects of pension reforms that reduce benefits or close plans altogether. The study finds that these types of policies—which are usually implemented for the purpose of saving money—may end up costing more due to the dynamic interrelationship between pension reforms, income inequality, the economy, and market returns.

Policymakers are often tempted to make cuts to pensions in the face of tightening budgets, but this approach is rarely an effective tactic in the long run. Unfortunately, there is no one-size-fits-all approach to funding public pensions. But to fend off damaging reforms and to support the long-term health of our funds, we can learn what works—and what doesn't—from case studies, academics, and peer funds. This is how NCPERS Public Pension Funding Forum was developed.

Now in its eleventh year, the Forum showcases emerging funding solutions and delves into case studies that offer a practical perspective on which pension reform initiatives are most effective. The program provides insights into the fiscal, political, social, and economic forces impacting pension systems across the country.

This year's Forum, held August 18-20 in Boston, has a special focus on funding solutions for plans with a negative cashflow. These plans—often referred to as mature plans—are becoming increasingly common. Looking collectively at state and local plans in the US, all but four states had negative cashflows as of July 2023.

The 2024 program invites discussions on how demographic shifts and AI will likely impact the workforce, exacerbating the challenges already facing mature plans. Public plan trustees, executives, and industry leaders will share innovative investment, policy, and actuarial strategies to address these funding gaps. View the agenda here to see the full lineup of speakers.

While funding levels are generally trending up, it's still crucial for plan staff and trustees to stay informed about funding solutions (and threats) to ensure the long-term health of their funds. Understanding the landscape can help us better protect our funds from damaging rhetoric and reform initiatives that are bad for plans, participants, and the public. Register here to join this important conversation at the 2024 Public Pension Funding Forum. ◆

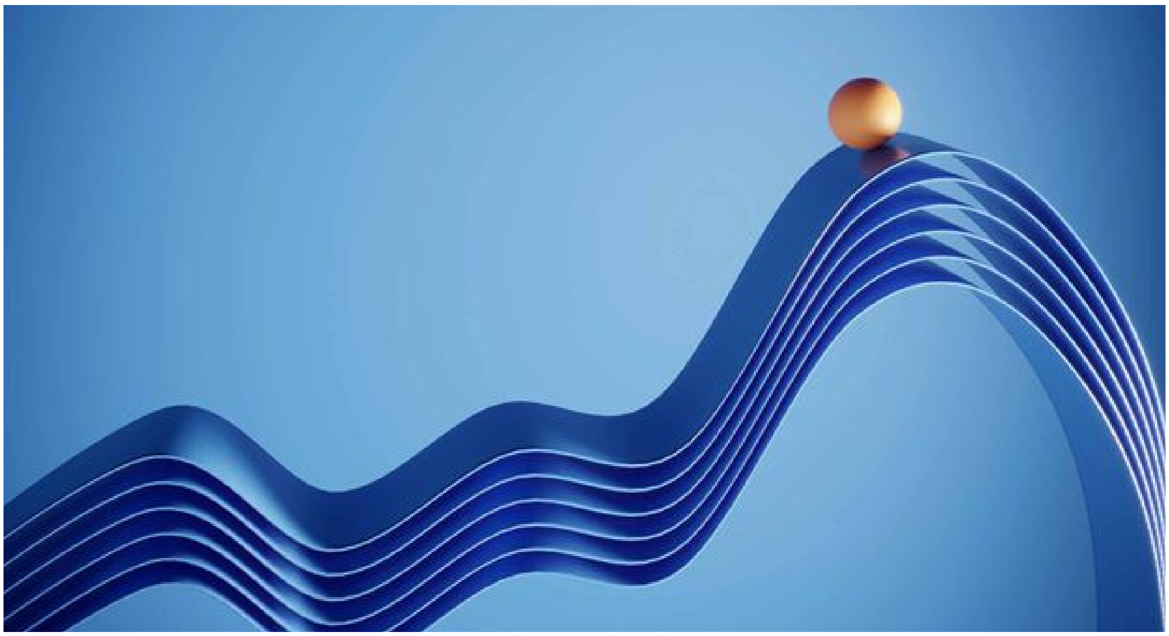
In This Issue

NCPERS In This issue

NCPERS In This issue

The Unintended Consequences of Benefit-Tier-Related Pension Reforms

By: Jonathan Scarpa, Segal



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In the wake of the global financial crisis of 2008 and 2009, many public pension plans adopted reforms intended to address rising pension costs and improve funded levels. One common approach was to create less valuable, lower-cost benefit tiers for new hires. Often, these new benefit tiers included some combination of adjusting retirement ages, the period of compensation in which a benefit is determined, and the benefit multiplier (the percent of salary replaced for each year of service).

Applicable for new hires, these changes alone did not reduce a plan's then-current unfunded liability. Rather, cost savings were expected to be realized over the long term as members of the new benefit tier gradually phased into the active population.

Backpedaling on reform

Fast-forward fifteen years and we have seen increasing pressure to reverse the benefit reforms. Some plans have already done so, while others are proposing legislation or at least considering it.

At the time of enactment, it was clear these changes would reduce member benefits. What may not have been as clear was the influence the changes would have on employee behavior and morale as well as the resulting broader impact.

The most critical point to remember is the historical value public employees place on retirement benefits. Those benefits are an essential component of their working career. And the importance of defined benefit plans is not limited to employees. For employers, the plans and their individual provisions represent valuable attraction, retention, and workforce-management tools.

Multiple layers of impact from reform

On the surface, descriptions of benefit tier reductions do not always capture the true impact on members. Digging deeper to quantify the impact helps to illustrate why these changes can influence employee behavior in unexpected ways.

Consider a sample plan that increased the final average compensation period from three to five years and decreased the benefit multiplier from 1.75% to 1.50% per year of service. For a member of the new tier entering the plan at age 30 and retiring at age 65, the percentage of salary replaced at retirement decreases from 59% to 50%.

However, this example does not consider a potential elimination in benefit subsidies prior to normal retirement age. Changes like this were common and can exaggerate the difference highlighted above. To illustrate this, consider the same plan that also added a modest 3% reduction in benefits per year of retirement below age 65 for the new benefit tier. In this scenario, the same member retiring at age 60 would have a decrease in the percent of salary replaced at retirement from 51% to 36%.

Understanding the full picture

These examples highlight the material loss in benefits for a career public employee. If a public employee were to remain in the system, they must supplement their retirement income with personal savings to close the gap, delay retirement, or do both. Considering the value public employees place on retirement benefits, this situation can create a negative impact on morale. This drop in morale is a partial motivation for the push from public employee organizations to reverse the reforms implemented years ago. The timing of this trend, a decade or more after reforms, is relevant because members in the newer, less generous tiers represent an increasingly larger percentage of the working population.

Alternatively, members may be incentivized to leave the plan for either a similar public job that provides a more attractive benefit or the private sector. Numerous recent studies have shown increased member turnover among plans that have implemented significant benefit reductions, highlighting a direct link between benefit levels and employee behavior.

There are several outcomes of high attrition felt by the employer, the public, or both. When a member leaves employment, an employer must allocate resources to hire and train new employees. Attracting new employees may prove to be difficult given the less-attractive benefit levels. Higher attrition also results in a less-experienced workforce and may contribute to a loss in the quality of public services. This may be especially true in industries where a significant amount of expertise is required, like public safety employees and teachers.

Finding the balance

The balance between benefit levels and the cost of funding them is delicate. The reforms adopted over a decade ago were intended to manage the cost of public pensions. However, in retrospect, the unintended consequences of benefit-tier-related changes on employee behavior, morale and the public plan environment require understanding and consideration. ◆

Jonathan Scarpa, FSA, MAAA, EA *is a Vice President and Consulting Actuary in Segal's New York Office, where he works with statewide and local public retirement systems. His responsibilities include presenting to boards of trustees and other audiences, reviewing actuarial valuations, conducting experience studies and managing special projects for public sector retirement systems. Examples of special projects include analyzing benefit design changes, evaluating legislative proposals and helping clients navigate complex funding and solvency issues. Mr. Scarpa is a member of Segal's New York Region Experience Study Committee and Segal's Public Plan Report Committee that ensures valuation reports meet client needs and adhere to actuarial standards.*

Financial Gravity

By: Kevin Kneafsey, Allspring Global Investments

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Why has the rapid rise in interest rates—from 0% to 5.5%—had such little impact on the U.S. economy? Many speculate it's due to a continued shift away from manufacturing and toward services, making the economy less debt dependent and less rate sensitive. But manufacturing hasn't changed much, hovering around 10% to 13% of gross domestic product (GDP) since the 1950s.

What has changed is the amount of borrowing. Scaled by GDP, borrowing has continued to trend upward from around 130% through the 1950s, 1960s, and 1970s to roughly double that today. As with much of the world, the U.S. economy has become *more* debt dependent, making it crucial to solve this puzzle. To shed some light, we introduce two concepts—first is the idea of financial gravity and second is the tale of a 4-foot man in a 5-foot hole.

Financial gravity posits that the weight of interest rates on the economy is a function of the level of interest rates and the period of time that rates stay at that level.

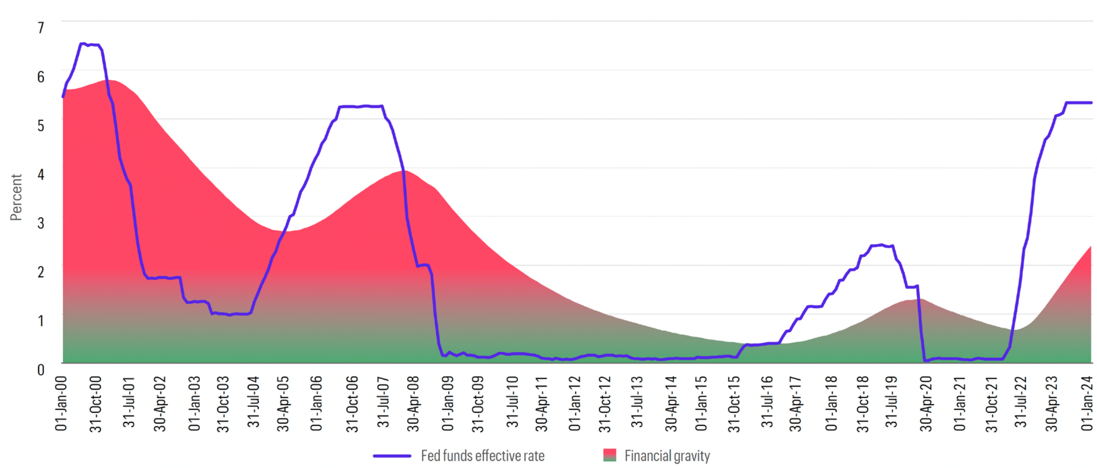
Financial gravity = rate x time

Markets have focused on the number of rate cuts. But the better question is how long rates stay at the higher level. Consider that a 500% interest rate for one minute would capture headlines but have virtually no impact. However, a 5% rate increase for five years could crush the economy. We are currently less than two years into the higher rate environment.

Markets have focused on the number of rate cuts. But the better question is how long rates stay at the higher level.

This is illustrated by the period from the post Global Financial Crisis (Q2 2009) through 2021. Financial gravity was very weak, with rates near zero for most of these 12 years. In that kind of environment, all assets tend to rise as there's little gravity to hold them down. Rates rose rapidly in 2022, but it takes time for the weight of higher rates to be felt. The equity market has priced in very low financial gravity, expecting significant rate cuts soon.

Financial Gravity Lags Changes in the Federal Funds Rate



Sources: Allspring and Bloomberg Finance L.P., 31-Jan-00 to 31-Mar-24

Time is an important factor because 1) it takes time for investors' expectations to adjust, 2) the longer the interval, the more debt that needs to be refinanced and the more new debt that needs to be issued, and 3) how long it takes to adjust is determined, in part, by how much debt is floating rate (the impact is swift) versus fixed rate (the impact is more delayed). Most U.S. debt is fixed rate, but heavy users of floating-rate debt—such as private equity—are already feeling the pinch of higher rates. In Europe and elsewhere, floating-rate debt is weighing more heavily on consumers.

The tale of a 4-foot man in a 5-foot hole illustrates another key point: the path of interest rates matters a lot. For this analogy, let the maximum base rate an investor can afford be represented by how tall he is. If an investor's maximum base rate is 4%, he is 4 feet tall; the depth of the hole he's in is set by the prevailing base rate, currently 5%. A 4-foot man in a 5-foot hole cannot get out—he can't afford higher loan payments, and he can't afford to refinance. So, a rate cut from 10% to 5% reveals a bunch of tall people in waist-deep holes. These borrowers can refinance, and many new borrowers—those 6-, 7-, 8-, and 9-feet tall—can also afford to borrow.

In Europe and elsewhere, floating-rate debt is weighing more heavily on consumers.

Conversely, we've just moved from a 12-year period of near-zero base rates to 5%, which means a lot of 1-, 2-, 3-, and 4-foot-tall people are now stuck in 5-foot-deep holes. A higher-for-longer environment may spark many defaults. Time and rate—financial gravity—determine the impact.

Investors should think about potential implications of a higher-for-longer scenario, including:

- Equities have priced in a no-landing scenario. If you're waiting for a meltdown, be patient—equity markets will crack along with the economy.
- Europe may lead the next global recession as over-leveraged consumers spend less.

- Real estate and other rate-sensitive assets have put off reality by not transacting. Financial gravity is not their friend, and neither is time.
- Private equity could struggle to return capital in a falling market and to pay more on debt than expected. Bankruptcies by private equity–owned firms would then spike.
- As the economy slows and rates fall, investors may prefer fixed-rate over floating-rate debt. Private credit has their money now but will struggle to raise new capital.
- Possible winners include gold; high-quality, medium-to-longer-term fixed-rate debt; trend-following strategies; long-volatility strategies; and market-neutral strategies. ◆

Real estate and other rate-sensitive assets have put off reality by not transacting. Financial gravity is not their friend, and neither is time.

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Kevin Kneafsey, Ph.D., *is a senior investment strategist for the Systematic Edge Multi-Asset team at Allspring Global Investments. He joined Allspring from its predecessor firm, Wells Fargo Asset Management (WFAM). He has taught classes at the University of Arizona in the Eller College of Management and at the University of California, Berkeley, in the masters in financial engineering program at the Haas School of Business. He currently teaches at CalPoly San Luis Obispo. Kevin began his investment industry career in 1994. He earned a bachelor's of business administration degree in accounting and finance from the University of New Mexico and a Ph.D. in finance from the University of Arizona.*

What Drives A Private Credit Manager's Outperformance?

By: Zia Uddin, Monroe Capital

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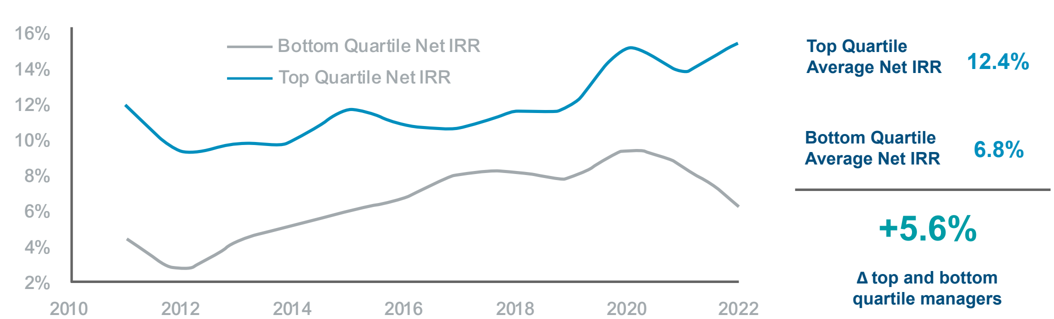
Secular tailwinds in Private Credit from higher base rates, regulatory changes, portfolio resiliency, and an increasingly supportive economic environment have led to the rapid growth of Private Credit. However, not all managers within Private Credit are the same, and extensive diligence is required by public pension plans on where to allocate capital within the asset class. We expect there will be increased divergence between managers over the coming years as elevated interest rates reduce operating flexibility for borrowers and increase the potential for defaults. There is also more competition for deals today due to asset class growth from new entrants. Outperformance in any asset class is typically most pronounced in periods of higher volatility. Managers that deliver top quartile performance will likely have a differentiated strategy, extensive track record, scaled origination platform, and a focus on capital preservation with lender protections to avoid losses.



Source: Preqin - Direct Lending North America (2024)

We believe the following factors are critical for alpha generation in Private Credit:

Differentiated Strategy

Private Credit managers that specialize and avoid commoditized lending will experience lower levels of competition and provide differentiated offerings to borrowers leading to higher returns. Examples of differentiated strategies include specialized sector expertise (e.g. Software, Healthcare or Recurring Revenue lending), highly bespoke/structured loans (e.g. Opportunistic, Distressed lending), or focus on highly fragmented markets with supply/demand imbalances (e.g. smaller transactions). These competitive attributes lead to higher pricing, lower leverage, and superior lender protections than more commoditized offerings.

Private Credit managers that specialize and avoid commoditized lending will experience lower levels of competition and provide differentiated offerings to borrowers leading to higher returns.

Extensive Track Record

With many new entrants into the direct lending space, it is important to assess whether managers have delivered consistently strong performance across multiple economic cycles. This will demonstrate that a manager has the ability to consistently apply a credit philosophy across vintages and not just during the recent bull market. According to Preqin, experience is also rewarded by the market when fundraising. New managers have flatlined in terms of average fund size, while experienced managers have grown rapidly.

A strong track record of deals can also generate incumbency lending opportunities. The ability to deploy capital via add-ons is an important tool for managers to grow their portfolio as M&A levels declined from the peaks observed in 2021 and 2022. In 2023, add-on acquisitions represented 35% of all transactions, versus 21% at the end of 2021. Along with generating deal flow, incumbency lending provides significant history and information on a borrower, resulting in materially lower risk of loss.

The ability to deploy capital via add-ons is an important tool for managers to grow their portfolio as M&A levels declined from the peaks observed in 2021 and 2022.

Scaled Originations Platform

A large origination team allows a manager to generate diverse deal flow and enables a manager to be highly selective and allocate towards high-quality borrowers. A dedicated originations platform *separate* from underwriting and workout teams reduces bias in credit evaluation and allows experts in workout/recovery to handle the distressed credits in the portfolio.

Focus on Capital Preservation to Avoid Losses:

With rates expected to stay higher for longer, alpha will be generated through a persistent focus on capital preservation rather than reaching for incremental yield that may lead to losses down the road.

- *Emphasis on Defensive, Recession Resilient Sectors*: Managers should focus on industries that have products and services that can generate sales no matter what stage the economic cycle is in. For example, portfolio mixes that prioritize industries including healthcare, business services, and technology are often more recession resilient and defensive than investments that focus on retail and consumer companies.

- *Bottoms-up Underwriting Approach*: Deal fundamentals must be underwritten from the bottom up rather than relying on the caliber and reputation of a sponsor. Managers who work with a wide array of sponsors are not beholden to a few sponsors for deal flow and are more able to have constructive conversations if a deal is underperforming.

- *Dedicated Workout Capabilities*: In-house workout experience can be a key differentiator when evaluating GPs. Dedicated workout teams can focus on early intervention, allowing a lender and borrower to have flexibility to discuss potential solutions before a borrower breaches a covenant or defaults on payment. The enhanced and more frequent oversight of underperforming deals can lead to fewer defaults and higher recoveries than the market.

In conclusion, Private Credit will continue to grow due to secular tailwinds in the asset class, however, not all lenders are created equal. In this higher current yield environment, strong managers with differentiated strategy, track record and capabilities will outshine commoditized lenders. ◆

__Zia Uddin__ currently serves as President of Monroe Capital. He is also responsible for the Institutional Direct Lending activities, as Co-Portfolio Manager, Institutional Portfolios of Monroe Capital. As President, he focuses on Monroe's day-to-day and strategic long-term growth initiatives. He joined the firm in 2007 and is a member of Monroe's Investment Committee. Mr. Uddin has 32 years of management consulting, corporate finance, private equity, turnaround and investing experience.

Maritime Private Credit: The Investment Opportunity Set Making Waves

By: Bryan Schneider, EnTrust Global

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Over the last few years, private credit has garnered extensive attention from institutional investors with assets under management across the strategy now approaching record levels. Allocators looking to deploy capital across the strategy generally fall into two categories. One, a group of allocators who have developed their strategic roadmap for building out their exposure; these investors have made initial allocations and are now in the market seeking diversifying approaches. The second is a group of allocators earlier in their capital deployment cycle, who are seeking value-added strategies within private credit while aiming to avoid some of the pitfalls often associated with investment areas that have experienced rapid growth. Maritime Finance, with its compelling fundamentals, offers a solution that can solve the needs of both allocator groups.

Maritime Industry Overview

The global maritime industry, or shipping, plays a pivotal role in the worldwide economy. With 85% of world trade carried out by sea,[1] its importance cannot be overstated. The industry serves as the backbone of international trade and commerce, facilitating the movement of goods, raw materials, and energy resources across the world.

The global fleet, which is generally mobile and can relocate and operate globally, is comprised of approximately 108,000 assets (vessels that have a combined estimated value of approximately $1.8 trillion).[1] The industry consists of numerous differentiated and uncorrelated sectors whose earnings and values are driven by idiosyncratic supply and demand factors. The industry's ownership structure is highly fragmented and is estimated to consist of approximately 3,900 shipowners, of which the vast majority are considered small- or medium-sized operations. The industry is capital intensive, requiring an estimated $90 billion per annum[2] to facilitate the purchase of new and used vessels and refinancing of existing loans.

Compelling Fundamentals of Maritime Finance

Historically, traditional bank lenders provided the majority of debt capital to service the maritime industry. However, the maritime industry has experienced a steady trend of declining lending activity from such banks, that can be traced back to the aftermath of the 2007-2008 Global Financial Crisis. As a result of the new banking regulations that followed the Global Financial Crisis (Basel III & IV, among others), banks were required to raise the amount of capital they held against certain loans, greatly diminishing their economic desire to add maritime exposure, leading to a material retreat – a decline of 36% in total bank lending and a decline of 62% in European bank lending since 2010 – from providing financing to the capital-intensive maritime industry (see Figure 1).[3] Concurrently, the maritime fleet has grown by 30% since 2010, together with global GDP expansion (see Figure 2), amplifying the disparity between capital needed by the industry and its actual availability. Moreover, recent turmoil within the banking sector, exemplified by the collapse of Silicon Valley Bank and the distressed acquisition of Credit Suisse (which had a $10 billion shipping portfolio), has further dampened banks' extension of credit.

Figure 1: Bank Shipping Portfolios Have Decreased Over Time ($ billions)

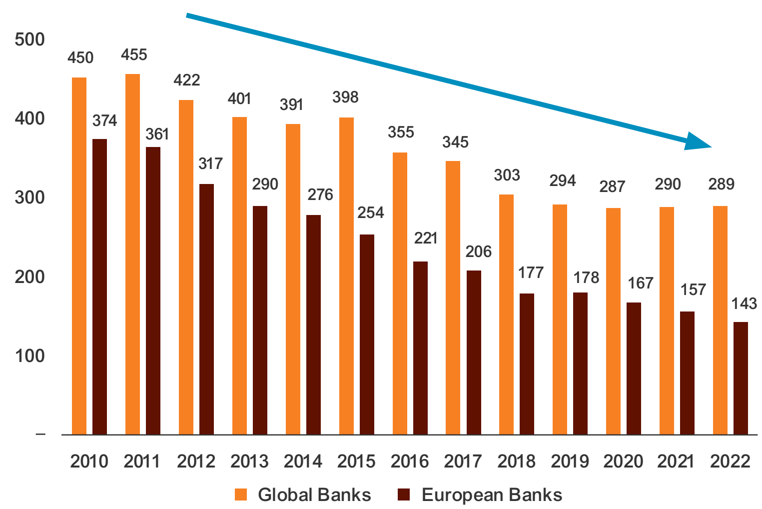
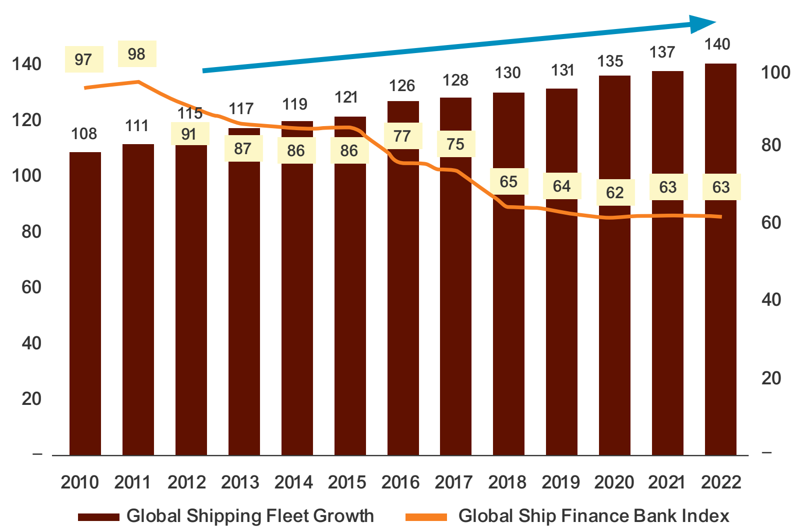


Figure 2: The Global Shipping Fleet Has Increased Over Time



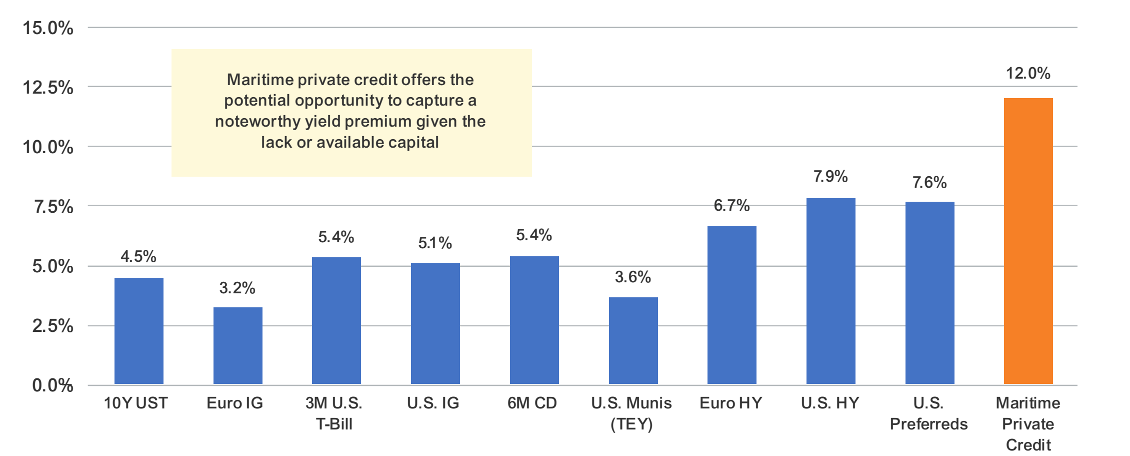
Potential Investor Advantages

Given the supply/demand imbalance between the ever-increasing capital required by shipowners and the limited availability of credit due to the pullback by traditional bank lenders, alternative lenders exert a degree of negotiating leverage that generally enables them to extract favorable terms for their investors, due to the scarcity of the capital they provide. These favorable terms come in the form of a notable return premium that can be achieved, and tight risk controls though robust security and covenant packages.

A strong understanding of the maritime industry and the differences among the various assets, as well as proprietary sourcing capabilities, are essential to building a durable portfolio of shipping loans and investments. These conditions have greatly limited new entrants. This distinctiveness sets the maritime industry apart from other over-banked areas characterized by intense competition and easier access to capital – factors that have led to the proliferation of "covenant-lite" structures over time in those other industries.

It is important to highlight that the potential yield premium from maritime private credit, as shown in the table below (Figure 3), is achieved through investments typically characterized by moderate leverage, which are senior in borrowers' capital structures and collateralized by highly liquid assets that are indispensable to global trade, and which have consistently demonstrated limited correlation with a wide range of investment alternatives, including other real asset sectors. For allocators, the attractive fundamentals of maritime finance allow them to diversify their portfolios, while participating in opportunities that can offer superior returns on a risk-adjusted basis.

Figure 3: Current Yields Across Various Fixed Income Type Investment Options



***Bryan Schneider** is a Senior Managing Director & Product Specialist at EnTrust Global on the Blue Ocean team. Mr. Schneider joined the firm as a Senior Vice President in January 2010 with 10 years of prior experience in the financial services industry. Before joining the firm, Mr. Schneider was a Senior Consultant at NEPC where he was responsible for overseeing more than $20 billion of client investments. Mr. Schneider holds a BA in Mathematics from Saint Anselm College and is a member of the Boston Security Analysts Society, the CFA Institute and holds the Chartered Financial Analyst designation.*

Endnotes:

[1] Source: Clarksons Shipping Intelligence Network as of January 2024.

[2] Source: Clarksons World Fleet Monitor - September 2022.

[3] Petrofin Research – 2023.

Supreme Court Holds That Pure Omissions Are Not Actionable Under Rule 10b–5(b)

By: Joshua W. Ruthizer and Antoinette Adesanya, Wolf Popper

Photo Illustration © 2024, alamy.com

On April 12, 2024, the U.S. Supreme Court decided *Macquarie Infrastructure Corp. v. Moab Partners, L.P.,*[1] and held that SEC Rule 10b–5(b)[2] prohibits only affirmative misstatements and half-truths (i.e., an affirmative statement that is misleading because it omits information). It does not prohibit pure omissions.

In our view, this decision should not have a significant practical impact on future securities litigation.

Macquarie Infrastructure Corporation, through its subsidiary International-Matex Tank Terminals ("IMTT"), operated terminals that stored, among other things, No. 6 fuel oil. In 2016, the United Nations International Maritime Organization adopted regulation IMO 2020, which capped the sulfur content of fuel oil used in shipping at 0.5% by the beginning of 2020. No. 6 fuel oil has a sulfur content closer to 3.0%. Macquarie did not discuss IMO 2020 until February 2018, when Macquarie announced that IMTT's contracted storage capacity had dropped in part because of the structural decline in the No. 6 fuel oil market. Macquarie's stock price fell around 41%.

Moab Partners sued Macquarie, alleging violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(b). Pursuant to the authority in Section 10(b), Rule 10b-5(b) makes it unlawful for persons to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."[3]

Moab alleged that Macquarie's statements were "false and misleading" because Macquarie "concealed from investors that IMTT's single largest product . . . was No. 6 fuel oil," which "faced a near-cataclysmic ban on the bulk of its worldwide use through IMO 2020."[4] Moab alleged, among other things, that (a) Macquarie was required to disclose the impact of IMO 2020 under Item 303 of SEC Regulation S-K, which requires disclosure of "a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial conditions,"[5] and (b) the omission of this information rendered affirmative statements false and misleading.

The District Court dismissed the complaint. The Second Circuit Court of Appeals reversed and reinstated the complaint. On review of the Second Circuit's decision, the Supreme Court unanimously held that "[p]ure omissions are not actionable under Rule 10b–5(b)."[6] The Court looked to the text of Rule 10b-5, which prohibits omitting material facts necessary to make the "statements made . . . not misleading," and concluded that "[l]ogically and by its plain text, the Rule requires identifying affirmative assertions (i.e., 'statements made') before determining if other facts are needed to make those statements 'not misleading.'"[7]

While this decision is important, in our view it is likely to have limited impact. Under Section 11 of the Securities Act of 1933, investors can still allege claims for pure omissions in connection with IPOs, SPOs, and other securities offerings. Section 11 prohibits any registration statement that "contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading."[8] As the Court noted when comparing Section 11 to Rule 10b-5, Section 11 creates liability for both half-truths and a "failure to speak on a subject at all."[9] Also, most complaints alleging violations of Rule 10b-5(b) already allege affirmative statements that were rendered misleading due to the defendants' omissions. This is because prior to the Court's decision in *Macquarie*, there was a circuit split since at least three Courts of Appeals (Third, Ninth, and Eleventh) covering 15 states had ruled that a failure to disclose information required by Item 303 did not support a Rule 10b-5(b) claim.

Further, *Macquarie* does not address pure omissions under Rule 10b-5(a) or 10b-5(c),[10] which make it unlawful for any person to "employ any device, scheme, or artifice to defraud" or "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[11] In 2019, the Supreme Court stated that "[i]t would seem obvious that the words in these provisions are, as ordinarily used, sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud."[12] We expect future securities actions to allege that pure omissions are violations of Rule 10b-5(a) and 10b5-(c), and for courts to opine whether these rules are broad enough to include claims for pure omissions. ◆

The author's bios can be found online at the Wolf Popper website:

Joshua W. Ruthizer, Partner

Antoinette Adesanya, Associate

Endnotes:

1 601 U.S. 257 (2024).
2 17 C.F.R. § 240.10b-5(b).
3 *Id.*
4 *Macquarie*, 601 U.S. at 261 (quoting *City of Riviera Beach Gen. Emps. Ret. Sys. v. Macquarie Infrastructure Corp.*, 2021 WL 4084572, *6 (S.D.N.Y. Sept. 7, 2021)).
5 17 C.F.R. § 229.303(a)(3)(ii).
6 *Macquarie*, 601 U.S. at 266.
7 *Id.* at 264.
8 15 U.S.C. § 77k.
9 *Macquarie*, 601 U.S. at 264.
10 *Id.* at 266 n.2.
11 17 C.F.R. § 240.10b-5.
12 *Lorenzo v. SEC*, 587 U.S. 71, 78 (2019).

The Supreme Court's *Macquarie Infrastructure* Decision: Pure Omissions and Half-Truths

By: James T. Christie and Jacqueline Meyers, Labaton Keller Sucharow LLP

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The United States Supreme Court's unanimous opinion in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.* which held that claims premised on pure omissions are not actionable under Rule 10b-5(b).[1] Rather, actionable omissions must make an affirmative statement a misleading half-truth.

Through its holding, the Court resolved a longstanding circuit split and created consistency. Practically, the Court's decision is narrow because relatively few claims allege pure omissions as the sole basis for liability under Rule 10b-5(b). The decision also carries the potential to disincentivize companies from speaking on a particular troublesome subject matter, given that silence alone cannot give rise to a private securities fraud claim under Rule 10b-5(b).

Question Before the Supreme Court

Promulgated under Section 10(b) of the Securities and Exchange Act of 1934, Rule 10b-5(b) makes it unlawful to omit material facts in connection with buying or selling securities when that omission renders "statements made" misleading.[2] In *Macquarie*, the Court addressed the question of whether a failure to disclose certain known trends and uncertainties required by Item 303 of SEC Regulation S-K ("Item 303") could support a private action under Rule 10b-5(b), if the failure alleged is a "pure omission" and does not render any "statements made" misleading.[3]

Throughout its opinion, the Court declined to opine on issues "tangential to the question presented," including the meaning of "statements made" or application of its pure omission analysis to other subsections of Rule 10b-5.[4]

Factual & Procedural Background

Petitioner Macquarie Infrastructure Corporation ("MIC") owns a subsidiary that handles and stores certain chemicals, including No. 6 fuel oil, a byproduct with a typical sulfur content of 3%.[5] In 2016, the United Nations' International Maritime Organization ("IMO") formally adopted a regulation capping the sulfur content of fuel oil used in shipping at 0.5% by 2020.[6]

Despite IMO 2020 impacting MIC's subsidiary's ability to store No. 6 fuel oil due to its sulfur content, MIC did not discuss IMO 2020 in its public offering documents following its 2016 enactment.[7] In February 2018, however, MIC announced a drop in the amount of storage contracted for use by its subsidiary due in part to the decline in the No. 6 fuel oil market. Following this disclosure, MIC's stock price fell 41%.[8]

Moab Partners, L.P. ("Moab") filed suit in the Southern District of New York, alleging, among other things, a violation of Rule 10b-5(b) premised on MIC staying silent on IMO 2020's impact despite its Item 303 disclosure obligations.[9] The District Court dismissed Moab's complaint, and the Second Circuit reversed, concluding that a failure to disclose under Item 303—a pure omission—can support a claim under §10(b) and Rule 10b-5(b), without an otherwise-misleading statement.[10]

Analysis: Pure Omissions v. Half-Truths

In the context of Section 10(b) cases, pure omissions occur in a vacuum, "when a speaker says nothing, in circumstances that do not give any special significance to that silence."[11] By contrast, half-truths "state the truth only so far as it goes, while omitting critical qualifying information."[12] As the Court analogized, "[i]n other words, the difference between a pure omission and a half-truth is the difference between a child not telling his parents he ate a whole cake and telling them he had dessert."[13]

The Court reasoned that Rule 10b-5(b) does not proscribe pure omissions through its text.[14] Extending the analogy above, the Court interpreted Rule 10b-5(b) as requiring "disclosure of information necessary to ensure that the statements already made are clear and complete (*i.e.*, that the dessert was, in fact, a whole cake)."[15]

Despite its narrow holding, the Court clarified that private parties remain free to bring claims based on misleading half-truths and the SEC retains authority to prosecute regulatory violations.[16]

Practical Impact

The Court's decision resolved a long-standing circuit split.[17] However, cases alleging only pure omissions under Item 303 as a basis for liability under Rule 10b-5(b) are relatively rare.

Further, the Court declined to opine on the impact this ruling would have on claims brought pursuant to other subsections of Rule 10b-5, including scheme liability. The Court also did not opine on the effect that its rejection of pure omissions theories under Rule 10b-5(b) would have on lower court's analysis of actionable half-truths.[18] As a result, lower courts will be left to perform potentially varied analyses with respect to these open issues as they arise.

Practically, the most important aspect of the decision for plaintiffs will be that they must plead an affirmative representation, or half-truth, in connection with omissions-based theories under Rule 10b-5(b). Accordingly, to plead their claims effectively, practitioners will need to scour publicly available sources that are sufficiently related to the omitted information to render the statement a half-truth.

Further, the Court's ruling has the potential to incentivize companies to stay silent with respect to troubling topics. Because companies can choose not to speak on a given subject, plaintiffs might have to rely on savvy analysts to ask pointed questions about such topics to elicit company responses that plaintiffs can use to plead their claims. ◆

James T. Christie *is a Partner in Labaton Keller Sucharow's New York office, where he serves as Assistant General Counsel and as a member of the Firm's Executive Committee. He specializes in litigating complex securities fraud cases on behalf of institutional investors.*

Jacqueline Meyers *is an Associate in Labaton Keller Sucharow's New York office. She concentrates her practice on litigating securities fraud class actions, representing institutional investors.*

Endnotes:

1 *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 601 U.S. 257 (2024).
2 *Id.* at 263.
3 *Id.* at 257.
4 *Id.* at 266, n.2.
5 *Id.* at 261.
6 *Id.*
7 *Id.*
8 *Id.*
9 *Id.* at 261-62.
10 *Id.*
11 *Id.* at 263.
12 *Id.*
13 *Id.* at 264.
14 *Id.* at 264-65.
15 *Id.*
16 *Id.* at 266, n.2.
17 Compare *Stratte-McClure v. Morgan Stanley*, 776 F. 3d 94, 101 (2d Cir. 2015) (finding Item 303's affirmative duty to disclose can serve as the basis for a private securities fraud claim under Section 10(b)), with *In re Nvidia*, 768 F. 3d 1046, 1056 (9th Cir. 2014) (finding Item 303's affirmative duty to disclose insufficient to form the basis of a private securities fraud claim under Section 10(b)).
18 *Macquarie Infrastructure Corp.*, 601 U.S. at 266, n.2.

Waistlines and GLP-1s—Expanding in Unison

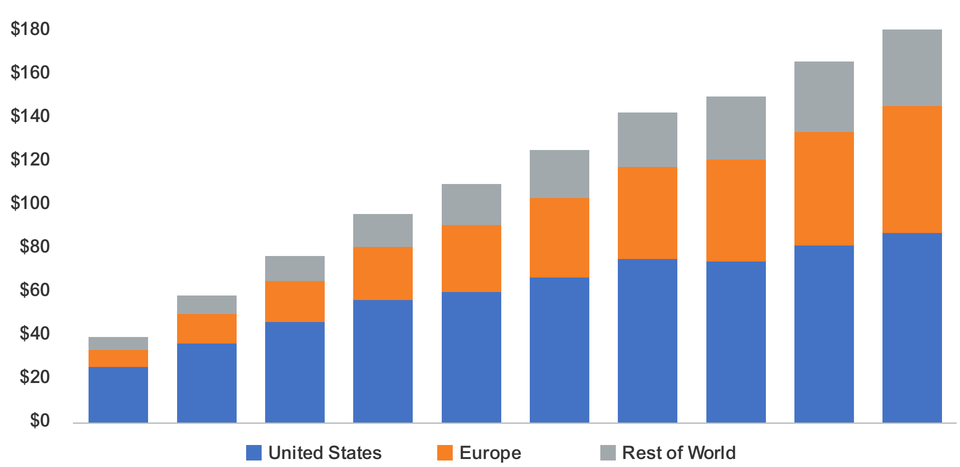
By: Tommy Sternberg and Daria Fomina, William Blair Investment Management

Photo Illustration © 2024, istock.com

It seems like everyone is talking about Ozempic, but this popular weight loss drug is only one of many glucagon-like peptide-1 (GLP-1) medications establishing themselves as the cornerstone in the management of obesity. What are the opportunities and risks for investors?

To frame the potential total addressable market (TAM) for GLP-1 medications, we can start with the 800 million people who are estimated to be overweight or obese worldwide.

Projected Obesity and Diabetes Market Size Increasing (in Billions)



Source: William Blair estimates.

If even a quarter of these individuals receive treatment at an estimated cost of $2,500 each, the TAM could reach $500 billion. Our internal models anticipate the market for obesity treatments alone (excluding diabetes treatments) to be around $180 billion by 2032. To put that number in perspective, the oncology sector, the largest single category within the prescription drug market, is forecast to be a $200 billion category.

Our internal models anticipate the market for obesity treatments alone (excluding diabetes treatments) to be around $180 billion by 2032.

Looking for Market Leaders

Only two companies, Eli Lilly and Novo Nordisk, have sizable GLP-1s available today, and we expect them to dominate the market over the intermediate term.[1]

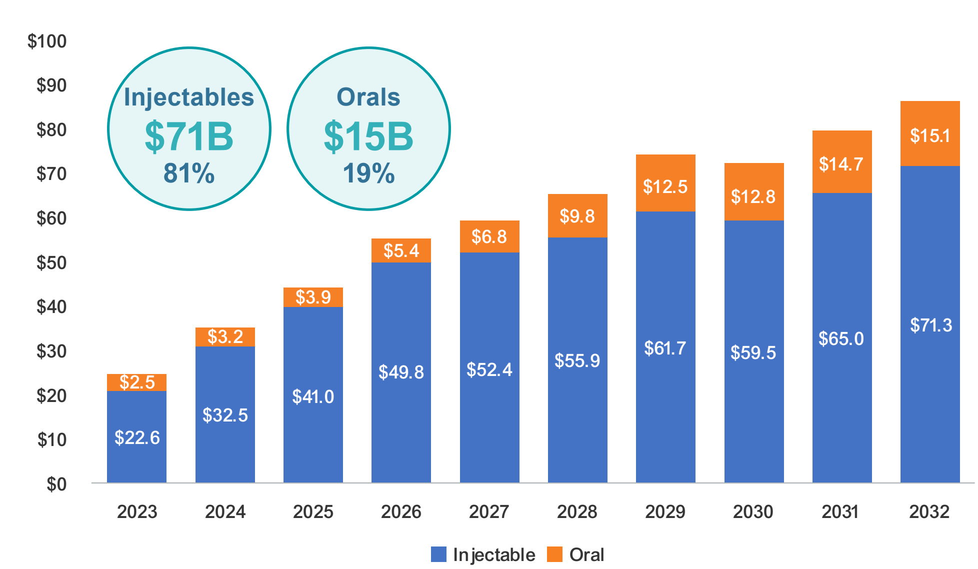
Both benefit from significant scale advantages, which are evident not only in their substantial investments in developing next-generation medicines but also in their production capabilities as well as sales and marketing efforts.

It could take years for competitors to make inroads given the time it takes to bring new drugs to market, and in our opinion, competitors will have to differentiate on other factors, such as convenience or tolerability.

Changing Market Dynamics

Speaking of convenience, current GLP-1 medications for weight loss take the form of injectables, but oral versions are on the horizon, and the price will likely be lower. We expect this to further expand the market. The chart below illustrates our anticipated market split.

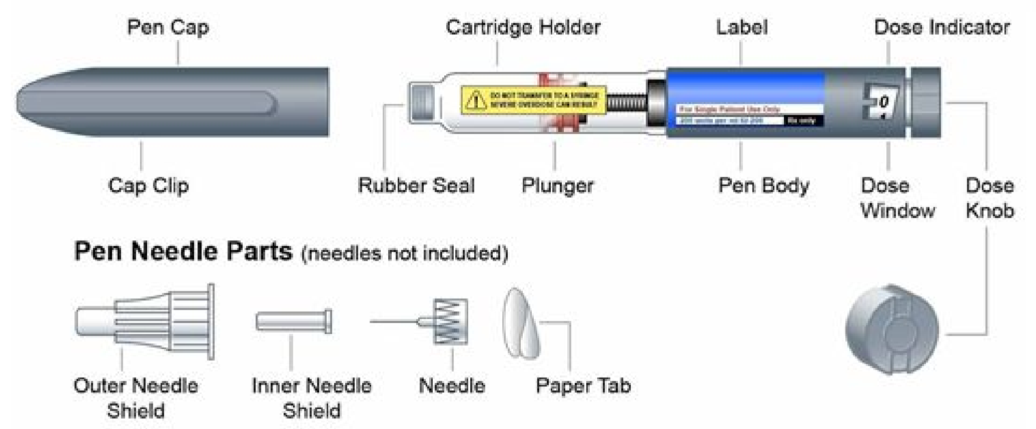
GLP-1 Sales by Delivery Mechanism (in Billions)



Source: William Blair estimates.

Companies beyond drug manufacturers might ride this tailwind. Certainly, companies involved with the production of injectable components and assembly of the devices stand to benefit, as do drug distributors (such as wholesalers and pharmacy benefit managers).

Pen Parts



And then there are complementary therapeutics. Because GLP-1s stop working when not taken, weight loss maintenance is another category of interest. So is muscle preservation, since part of any weight loss entails loss of muscle mass.

Of course, where there are winners, there are losers. For example, manufacturers of robotic equipment used in bariatric surgeries have seen a slowdown in demand as patients postpone bariatric surgeries while they try GLP-1 medications. We could also see a slowing demand for the obstructive sleep apnea market, which includes continuous positive airway pressure (CPAP) devices; joint replacements; and continuous glucose monitors and insulins pumps.

As companies navigate these shifts, understanding the broader economic and sector-specific dynamics is critical for investors.

The Ripple Effects on Consumer Markets

GLP-1 agonists are also impacting various consumer industries. Studies indicate that GLP-1 users consume 20% to 30% less energy, and the impact is particularly pronounced in junk food and other high-calorie foods. They also have the potential to make a profound impact on broader lifestyle choices, such as alcohol and tobacco consumption. These preference changes affect entire households, as studies indicate that GLP-1 users affect their household food procurement.

There are some dramatic left-tail-risk scenarios—for example, if all people with above-average body mass index take GLP-1 medications and stick to the prescribed regimen for a prolonged period, this could drive a decline in food consumption of more than 10%. However, we think the more likely scenario is a one- to two-percentage-point volume reduction over the course of a decade or more.

Different product types could also fare differently in this changing landscape. Early studies indicate growth (or slower decline) in volume for protein-forward products like some dairy products that appear to be less affected. In contrast, carbonated drinks and snacks might see severe cuts in consumption.

As companies navigate these shifts, understanding the broader economic and sector-specific dynamics is critical for investors. Active management certainly plays a role. ◆

This article is excerpted from our blog, which you can read in full here.

Tommy Sternberg, CFA, partner, global equity research analyst, covers large-cap healthcare companies. Before joining William Blair, Tommy spent two years as an equity analyst in Oak Brook Bank's investment management and trust department. Tommy received a B.S. in economics from Duke University and an M.B.A. from the University of Chicago's Booth School of Business. Daria Fomina, global equity research analyst, covers large-cap consumer companies. Before joining William Blair, Daria was head of the Pan-European leisure research team at Goldman Sachs Global Investment Research in London. Daria received a bachelor's degree in economics (with honors) and a master's degree in financial markets from the Higher School of Economics.

Disclosures:

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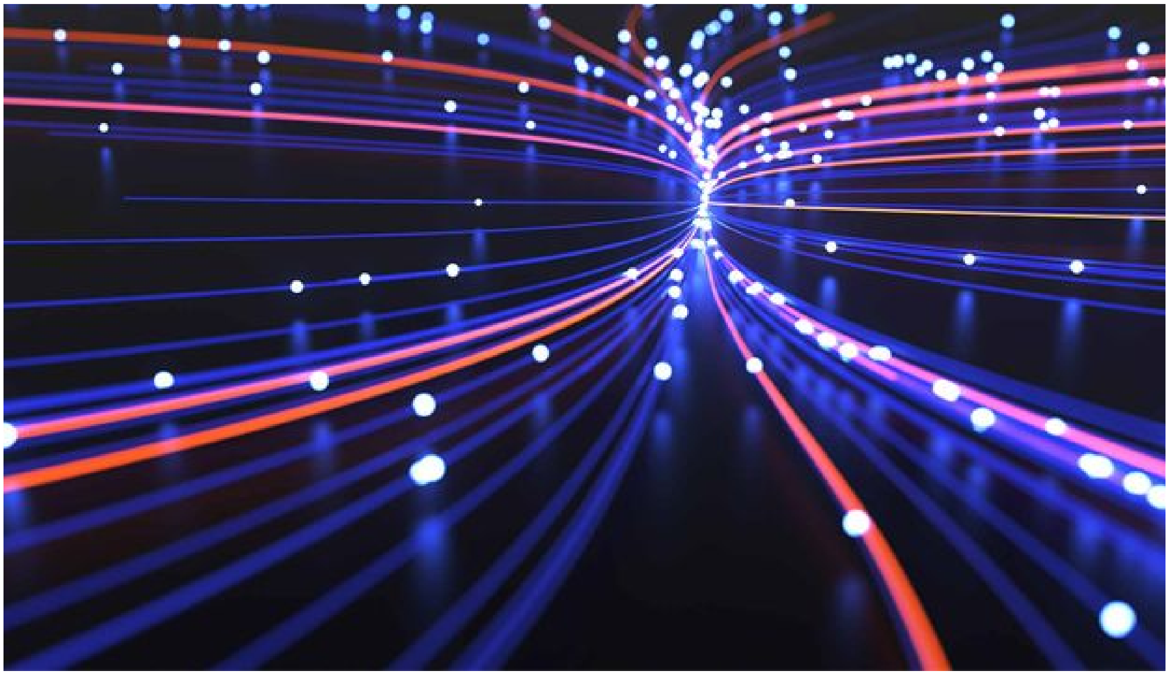
References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.

Endnotes:

[1] Elli Lilly and Novo Nordisk do not only produce GLP-1s and thus the companies' profits and losses are not solely correlated to these medications. Past performance is not indicative of future results, and it should not be assumed that any investment in the securities referenced was or will be profitable. References to specific securities and their issuers are for illustrative purposes only. William Blair may or may not own any securities of the issuers referenced and, if such securities are owned, no representation is being made that such securities will continue to be held. The securities referenced do not represent all of the securities purchased, sold, or recommended for advisory clients.

A Paradigm Shift: Infrastructure Equity 2.0

By: Nina Pacheco Nazemi and Addie Sparks, Barings



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Infrastructure Equity 2.0: The Evolution from Toll Roads to Carbon Capture

Infrastructure investing is changing. For decades, the asset class has been characterized by assets that provide essential services that are highly regulated—including toll roads, utilities, and ports. However, over the past 10 years, the opportunity set has evolved into a new version of infrastructure. Compared with the toll roads of the past, "Infrastructure Equity 2.0" includes companies and projects that are more distributed in nature (i.e., typically fixed assets that are distributed spatially), smaller in scale, and composed of multiple assets. These companies and projects are typically characterized by:

- More conservative capital structures (often with modest or no leverage),
- Fixed-rate debt with medium- to long-term maturities,
- Inflation protection,
- Contracted cash flows.

There are a number of secular tailwinds driving growth in both supply and demand for these assets over the coming years—from the exponential increase in data consumption globally, which is driving the need for enhanced digital infrastructure, to global efforts to meet climate goals, which is increasing demand for infrastructure related to the energy transition. These trends are shaping attractive investment opportunities in the next generation of infrastructure, particularly at the lower end of the market (i.e., enterprise values of $200-500 million).

Given that these trends are likely to persist and possibly even accelerate, we believe this segment of the market has the potential to outperform over the next decade—which is supported by the historical outperformance of the middle market, generally, over market cycles. Specifically, we see these opportunities across four key sectors (Figure 1):

Figure 1: Sectors Positioned for Strength Over the Next Decade

Source: Barings. For illustrative purposes only.

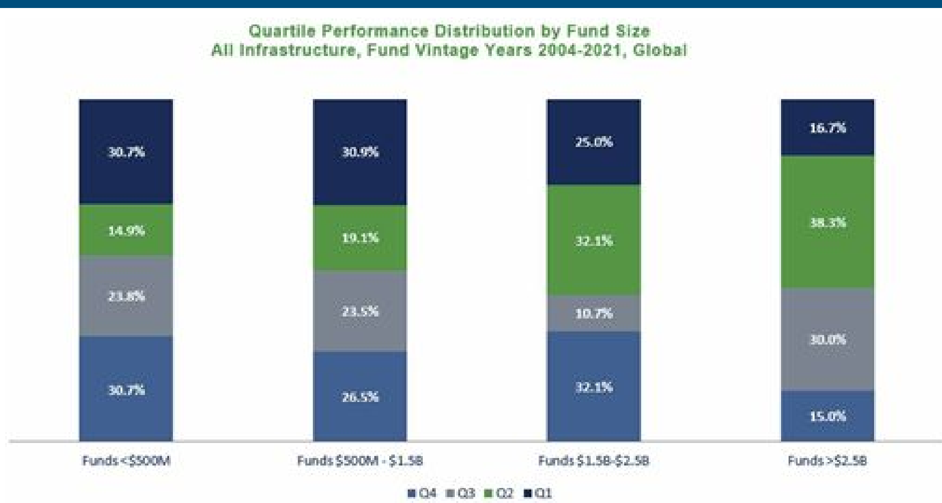
Record-level Fund Sizes are Emerging in Infrastructure

Infrastructure is currently experiencing trends similar to those that have characterized the private equity industry over the last decade. For one, there are fewer funds raising record-breaking fund sizes in the market. At the same time, there is a desire by limited partners (LPs) to consolidate their fund commitments with larger checks to fewer sponsors. In short, LPs are aggregating their capital to fewer and larger managers with 81% of the capital raised in infrastructure for the last five years funneling to funds over $1 billion.[1] This dynamic has led to a dearth of capital being raised in the lower and middle market.

Are Middle Market Funds Positioned to Generate Stronger Returns?

As investors in the asset class for over 10 years, we have observed that as infrastructure funds have grown larger and more established, performance has historically reverted to the mean (Figure 2). Alternatively, smaller infrastructure funds have historically outperformed their mega fund peers due to a number of reasons—including relatively attractive valuations, a wider opportunity set, and expanded exit environment.

Figure 2: Smaller Funds Have Historically Outperformed Mega Funds



Source: Barings, Pitchbook. As of March 1, 2024. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. Data set includes primary funds (i) employing infrastructure strategies, (ii) with vintages between 2004 and 2021, and (iii) domiciled globally. Funds must have performance data and fund size to be considered.

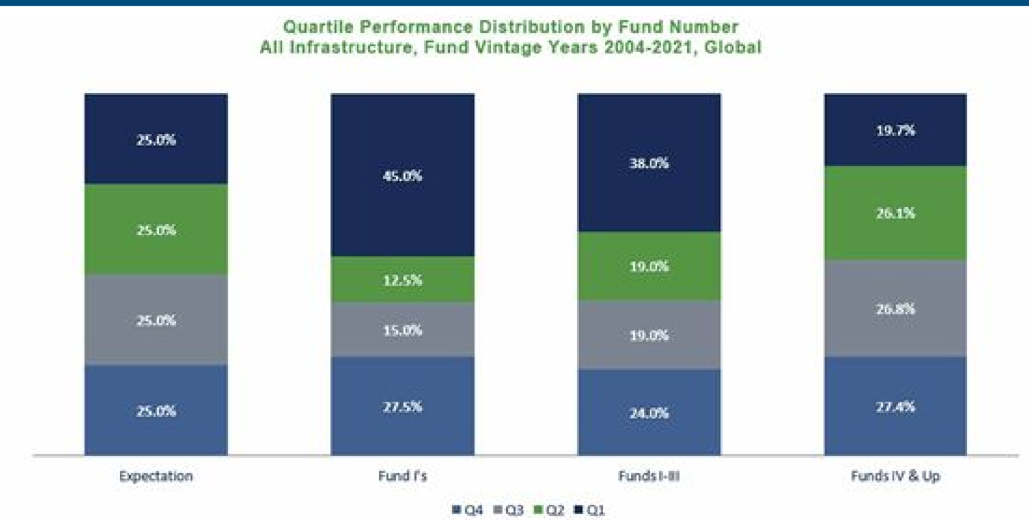
The middle-market, value-add segment of the market looks particularly attractive today. In addition to less competition, because funds in the middle market tend to be smaller in size, they allow managers to be more nimble and invest in less-efficient corners of the financial markets. As a result, smaller managers are well-positioned to identify companies that could potentially outperform and have historically benefited from more attractive valuations and capital structures.[2]

The middle-market, value-add segment of the market looks particularly attractive today.

Emerging Managers: Potential to Generate Outsized Alpha

In addition, the performance of larger, established managers has historically been trending toward the median (Figure 3). For the largest and most mature funds (Funds IV and higher), data shows that performance has declined over time, with more of these funds falling into middle quartiles. There are a number of reasons why, including the fact that larger GPs are often overseeing funds in various lifecycle stages (fundraising, investing, portfolio management, and exiting), while emerging managers can typically dedicate the majority of their time and attention to investing and managing a smaller portfolio with fewer assets. Also, emerging managers tend to be more strongly aligned with their investors, both financially and psychologically, as their long-term success is predicated on making strong investments out of the gate.

Figure 3: Emerging Managers Have Historically Generated Outsized Alpha



Source: Barings and Pitchbook. As of March 1, 2024. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. Data set includes primary funds (i) employing infrastructure strategies, (ii) with vintages between 2004 and 2021, and (iii) domiciled globally. Funds must have performance data and fund size to be considered.

Key Takeaway

We believe the opportunity appears most attractive in the middle market, where smaller infrastructure funds have historically outperformed their mega fund peers. That said, given the number of potential challenges that could impact private markets going forward, we believe disciplined manager selection and maintaining active portfolio management are key factors for success.

Mina Pacheco Nazemi *is the Head of the Diversified Alternative Equity team and serves on the investment committee. She is responsible for originating, underwriting and monitoring GP relationships, direct/co-investments and continuation vehicle opportunities for private equity and real assets. Mina has worked in the industry since 1998 with experience as a general partner and limited partner investor in private markets and focused on underwriting direct/co-investment opportunities. She is also a board member of the Pan American Development Fund and serves on the investment committee for the City of Hope and Cal State Los Angeles. Additionally, Mina is a current Finance Fellow for The Aspen Institute. Mina holds a Bachelor of Arts with honors in Economics and Political Science from Stanford University and her Master of Business Administration from Harvard Business School.*

Addie Sparks *is a member of Barings' Diversified Alternative Equity team and is responsible for originating, underwriting, and monitoring of private equity and real assets and co-investment & continuation vehicle opportunities in North America and Europe. Prior to joining the firm full-time in 2019, Addie interned on the Barings' Global Business Development team. Addie holds a B.S. in international business and finance and a minor in Chinese studies from the University of South Carolina.*

Endnotes:

[1] Source: Barings, Pitchbook Q1 2023 Global Real Assets Report. As of March 31, 2024.

[2] Source: DealEdge. As of October 4, 2023.

Don't Get Your Value from an Index

By: Andrew Wellington, Lyrical Asset Management

Photo Illustration © 2024, istock.com

Value stocks have a long history of delivering market-beating returns. But how you get your value exposure is a critical decision. For large-cap value, it is tempting to get exposure through low-cost passive products. However, these products have a serious problem: they track the large-cap value indices, and you don't want to get your value from an index.

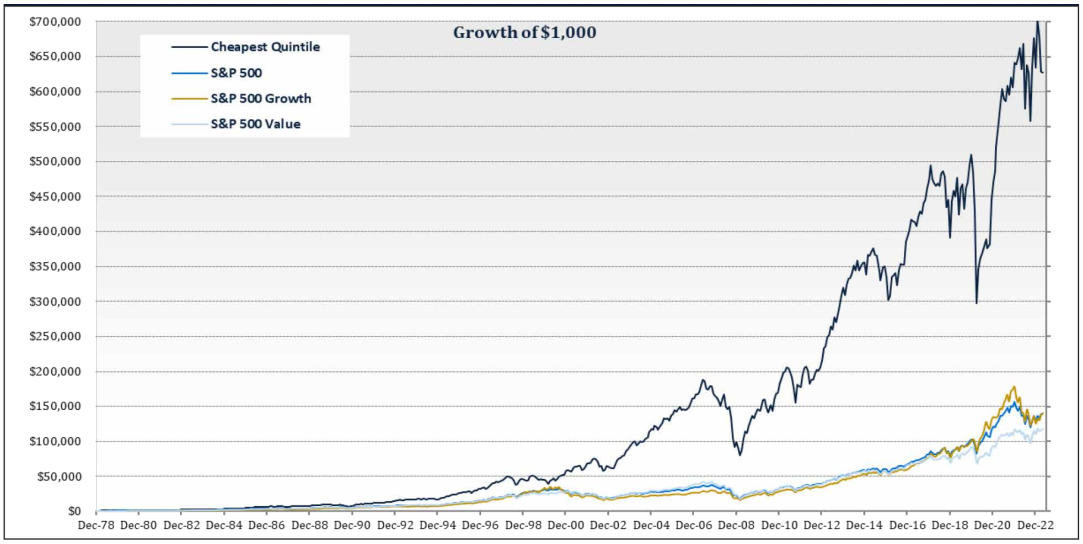
Over the decades, value stocks have handily outperformed the S&P 500.

VALUE STOCKS VS. VALUE INDEX

Over the decades, value stocks have handily outperformed the S&P 500. Since 1979 when S&P created their value and growth style indices, the cheapest stocks have outperformed the S&P 500 by nearly 400 bp per annum.

The graph below tells the story. The dark blue line plots the cumulative return of the cheapest quintile of our investment universe of the top 1000 stocks. Specifically, we sort that universe by valuation and then calculate the return of investing in an equal-weighted portfolio of the cheapest quintile, with quarterly reconstruction.

Why Value Stocks?



Source: FactSet. See Important Notes.

Below the returns of the cheapest quintile, you can see the lower historical performance of the S&P 500 and its Value and Growth style indices. Notice the pale blue line at the bottom, which is the S&P 500 Value index. Amazingly, over this 40+ year period when the cheapest stocks outperformed by so much, the worst performing S&P style index was their Value index. This is why you don't want to get your value from an index.

HOW MANY STOCKS ARE IN THE VALUE INDEX?!?

Why is the large-cap value index so bad?

One of the reasons is the huge number of stocks in the index. When S&P divides the S&P 500 into Value and Growth, it seeks to put half the cumulative market cap in each. Since many of the largest market cap companies fall into the growth index, they must put many more stocks into the value index to balance it out. Furthermore, by their methodology, some stocks are partially allocated to both the value and growth indices. As a result of this approach, there is an enormous number of holdings in their large-cap value index. In fact, more than 80% of the S&P 500 constituents are in the S&P 500 Value!

This means that the S&P 500 Value is not a value index concentrated in the cheapest stocks. Rather, it is more of a core index that owns everything except some of the most expensive stocks. To the extent that the cheapest stocks are in that index, their returns are diluted by the hundreds of other stocks also in that index. This is not just an S&P issue, as other popular "value" indexes follow similar methodologies.

ERROR OF TRACKING

It is not just the passive products you have to worry about. If you don't want to get your value from the index, you need to avoid many active products, too.

Many active large-cap value products are managed for a low tracking error to the value indices. Given the flawed construction and poor historical performance of the value index, the last thing you want to do is track it. In large-cap value, low tracking error is a liability, not an asset.

DON'Ts AND DOs

Large-cap value stocks have a long history of delivering market-beating returns. Unfortunately, getting access to these returns requires some homework. The large-cap value indices, and the passive and active products that track them, have been poor proxies for value stock returns.

Large-cap value stocks have a long history of delivering market-beating returns. Unfortunately, getting access to these returns requires some homework.

You don't want to get your value from an index. Instead, we suggest you look for value managers that are focused on value, not the index. Doing so, by necessity, will mean high active share and high tracking error, but that should be okay. Why would you want to look like or track the value index, given its disappointing history? ◆

Disclosures:

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

Cheapest Quintile:

For the period January 1960 – December 1984 we use Sanford Bernstein data for the cheapest quintile within the 1,000 largest U.S. stocks by market capitalization based on price to book value.

For the period January 1985 – December 1997 each quarter, based on FactSet data, we divided the 1,000 largest U.S. stocks by market capitalization into quintiles based on their beginning of quarter price to median trailing earnings multiple. Return for the lowest p/e quintile is the simple average of the total returns, including dividends, of each stock in that quintile. Returns for stocks that ceased trading are included through the date they ceased trading.

For periods after 1997, each calendar quarter, based on FactSet data, we divided the 1,000 largest U.S. stocks by market capitalization into quintiles based on their beginning of quarter price to median forward earnings multiple. Return for each quintile is the simple average of the total returns, including dividends, of each stock in that quintile. The universe average is the simple average total return of the 1,000 stocks over the period presented.

Returns for stocks that ceased trading are included through the date they ceased trading.

Andrew Wellington*, Co-Founder, Managing Partner & Chief Investment Officer of Lyrical Asset Management ("LAM"), has been a value investor for over a quarter century. After five years in management consulting, in 1996 Andrew joined Pzena Investment Management as a founding member and its first research analyst. Five years later, Andrew joined Neuberger Berman, where he went on to run their institutional mid-cap value product. At Neuberger, his investment performance improved his fund's 3-year Morningstar rating from 3-stars to 5-stars while product AUM tripled to $3.3bn in 2005. After Neuberger, Andrew spent two years in activist investing at New Mountain Capital.*

Andrew graduated summa cum laude and as the top graduating senior from the University of Pennsylvania's Management & Technology Program in 1990, earning a Bachelor of Science in Economics from the Wharton School and a Bachelor of Science in Engineering from the School of Engineering.

How the Inflation Reduction Act is Reshaping the Investment Landscape

By: Tom Osborne, IFM Investors

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Following decades of decline in public infrastructure spending and the failure of successive U.S. Administrations to properly address the funding shortfall, President Joe Biden's flagship Inflation Reduction Act (IRA) was heralded as a welcome investment in the future of U.S. renewables, manufacturing, and skills and training.

The $1.2trn IRA and companion Infrastructure Investment and Jobs Act (IIJA) are the envy of many countries, helping the private sector deliver the energy transition the U.S. requires while promoting a just transition that delivers apprenticeships and well-paid jobs. However, it initially drew the ire of some commentators outside the U.S. over concerns it would unduly distort the flow of private capital. Re-adjusting the U.S. investment tax credit (ITC) to a base rate of 6%, rather than 30%, projects are now instead rewarded with a 24% bonus credit where they meet wage and apprenticeship requirements – with the ITC rising as high as 50% depending on an investee's ability to draw on local steel, iron, and other goods. As a result, IRA-eligible projects immediately became more attractive to build stateside than nearly anywhere else in the world, placing the emphasis on the private sector to make investment decisions capturing the value of tax credits for their investors, rather than applying for the government grants offered through the IIJA where a successful application was not guaranteed.

It is hard to overstate the impact of the IRA. From the $739bn total funding under the IRA, $369bn will be provided for clean energy and climate investment, including tax incentives for investments in renewable energy, decarbonization, and energy security. Making the U.S. a highly attractive investment destination was a stated goal of the legislation. The IRA has led to significant investment inflows into the U.S., estimated by the White House at $110bn one year after its ratification. However, as it has shifted the weight of investment decisions towards the U.S., it has led to concerns of protectionism, which the U.S. Administration has addressed by opening up the benefits of the Act to other friendly nations and jurisdictions, such as those within the European single market, Australia and those with which the U.S. enjoys free trade agreements.

The IRA's introduction nevertheless resulted in calls from parliaments across the world for similar targeted tax breaks and subsidies to ensure each country's domestic manufacturing base and private capital market did not focus entirely on projects in America and could be similarly turbo-charged.

The transferability of tax credits

Benefits of investing under the IRA principally stem from the allocation of the tax credits – but also the ability to trade those credits if they are not fully utilized by the company that qualify for them. As the IRA is set to support the growth of renewable energy and other, newer climate change mitigation technologies, many projects taking advantage of the tax credits will be start-ups with little-to-no tax to pay. These entities may now trade their tax credits on the open market and bring forward their benefit by several years, thus further improving potential returns.

While a typical tax equity scheme allows project tax credits to be acquired by another entity, a specific allowance in the Act for transferability of credits greatly widens the field of buyers for those projects. As a result, the broader market means credits can be sold faster and on more favorable terms. Credit Suisse estimated that the tax equity market will grow to $49bn in 2024, a near doubling compared to 2022, and overall trade in tax credits will reach $500bn in the decade since the Act's introduction.

Prospects for pension capital

Ultimately, the large-scale rollout of renewable energy generation and transition to net zero will not be successful unless private, long-term capital can be deployed to support and accelerate the transition. This sustained investment can come from a number of places, but notably, pension funds will be a key source of this patient capital.

The IRA not only allows investors to benefit from the transferability of tax credits, but it should also ease the investment risk associated with a range of renewable energy projects. Overall, the IRA increases the potential returns for many climate-aligned and transition-friendly projects and is already driving immediate investment in both production and energy generation – creating a decade of policy certainty by expanding tax credits to a broad range of green and renewable projects in need of funding. From that perspective, the legislation is, arguably, unprecedented. ◆

Tom Osborne*, Executive Director, Infrastructure at IFM Investors, is responsible for the origination, analysis, structure and execution of IFM Investors' global infrastructure investments.*

Prior to joining IFM Investors, Tom was Head of Americas - Infrastructure in the Investment Banking Division of UBS. In this role, Tom was the founding group head of the Americas Infrastructure advisory practice with responsibility for strategic advice, mergers and acquisitions, lending and capital markets finance for major investors. At UBS, he also held the roles of Co-Head of US Infrastructure and Managing Director - Power and Utilities. Previously, Tom was a Director in the Power and Utilities Group at Credit Suisse First Boston and a First Vice President - Utilities Group at PaineWebber Incorporated.

Assessing the Impact of the Inflation Reduction Act on the Renewables Sector: From Job Creation to Domestic Energy Security

By: David Boyce, Greencoat America/Schroders

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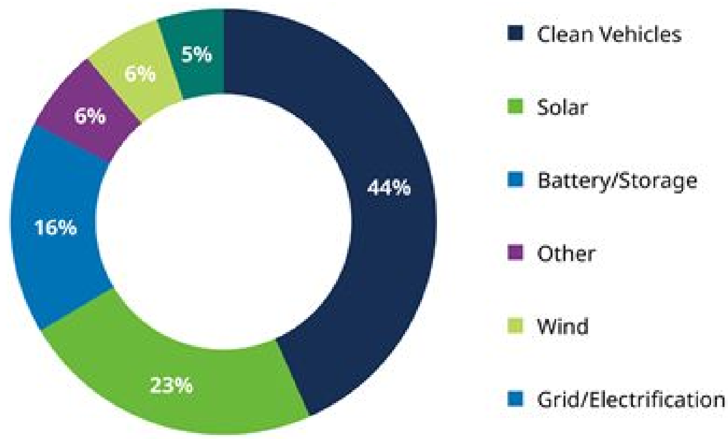
Geopolitical instability in recent years has laid bare the risks of interconnectedness or globalization, particularly in the energy sector. Ongoing conflicts in Europe and the Middle East have posed threats to the reliable supply of oil and gas, while the Covid-19 pandemic triggered a multi-year period of global disruption, dislocation, and bottlenecks. The deglobalization dynamic that we are seeing has hastened the need for governments and populations to identify secure energy sources with low geopolitical risk (i.e., conventional supply that is closer to home or located in stable, democratic regimes).

At a domestic level, the importance of energy self-sufficiency is growing. In August 2022, President Biden signed into law the Inflation Reduction Act (IRA). The Act provides tax breaks and subsidies worth an estimated $369 billion (1.5% of 2022 US GDP) for companies (i) building new renewable power generation projects, (ii) manufacturing components related to wind, solar and batteries, as well as critical mineral components, or (iii) involved in the production of electric vehicles. This legislation represents a new industrial strategy aimed at fostering onshoring of capabilities and skills, as well as building a long-term investment base for these industries in the U.S.

Job creation through new clean energy projects

According to data from E2, companies have announced over 300 new clean energy projects across 41 states that should qualify for the IRA tax credits since the passage of the legislation. These projects are projected to attract more than $120bn in investments and generate over 100,000 jobs, boosting the US economy (as of May 15, 2024).

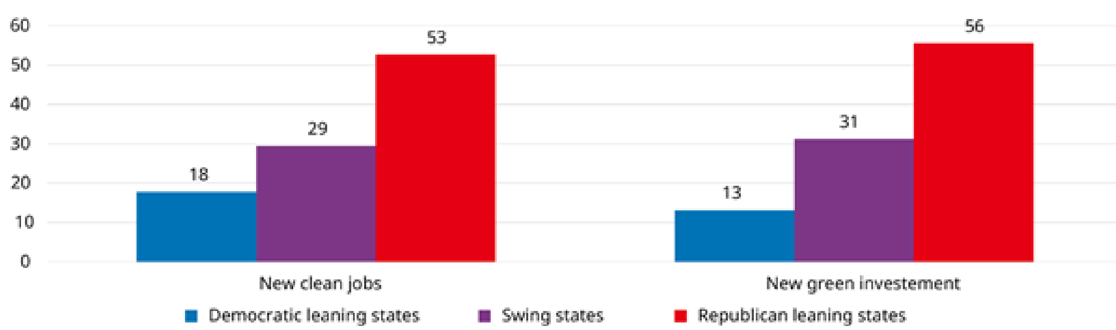
Figure 1: Investment breakdown by sector since August 2022



Source: E2, June 2024. Data from 8/25/2022 - 5/15/2024. The Other category includes biofuel, energy efficiency, geothermal, and hydrogen projects. Shown for illustrative purposes and should not be interpreted as investment guidance.

Interestingly, our analysis of the data on green energy projects reveals that, since the implementation of the IRA, more than 50% of newly created jobs and capital expenditure have been announced in Republican-leaning states compared to 20% in Democrat-leaning states (see chart below). It is also worth highlighting that swing states have seen large benefits from the IRA tax credits. More than 30% of the green investments since August 2022 have been in states like Arizona, Georgia, Michigan, Pennsylvania, and Wisconsin, boosting job creation locally.

Figure 2: Jobs and CAPEX since August 2022



Source: Source: E2, Schroders Economics Group, February 2024. Classification for states based on the political leanings of the previous two terms. It is a swing state if it switched from one majority to another in the last presidential election in 2020, it is a red (blue) state if the majority voted Republican (Democrat) in the past two elections.

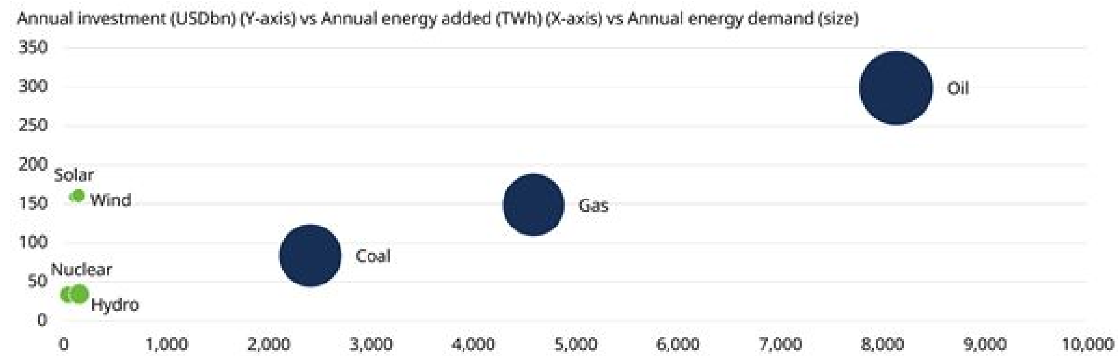
Increased focus on energy security

Ensuring energy security and diversifying energy sources has become a top priority for governments. The goal is not only to accelerate the energy transition from a climate perspective, but also to safeguard against potential energy security risks. These dual drivers emphasize the importance of rolling out renewable energy sources to secure various methods of energy supply.

Several factors have contributed to these heightened concerns. For example, underinvestment has caused a reduction in spare capacity, while there has been an acceleration in demand growth for energy in both developed and emerging countries. For another example, supply chains were severely disrupted during the pandemic, particularly for key components flowing into the U.S., uncovering a vulnerability to the power plant build out.

In the U.S. alone, our electricity needs – excluding electric vehicles or a massive transition from gas to electric heating – are growing at a rate of 1% annually. Further, there is another approximate 1% of the existing fleet, such as coal plants from the 1950's, retiring each year. Based on US EIA figure of installed domestic capacity, just keeping up with electricity demand would necessitate building over 150 new power plants per year. Renewables such as wind and solar will need to play a significant role and will require substantial levels of investment. Unlike oil and gas, renewables can be accessed by most countries and owned domestically, making them highly attractive from an energy security standpoint.

Figure 3: Annual investment required to meet the annual energy demand



Source: Thunder Said Energy, IEA, World Bank, Schroders - February 2024. Forecast may not be realized.

In conclusion, developing a domestic renewable energy supply could be far less susceptible to geopolitical tremors such as war, terrorism, and global health events than the status quo. However, it may require committed upfront capital on a scale that has never been seen before.

To learn more, visit our energy transition landing page. ◆

David Boyce *joined Greencoat in July 2021 to head Greencoat's US business. David has worked in the US power generation industry since 1997 and full time in renewables since 2007. Since 2012, prior to joining Greencoat, David has held CEO roles at both Wind Capital Group, a fully integrated US wind generation business and Conifer Power, a US wind, solar and storage developer. Prior to that, David held senior finance and commercial roles at Wind Capital Group, Airtricity and SkyGen/Calpine. He also ran the project finance group of CoBank from 2002 to 2007, which covered the energy sector with a focus on power generation. David holds finance and accounting degrees from the University of Illinois and an MBA from the University of Chicago.*

Disclosures:

Inflation Reduction Act Cuts Retiree Drug Costs: Employers Face Tough Choices

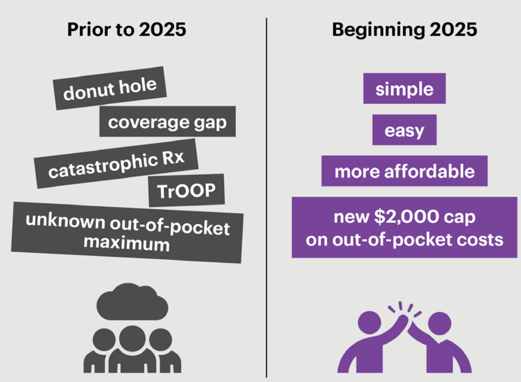
By: Barry Carleton, WTW's Via Benefits

Photo Illustration © 2024, istock.com

The Inflation Reduction Act (IRA), passed in 2022, includes major changes to Medicare Part D intended to control prescription costs, cap maximum retiree out-of-pocket costs, and simplify coverage for Medicare enrollees. This strengthening of Part D offers improved coverage for retirees as well as new risks and opportunities for employers who sponsor group Medicare Part D plans.

The current Part D benefit contains a range of complex program terms, which confuses retirees and leaves them without a clear understanding of their maximum out-of-pocket cost liability. With the IRA comes a new (in 2025) Part D benefit approach that eliminates the prior complexities by adopting a much simpler structure, plus a $2,000 cap on an enrollee's annual out-of-pocket costs. In addition, for the first time, the federal government is capping prescription drug cost inflation and negotiating drug prices with the pharmaceutical makers. These changes go far to realize the vision of Part D as a comprehensive and fully adequate source of Medicare prescription drug coverage.

Prior to 2025, Part D had lots of complexities, including the coverage gap (or "donut hole"), the true out of of pocket (TrOOP) maximum, and the 5% catastrophic coinsurance (eliminated for 2024). Under the IRA, Part D will be dramatically simplified for Medicare recipients beginning in 2025.



The new Part D program eliminates provisions such as the coverage gap (the "donut hole") and the "true out of pocket" (TrOOP) maximum. Also eliminated (in 2024) is the 5% cost share paid by enrollees after their annual spending has reached the TrOOP maximum. Starting in 2025, Part D plans may have a deductible and then cost sharing will apply until the member has reached $2,000 in out-of-pocket costs, after which the plan will pay 100% of the cost for the remainder of the year. It's as simple as that.

While these changes are highly beneficial to enrollees, there may be financial risks to employers sponsoring group Medicare Part D plans (a.k.a. Employer Group Waiver Plans or EGWPs).

How does the IRA impact Part D plan sponsors?

While Part D is becoming far more attractive to Medicare seniors, the changes under the IRA may not be beneficial for EGWP sponsors. This is because the IRA is mandating substantial benefit enhancements and changing how it pays Part D plans in a way that could be adverse to EGWP sponsors. Under Part D, EGWP sponsors receive funding from various sources to offset the cost of the group plan. The government provides these funding sources to EGWP sponsors as an inducement to retain group post-65 prescription drug coverage. Changes in 2025 to the formulas for determining these funding sources (e.g., direct subsidies, pharmaceutical discounts and federal reinsurance) could reduce the total level of these third-party payments to an EGWP sponsor, thus increasing their net plan cost. This presents plan sponsors with some unpleasant choices:

- Absorb the cost increase, making retirees happy, but their finance department unhappy.
- Pass the cost increase onto retirees in the form of contribution increases or benefit cuts, leading to a happy finance department, but less-than-happy retirees.

To avoid these unpleasant options, employers can cease group plan sponsorship and instead direct retirees to obtain individual Medicare Part D coverage (and medical coverage) through a marketplace exchange, with employer funding through a Health Reimbursement Arrangement (HRA). With this approach, retirees gain all the benefits of the new Part D program while employers enjoy a reduction in their administrative effort and potentially in their coverage costs. Many employers have done exactly this over the years as individual market insurance coverage has become more attractive compared to group plan coverage. With the IRA-driven enhancements to Part D, 2025 may be the year for some employers to consider (or reconsider) a shift to an individual market for their retirees.

Additional improvements to Part D

Insulin copay capped at $35/month per prescription

Access to recommended adult vaccines without cost-sharing

Expansion of the low-income subsidy program (LIS or "Extra Help") under Medicare Part D to 150% of the federal poverty level starting in 2024

Medicare has started to negotiate directly with drug manufacturers to lower the price of some of the costliest brand-name Medicare Part B and Part D drugs.

New $2,000 cap on member out-of-pocket costs

Employers sponsoring EGWPs are advised to assess the possible financial impact of the IRA on their group Part D plans. A modeling of the IRA impact on their EGWP, such as one that Via Benefits provides, will help plan sponsors make the best decision for the organization and its retirees. ◆

Barry Carleton *is a WTW consultant with over 35 years of experience specializing in all aspects of retiree medical strategy, financial evaluation, market dynamics, procurement, implementation and communication. His expertise covers the range of group and individual market programs for Medicare and pre-Medicare retirees.*

In his current role, he is an advisor to the Senior Actuary of WTW's Via Benefits individual marketplace. He also functions as a liaison between the individual marketplace business and Retirement and Health & Benefits consultants on market, legislative and regulatory developments affecting group and individual retiree medical plans.

Prior to joining WTW's individual market business, Barry spent many years as a WTW Health & Benefits consultant working with an array of clients on all aspects of retiree medical consulting.

From Stability to Agility: Nine Implications for a New Investment Landscape

By: Nathan Shetty, Nuveen

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Most institutional investors agree we have entered a period of elevated macroeconomic and geopolitical uncertainty, according to Nuveen's 2024 EQuilibrium survey. In response, they are exploring a variety of avenues to build more resilient portfolios and capitalize on new opportunities in the post-pandemic world.

While nearly half of institutional investors surveyed are focused on improving their flexibility and adjusting their regional allocations, most are overlooking key strategies that we believe will lead to greater portfolio resilience.

Nuveen identified nine themes that investors should consider to enhance portfolio resilience and adapt portfolios for the new investment landscape.

1. Reframe resiliency after decades of distortion

Investors should use caution when relying on forecasts derived from relationships that were dependent on the conditions that existed during the great moderation. These conditions are highly unlikely to repeat. Going forward, it is likely that the strategies that were laggards during the era of loose money will play a more constructive role in diversified portfolios.

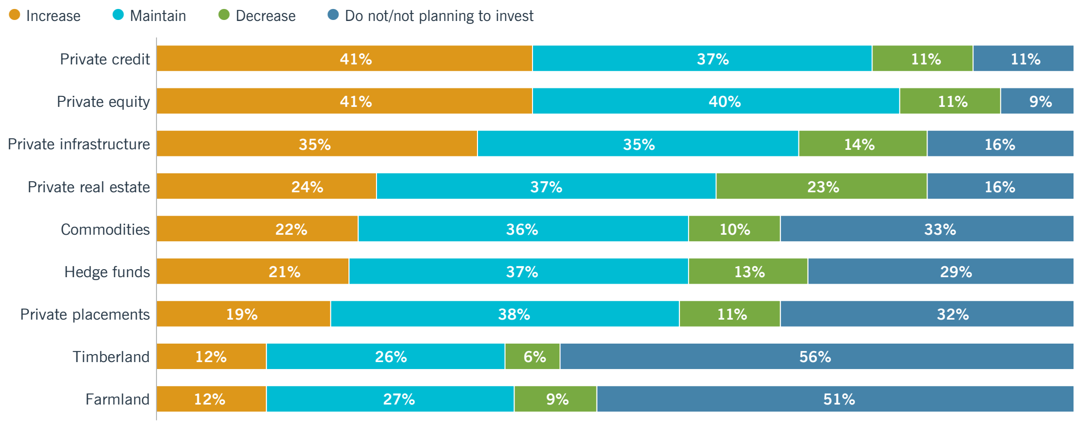
2. Privates are not compelling just because they are private

Investors looking to move into private markets should keep the following dynamics in mind: 1) product wrappers are not a feature of economic exposures or risk, 2) private assets do not strengthen or add diversification to a portfolio simply because they are private, and 3) some private market investment exposures are easily and cheaply accessed publicly.

Investors should focus on the idiosyncrasies that private markets deliver, often derived from unique investments not replicable in public markets, such as deal sourcing, operational improvements, and structuring expertise.

FIGURE 1: Institutional allocation plans across alternative asset classes

Please select the alternative investments you are currently allocated to and how you plan to adjust allocations over the next two years. (800 respondents)



Figures may not sum to 100% due to rounding.

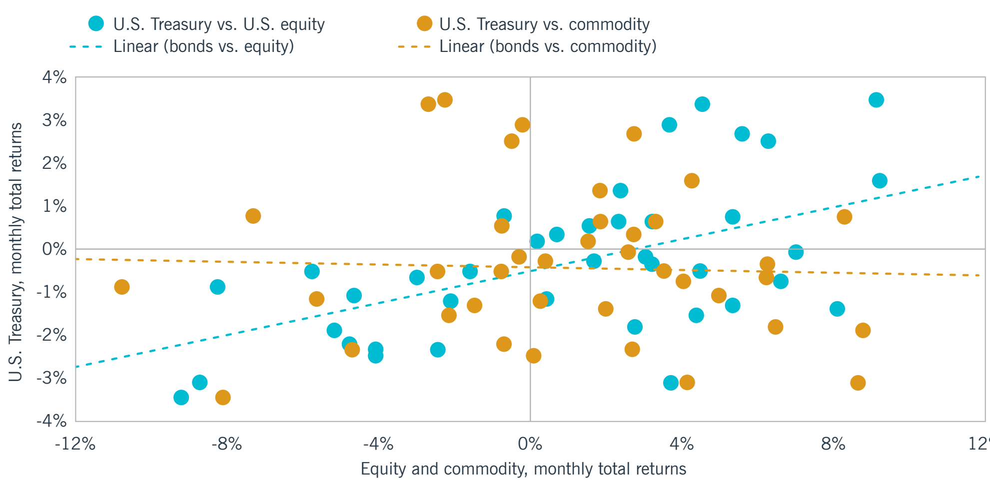
Source: Nuveen, 2024 EQuilibrium survey

3. Appreciate the scarcity value of real assets

Many of the underlying risk factors that drive the value of real assets are unique. These idiosyncrasies, when combined with supply limitations, enable real assets to retain their portfolio diversification benefits in a post-moderation world where heavily financialized assets may have lost some luster.

FIGURE 2: Real assets provide diversification in a post-moderation world

In the post-moderation period, the correlation between equities and bonds has reverted back to its normal, positive relationship. The correlation between bonds and commodities, however, continues to show no relationship.



Source: Bloomberg monthly data S&P 500 Total Return Index, Bloomberg Commodity Index Total Return, and Bloomberg US Treasury Total Return Unhedged USD from 31 Dec 2020 through 30 April 2024.

4. Be active where you can have the greatest impact

In a world of heightened macro variability, the unintentional risk and return drift incurred by holding asset allocations constant will likely be much larger. Expected risks and returns, which are driven by a common set of macro factors, are changing. This warrants a more active asset allocation.

5. Beware the declining utility of global cap-weighted allocations

From a portfolio construction perspective, global market capitalization-weighted indices will likely be suboptimal vehicles to achieve geographic diversification. Instead, investors can more effectively build their geographic allocations by placing a greater weight on the economic forces that drive a country's or region's market risks and return. Incorporating geopolitical factors, such as rule of law, military prowess, strong property rights, access to innovation, advanced financial markets, capitalistic tendencies, and plentiful natural resources, will further aid in fine-tuning geographic allocations.

6. Respect the limits of central banks' power to control inflation

While monetary policy may be effective to control inflation in the short-term, investors should be mindful that inflation is not solely a function of central bank behavior over the long term. Four structural trends will impede global central banks from achieving their low targeted rates of inflation: de-globalization, energy transition, aging demographics, and deficit spending.

7. Artificial intelligence is a double-edged sword when it comes to inflation

Despite AI's enormous potential as a productivity enhancer, investors should not take for granted that it will completely offset the wide range of inflationary tailwinds mentioned above. The massive amount of computing power required for AI's ongoing expansion will consume exorbitant amounts of materials, physical space, and energy — real-world inputs that are in limited supply.

8. Rethink government bonds' role in portfolios

It may be more appropriate to view government bonds as risk assets rather than diversifiers. Although they are mostly free from default risk, developed market government bonds are not free from interest rate risk. Even long-term investors should evaluate whether they are duly compensated for the risk they bear, particularly when term premiums are depressed.

9. Do not take more risk than you need

Now that the risk-free rate has reset higher, targeted returns can be achieved with less risk. Today's environment creates a greater need to adopt a more nuanced approach to diversification and risk management, as well as a more dynamic approach to strategic asset allocation. Analyzing portfolio risk factor exposures will become increasingly important in the new regime.

To learn more, visit Nuveen's Equilibrium hub or download the full version of "From stability to agility: nine implications for a new investment landscape". ◆

Nathan Shetty *oversees Nuveen's Multi-Asset team. He joined the firm from UBS, where he was global co-head of portfolio management for Investment Solutions. In that role, he oversaw $110 billion of client assets and managed a large team of portfolio managers. Similar to Nuveen, the team delivered customized investment solutions to institutional and wealth management clients around the globe. Prior to that, he launched the Investment Solutions group at Mesirow Financial after having been a senior portfolio manager in the currency group. Prior to that, he was at Pareto Partners. He started in the industry in 2001.*

Nathan graduated with a Master of Science in Communication from Northwestern University, an M.B.A. from the University of Chicago and a Master of Science in Statistics from Texas A&M. He holds the Chartered Financial Analyst designation and FRM certification from the Global Association of Risk Professionals.

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Data Breaches: A Looming Threat for Pension Administrators

By: ABL Tech Team

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Data breaches are a constant worry in today's digital age. Even industry giants aren't immune, as high-profile cases involving UnitedHealthcare and AT&T demonstrate. These incidents highlight the vulnerability of sensitive data, which is a major concern for pension administrators entrusted with protecting participants' financial information.

The Risk of Data Breaches in Pension Administration

Pension plans often manage a wealth of sensitive information, including Social Security numbers, addresses, and salary data. A data breach can have severe consequences for both the administrator and plan participants:

- **Identity Theft and Financial Loss:** Exposed data can be used for fraudulent purposes, leaving participants vulnerable to identity theft and potentially leading to financial losses.
- **Regulatory Scrutiny and Investigations:** Data breaches can trigger investigations and from regulatory bodies for both the administrator and any third-party vendors involved.
- **Erosion of Trust:** A breach can shatter plan participant confidence in the administrator's ability to safeguard their financial future. This can lead to reputational damage and even legal action.

Protecting Member Data: A Shared Responsibility

While the primary responsibility lies with the pension administrator, data security is a shared effort.

Here's why:

- **Third-Party Vendors:** Pension administrators often rely on external vendors like data analysis services to streamline operations. This creates a shared responsibility – both the administrator and the vendor must prioritize data security.
- **Evolving Threat Landscape:** Cybercriminals are constantly developing new methods to exploit vulnerabilities. Staying ahead of these threats requires ongoing vigilance and collaboration.

Strategies for Enhanced Security

To mitigate the risk of data breaches, pension administrators can implement several strategies:

- **Strict Data Security Protocols:** Implementing strong encryption for data at rest and in transit, following industry standards and best practices.
- **Vendor Due Diligence:** Carefully vetting and selecting third-party vendors with a proven track record of robust data security practices.
- **Employee Training:** Regularly educating employees on cyber threats and best practices for secure data handling.
- **Regular Security Audits:** Conducting periodic assessments to identify and address potential vulnerabilities in systems and procedures.
- **Disaster Recovery Plan:** Having a well-defined plan in place to respond to a breach, minimize damage, and notify participants promptly.

Building Trust Through Transparency

Transparency is crucial in building trust with plan participants. In the unfortunate event of a data breach, administrators should:

- **Prompt Notification:** Communicate the nature and extent of the breach promptly, providing clear instructions on how members can protect themselves.
- **Credit Monitoring:** Offer affected participants credit monitoring services to help them detect and address potentially fraudulent activity.
- **Ongoing Support:** Provide resources and support to help participants understand the risks and take steps to safeguard their personal information.

Elevated Risks of Partnering with Previously Breached Agencies

Working with agencies that have already experienced data breaches poses a heightened risk to security and operational integrity. These agencies might have unresolved vulnerabilities or insufficiently addressed security gaps, making them prime targets for future attacks. Additionally, compromised data from previous breaches can be exploited by cybercriminals to engineer more sophisticated and targeted attacks.

Choosing the Right Advisors: Putting Members First

In the aftermath of a data breach, pension administrators may consider seeking external assistance. However, it's crucial to choose advisors who prioritize the members' best interests.

Here's why:

- **Alignment of Interests:** Some advisors may have a vested interest in promoting specific products or services, which might not always align with the long-term goals of the pension plan.
- **Understanding Member Needs:** Effective advisors should possess a deep understanding of the specific needs and financial situations of the plan participants. Generic solutions may not be the best approach.
- **Transparency and Disclosure:** Choose advisors who are transparent about their fees and compensation structures. This fosters trust and ensures participants are aware of any potential conflicts of interest.

By prioritizing member-focused advisors, pension administrators can navigate challenges like data breaches while ensuring the financial security of their participants. This focus on member well-being strengthens trust and reinforces the administrator's commitment to its core responsibility. ◆

__ABL Tech__ is a data and technology company that specializes in helping organizations like insurance companies, pension funds, and financial institutions with mortality verification and beneficiary identification. Their services include mortality verification also known as a death audit, data analysis, and algorithms to ensure accurate records and prevent fraud. Their headquarters are in Orlando, Florida and their website is www.abltech.com.

Bridging the Cybersecurity Skills Gap with Virtual Chief Information Security Officer (vCISO) Services

By: Peter Dewar, Linea Solutions

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The cybersecurity skills gap encompasses a wide range of needs, from policy formulation to vulnerability management. Effective cybersecurity requires personnel who can write and implement comprehensive policy documents that cover access control, back up, incidence response, and acceptable use. These policies must be crafted by someone with broad knowledge of all cybersecurity controls and the ability to communicate and enforce them among staff.

Pension funds face the critical challenge of closing this skills gap – a mix of technical expertise and business operations knowledge – essential for protecting sensitive data and maintaining robust security protocols. Virtual Chief Information Security Officer (vCISO) services offer a strategic solution to this problem, particularly for pension funds who have limited resources.

The cybersecurity skills gap encompasses a wide range of needs, from policy formulation to vulnerability management.

Key Components of vCISO Services

- Vulnerability Management: Identifying vulnerabilities within the organization's environment and mitigating them effectively.

- Third-Party Risk Management: Identifying and mitigating areas of vulnerabilities that these service providers pose to the organization.

- Penetration Testing: Exploiting discovered vulnerabilities to assess the organization's susceptibility to specific threats, including zero-day vulnerabilities.

- Incident Response Planning:
  - Developing and training staff on incident response plans, creating detailed playbooks for various scenarios.
  - Conducting tabletop exercises to simulate responses to system outages and test the robustness of these plans.

- Training and Social Engineering: Educating staff through simulated phishing attempts, phone calls, and other social engineering tactics to recognize and respond to threats.

Hiring a vCISO can bring a wealth of knowledge and expertise to an organization on an as-needed basis. This arrangement can help lower costs for organizations as well.

This approach is particularly beneficial for pension funds, where IT staff sizes are typically small, and maintaining a full-time cybersecurity team is impractical. vCISO services provide the following advantages:

- A vCISO can bring together diverse skill sets that are often not found in a single individual, addressing both technical and strategic needs.
- They work with many other organizations and are able to implement industry best practices.
- They understand the inherent risks specific to the business, such as those associated with third-party interactions, actuarial analysis, and external money managers.

The cybersecurity skills gap poses a significant challenge to protecting funds against the wide variety of cybersecurity threats. By leveraging vCISO services, funds can access the expertise needed to develop robust security measures, manage vulnerabilities, and train staff effectively. This strategic approach not only enhances security but also ensures that funds can adapt to evolving threats without the burden of maintaining a full-time cybersecurity team. Embracing vCISO services is a proactive step towards bridging the skills gap and safeguarding the future of the organization. ◆

Peter Dewar *has over 25 years of experience in cybersecurity and leads the cybersecurity practice for the Linea group of companies that provide services across the United States and Canada. Under his leadership Linea has developed a Pension Cyber Security Framework (PCSF) to complement the generalized standards for protecting information systems. The PCSF focuses on the business process employed, services provided, and technology utilized by pension and benefits organizations, and devises controls to minimize and mitigate the inherent cybersecurity risk experienced by the industry.*

Peter has a Master's degree in Information Systems from the George Washington University, a Bachelor's degree in Information Systems from the University of the District of Columbia, is a Certified Information Systems Security Professional (CISSP), Certified Data Privacy Security Engineer (CDPSE), and has received certificates of achievements from the Harvard Kennedy School of Government, Gartner CIO Academy, and International Foundation of Employee Benefit Plans.

Building Organizational Resilience to Ensure Successful Change Management

By: Karen Chavez, Segal

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Organizational resilience is the ability of an organization to adapt to changes, both expected and unexpected. Key characteristics of resilient organizations include the ability to anticipate, prepare, respond, and adapt to changes.

The benefits of building a resilient organization are:

- An improved ability to navigate challenges and uncertainty
- Increased organizational agility and adaptability in times of change
- Enhanced employee morale and well-being during disruptions
- Stronger long-term operational performance

Being resilient is particularly advantageous when projects take longer than anticipated. An example is implementing a Pension Administration System (PAS), which, on average, takes 44% longer than projected, as Jeff Mills and Meir Schecter noted in their Spring 2024 *PERSist* article, "Creating a Realistic Schedule for Your New Pension Administration Solution (PAS)."

Resiliency Improves an Organization's Capacity to Cope with Change

Resiliency is important because organizations like public sector retirement plans don't experience one change at a time. Typically, staffing, budget, legislative and policy changes occur at the same time as a major project. The combination of administrative changes and long-running, concurrent or serial projects — change saturation, when too much change is happening simultaneously — can make it hard for an organization to absorb changes. Change fatigue is the sense of exhaustion that comes from being in a continual state of change. Change saturation and change fatigue, which are indicators of insufficient capacity for change, are often accompanied by a reduction in productivity. When capacity is stretched, individuals and teams lose focus and may feel stressed.

Without the proper preparation, this stress response can impact your project and your employees' well-being. It can also lead to morale issues as employees lose enthusiasm for a project or change, leading to a slowing of project progress and increased inefficiencies. Given the dynamic pace and variety of changes in the public retirement systems, you need both traditional change management for key projects and organizational resilience to set your team up for long-term success.

The Key Differences Between Organizational Resilience and Traditional Change Management

Traditional change management and organizational resilience both have their place and when done well, the two disciplines complement each other. Some of the main differences between traditional change management and organizational resiliency include:

- **Reactive vs. Proactive:** Change management reacts to a defined need such as a project, while resilience builds proactive, global capabilities within the workforce and culture, like a growth mindset.
- **Focus:** Change management focuses on the specific change defined by a project's scope, while resilience prepares the organization for anything.
- **Outcome:** Change management aims for successful implementation of the change initiative, while resilience aims for successful implementation and long-term growth to prepare for the next change.

Organizational resilience goes beyond traditional change management, building organizations that are stronger and better able to adapt to the dynamic changes taking place in the world. By building an adaptive response in anticipation of future changes alongside change management practices, your employees are better able to complete projects on time and set up your next projects on the path to success before they begin.

Steps to Build Resiliency

What are the first steps?

- **Build resiliency into your strategic plan.** Identify changes that are likely to occur in the next five to 10 years, including staffing changes, projects, potential threats, and opportunities that you might be able to anticipate.
- **Take a fearless inventory of your organization's change capacity.** Look at the amount of change that has occurred over the past three years and the changes you want to introduce.
- **Foster a culture of learning and emotional intelligence.** Part of your strategic plan should include a path for building trust and psychological safety and creating a culture of learning and growth. Your workforce needs to feel safe expressing concerns and trust those concerns will be taken into consideration.
- **Develop strategies and structures for effective transitions.** Establish clear lines of communication that are compassionate and supportive and provide information and guidance. Be available and listen to how the change is being experienced.

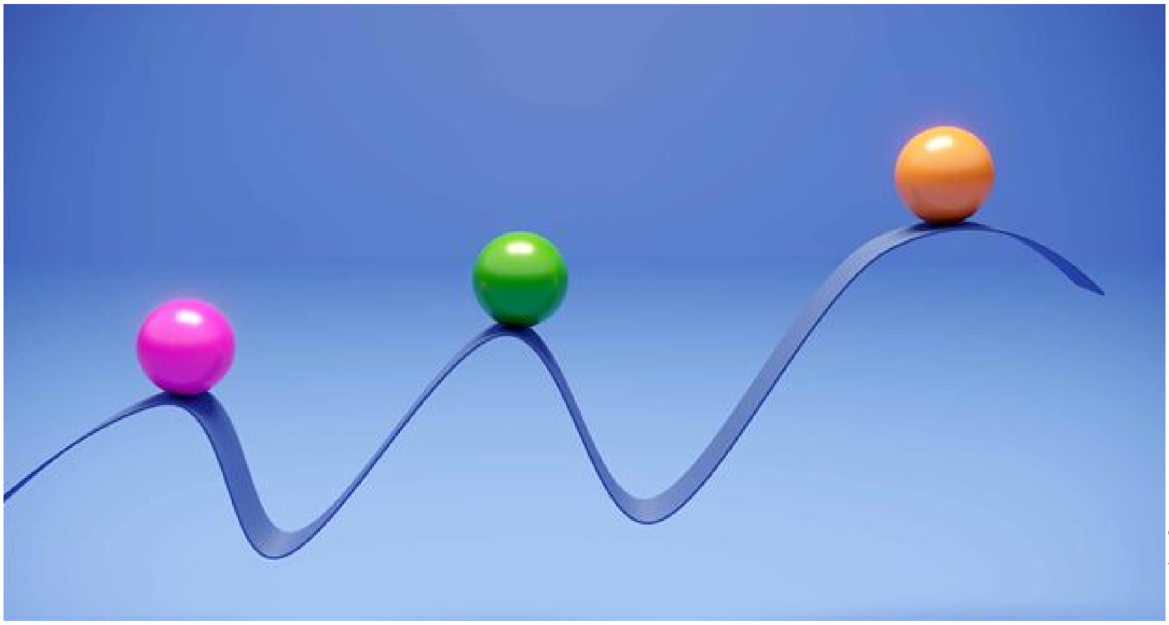
Organizational resilience is about building and maintaining robust and adaptive teams that can navigate through challenges and emerge stronger on the other side.

In the NCPERS 2024 Public Retirement Systems Study, two of the top trends in business practices are updating or enhancing administrative software and updating or enhancing a mobile app for members. Both of these directly impact plan operations and require changes in how you deliver benefits. Changes like these make resilience a strategic imperative for long-term organizational success. ◆

Karen Chavez *is a consultant in Segal's Administration and Technology Consulting (ATC) Practice. She has more than 20 years of experience in public sector pension and health benefits administration. Prior to joining Segal, Karen was the administrator of the Oregon Public Employees Retirement System Retiree Health Insurance Program.*

Balancing a Plan's Risk Exposure with Securitized Fixed Income

By: Dan Dreher, LGIM America



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Public pension plans have traditionally prioritized three key pillars in their investment strategies: diversification, enhanced return, and liquidity. However, achieving these objectives is increasingly challenging in today's financial landscape. Diversification has become more difficult as a smaller percentage of issuers now make up a larger portion of most standard public indices – i.e., top ten holdings make up 35% of S&P 500. Liquidity has also become a challenge amidst growing allocations to less liquid private market asset classes in exchange for higher expected returns – broad category has seen over $11 trillion in AUM growth in last 10 years.[1,2]

Some plans have identified the need for a portfolio that helps balance these pillars. While oftentimes called "Risk Mitigating" or "Crisis Risk Offset" portfolios, they are designed to better protect assets during deep and extended equity market declines largely comprised of liquid investment strategies. Naming conventions aside, plans are recognizing the need for liquidity as fulfilling private market capital calls, quarterly rebalancing activity, and benefit payments are essential to their operations.

Securitized products: the sweet spot

These optimization efforts frequently include an allocation to securitized products – and in the face of modern financial challenges, securitized assets stand out as a compelling solution. Unlike some public indices, which are concentrated in a smaller percentage of issuers, securitized assets encompass a wide range of underlying asset classes and market sectors. They also offer a level of liquidity typically higher than private market assets, while still providing the potential for enhanced returns relative to other public fixed income investments.

However, at first glance, certain risk metrics can screen concerning – for example, the time series in Figure 1 of auto loan defaults prime and non-prime loans increasing to 2% and 12%, respectively. But a deeper look reveals a different story.

Figure 1: ABS – Auto loan, constant default rate

Source: LGIM America. Data as of April 30, 2024. For illustrative purposes only.

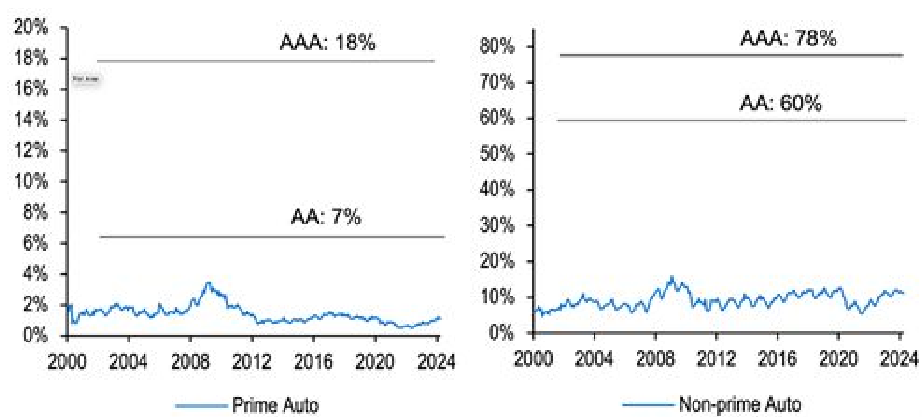
Securitized transactions are unique in that they are structured into multiple tranches, each with its own credit rating, rather than having a single rating for an individual bond. Tranches are arranged in a hierarchy based on seniority and risk. Senior tranches have higher credit ratings and are paid out first, while junior tranches, which are first to absorb losses, have lower ratings and higher yields. Additionally, "default rates" are not always as concerning as it sounds – many transactions are structured with built-in mechanisms for workouts and recoveries.

Customization and credit enhancements

Structuring within transactions is a key aspect of securitization that allows for the creation of securities with varying risk profiles to cater to different investor appetites. Credit enhancements are a primary customization tool and act as protection in the form of financial support against losses on securitized assets in adverse circumstances. From the investor's perspective, so long as the pool of assets does not experience losses above the enhancement level, the investor will receive full economic benefit. The level of credit enhancement, which aligns with the rating of each tranche, varies across asset class. Said differently, an investor with a credit enhancement at 40% would be insulated from the first 40% of losses in the transaction.

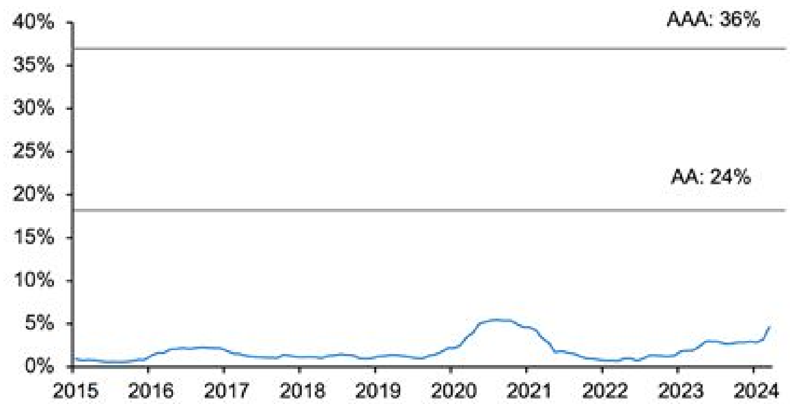
Figure 2 shows the same time series for auto loan defaults but this time we've overlaid recent credit enhancement levels for a given rating. We've also done the same with other securitized sectors (see Figure 3-4).

Figure 2: ABS – Auto loan, constant default rate



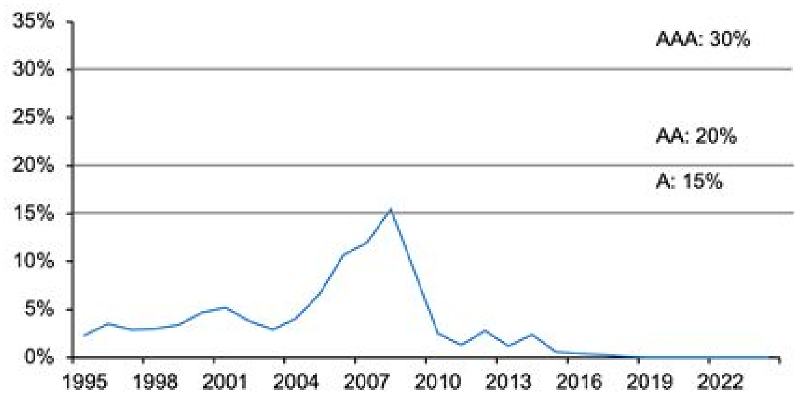
Credit enhancement by rating

Figure 3: CLO – 12-month trailing (including restructuring) over time



Credit enhancement by rating

Figure 4: CMBS (conduit) – Historical loss %



Credit enhancement by rating

The default rates of securitized products can be misleading if not viewed in the context of tranche hierarchy. While lower tranches might experience higher defaults, this does not necessarily reflect the overall quality of the entire asset class. By concentrating on the higher-rated tranches, investors can benefit from strong credit enhancements and lower default risks, which can make the asset class more attractive than it might appear when considering risk metrics at the transaction level.

Securitized in public pension portfolios

Currently, many plans are using securitized products with a policy allocation between 15-20%. Others have recently signaled intentions to increase their allocation to a similar level.

Plans recognize the ability of securitized products to balance out the competing interests of diversification, enhanced return, and liquidity. The diversity of exposures – asset-type, sector, geography, liquidity, cash flow profile, discount margin, etc. – point to securitized products as a means of obtaining customized exposure without sacrificing any of the three pillars. And notably, the use of credit enhancement may offer an outlet for meaningful downside protection in adverse market conditions. ◆

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Dan Dreher *is a Solutions Strategist at LGIM America. In his role, he supports the design, structuring, management and business development of LGIM America investment strategies and is the primary liaison between prospects, clients, consultants and LGIM America investment disciplines.*

Dan rejoined LGIM America in 2023 after co-creating Bopdrop Inc., a music sharing platform with over one million users. As Chief Operating Officer, he led all business development efforts while designing and implementing robust analytics tools dynamically synced with growth, revenue and cost models. Prior to this, Dan worked at LGIM America for over five years, most recently as a Senior Strategy Associate where he helped design solutions for LGIM America’s client base as well as supported the development of new products and investment strategies.

Dan earned an AB in Politics from Princeton University. He holds a Series 3 license registered with the NFA.

Endnotes:

1 Bloomberg as of 6/25/2024
2 Preqin from 12/31/2013 – 9/30/2023

Risk Mitigating Strategies

By: Jean-Francois Tormo, Wilshire

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Over the last several years, Wilshire has observed increased appetite from institutional investors for Crisis Risk Offset, also referenced as Risk Mitigating Strategies ("RMS"). These programs tend to capture several strategies which have in common a low to negative correlation to equity markets. Most are systematic and capitalize on well-documented and researched risk premia and factors.

Each underlying strategy has a different response function to financial market shocks and behaviors. As a result, they can be assembled in multiple ways, depending on the level of expected protection to a prolonged equity market sell-off that is needed by the investor.

Strategy	Key Characteristics
Trend Following ("Trend")	• Low to negative correlation to most asset classes with an implicit long volatility bias. • May be challenged in non-trending environments or around abrupt market reversals.
Global Macro ("Macro")	• Seeks to capture large macro disruptions across most asset classes (primarily fixed income and currencies) and expected to exhibit diversifying behavior around market inflection points. • Implemented in a discretionary or systematic approach.
Alternative Risk Premia ("ARP")	• Seeks to capture traditional and alternative risk premia. • Can be used tactically to enhance returns or provide defensive benefits in stretched markets.

There are multiple ways to construct RMS programs, with key considerations highlighted below for investors who are in the process of building and running these programs:

- Establish the program as a strategic allocation before the actual downturn occurs, while also being prepared to be tactical/active when relevant.
- RMS building blocks need to have defensive strategies (Trend Following) to provide convexity, which should be complemented with income-generating elements (Risk Premia) to offset the negative carry associated with the defensive components. Other components that are more dynamic can play both defensive and income-generating roles (Global Macro).
- Allocate to underlying strategies with low correlations to increase the probability of performing well at different points in the cycle.
- Manager selection is key to implementing these programs, with the goal of ensuring that the managers perform in line with their desired role – defensive, income-generating or both.
- Active rebalancing is essential.
- Maintain the ability to implement tactical tilts to some of the core components in stretch environments.
- Remain disciplined in the allocation to the program during equity bull markets.
- Furthermore, given the challenges that these programs may face in certain market environments, we believe that RMS programs can be enhanced by incorporating additional elements to the core components of Trend, Global Macro and Risk Premia, which may include:
- Actively-managed tail risk strategies to enhance the convexity with managers and/or solutions that actively seek to minimize the negative carry and have systematic monetization rules in periods of strong performance.
- Complement these programs with uncorrelated strategies to improve overall performance when markets rally.

Markets have provided us with numerous shocks during the last five years, which provide a relatively robust set of observations for analysis: Covid in March 2020 and the following extraordinary monetary and fiscal stimulus, rising inflation – exacerbated by the Ukraine-Russia war and associated supply chain disruptions, and the fastest hiking cycle in decades. The U.S. financial markets responded accordingly to these events, all of which have coincided with historical moves in most asset classes.

We believe that RMS programs represent a compelling source of diversification to traditional multi-asset portfolios. ◆

*To read more about Wilshire's approach on building an RMS program, please contact us at **AltsMAP.ClientServices@wilshire.com**.*

Jean-Francois Tormo, CAIA *is a Senior Vice President focused on alternatives portfolio management and hedge fund research on Wilshire's alternative managed accounts team. He joined the firm in December 2023 as part of the Lyxor U.S. acquisition.*

Prior to joining Wilshire, Jean-François worked at Lyxor U.S. as the lead portfolio manager in charge of managing discretionary fund of hedge funds and providing customized advisory services on alternative investments. He also worked in hedge fund research, focusing on relative value and fundamental strategies. Before joining Lyxor U.S., Jean-François was based in Paris where he worked on the asset allocation team at Lyxor. Prior to Lyxor he worked at BNP Paribas Arbitrage and Credit Lyonnais in investment banking.

Jean-François holds a master's research degree in economics, banking, and finance from Paris-Panthéon-Assas University and a master's degree in finance from Paris Dauphine – PSL University. Jean-François holds the Chartered Alternative Investment Analyst Association designation.

Three Securitized Debt Trends We're Watching

By Nick Rinaldi, Newfleet Asset Management/Virtus Fixed Income Advisers

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Securitized debt sectors have seen a lot of action this year: U.S. consumer and office property delinquencies are on the rise, while mortgage rates soared to a 22-year high as investors reconcile themselves to "higher for longer" interest rates. So, what's our outlook for securitized debt? Here are three trends we're following.

1. While we think commercial mortgage-backed securities (CMBS) are still in the early innings of their credit cycle, we expect to see more interesting opportunities to invest in high-quality single-asset single-borrower (SASB) and conduit deals as foreclosures start to tick up. Tighter lending standards within the asset-backed securities (ABS) autos sector first implemented in 2023 are beginning to bear fruit, as we believe subprime auto deterioration has reached its peak.

Even with spiking mortgage rates, record low levels of housing inventory and low levels of mortgage delinquencies have bolstered this market. We think non-agency residential mortgage-backed securities (RMBS) demonstrate the best opportunity within housing due to their stable performance and attractive spreads. The CMBS sector continues to face challenging headwinds, including a looming maturity wall, reduced office demand, and an excess supply of multifamily housing. According to Real Capital Analytics, peak-to-trough valuations for office and multifamily are down 47% and 19%, respectively. That said, CMBS market valuations have rallied while spreads have compressed dramatically from year-end 2023. This signals that a floor may have been set on commercial real estate (CRE) valuations, and that CRE losses may not be as high as initially expected. On a year-to-date basis, new issue supply is up 184% as investors are comfortable putting dollars to work in conservatively underwritten deals.

Our Outlook: Expect to see a lot of extension modifications for maturing loans due to tighter credit conditions. In addition, look for an increase in downgrades as rating agencies evaluate current negative fundamentals.

2. Floating rate coupons are extremely attractive in this higher-for-longer environment. U.S. consumer fundamentals remain strong. Unemployment (3.9%) remains near all-time lows, job openings (8.9 million) are near all-time highs, employment wage growth (4.2%) is nearly double the pre-pandemic growth rate, housing data remains robust, and the stock market is near all-time highs. Tighter underwriting for lower FICO borrowers also commenced in 2023. As a result, we think newer underwritten loans with lower debt-to-income ratios should produce lower losses going forward. Though delinquencies are worsening for all types of borrowers, the increase is more pronounced for lower-scoring FICO borrowers. That said, unemployment is still historically low at 3.9%.

Our Outlook: We're seeing a return to more normal credit metrics. However, we believe consumer credit should still perform well in a high 4% or even low 5% unemployment rate scenario.

3. Despite affordability headwinds from higher rates, mortgage credit fundamentals still look solid, in our view. Though mortgage rates spiked from generational lows, threatening to dampen a hot housing market, the fallout has been relatively mild due to the ongoing housing supply shortage, which remains historically low and creates a floor for any potential price declines. Additionally, most homeowners were able to lock in rates over the last couple of years, creating low mortgage debt service levels. Meanwhile, mortgage delinquency rates are staying low. Homeowner equity levels have ballooned to nearly $30 trillion, and stringent underwriting has helped bolster performance. That, coupled with expected low levels of supply, makes RMBS valuations look attractive as a result.

Our Outlook: Higher mortgage rates and a subsequent fall in housing activity bode well for fundamentals and technicals for this sector. Credit quality remains healthy, while the non-qualified-mortgage market is issuing enough paper to remain stable. Overall, RMBS issuance is expected to be up 40% from 2023, allowing for many opportunities. RMBS spreads should track agency mortgage-backed securities with additional carry, allowing for outperformance.

A disciplined strategy offering exposure to undervalued securitized sectors may offer higher yield and carry at lower levels of volatility compared to corporate bonds of similar duration and credit rating. ◆

Disclosures:

Investing is subject to risk, including the risk of possible loss of principal.

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Nick Rinaldi *is a senior managing director and portfolio manager of securitized products at Newfleet Asset Management, a division of Virtus Fixed Income Advisers, LLC ("VFIA"). Mr. Rinaldi is co-head of the securitized products team, specializing in asset-backed and commercial mortgage-backed securities.*

About Newfleet Asset Management
Newfleet Asset Management, distinguished by its longstanding multi-sector approach, dynamic structural integration, experience, and culture of collaboration, has a proven track record of successfully navigating the fixed income markets to consistently generate excess returns over full market cycles.

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Understanding India

By: Alison Adams, Meketa Investment Group

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India, the world's most populous democracy, has emerged as one of the fastest-growing major economies. Its economic journey has been characterized by significant reforms and growth spurts, particularly since the liberalization of the 1990s. This essay explores the key facets of India's economic evolution, challenges, and potential.

India's economic liberalization in 1991 marked a turning point. The reforms introduced included reducing import tariffs, deregulating markets, and opening up to foreign investment. These changes led to an increase in GDP growth, transforming India into a global economic player. From 1991 to 2022, India's GDP grew at an average annual rate of 6-7%, positioning it as a major driver of global economic growth. The services sector has been a significant contributor, accounting for over 50% of GDP during that period, followed by industry and agriculture. Liberalization attracted substantial foreign direct investment (FDI), with sectors like telecommunications, IT, and automotive seeing robust growth. FDI inflows have helped modernize India's infrastructure and boost employment.

India, the world's most populous democracy, has emerged as one of the fastest-growing major economies.

India's economic model is heavily consumption-driven. Private consumption accounts for nearly 60% of GDP currently, supported by a growing middle class and rising incomes. Investment rates, although fluctuating, have generally remained robust, driving infrastructure development and industrial growth. Despite a focus on consumption, India has also strengthened its export base. Key exports include software services, pharmaceuticals, textiles, and machinery. However, the trade deficit remains a concern, driven by high imports of oil and gold.

India's economic journey is not without challenges. Structural issues like poverty, income inequality, and unemployment persist.

India's economic journey is not without challenges. Structural issues like poverty, income inequality, and unemployment persist. The informal service sector, which employs a significant portion of the workforce, lacks social security and stability. Infrastructure gaps, particularly in rural areas, and bureaucratic hurdles also impede growth. Despite economic growth, a substantial part of the population remains below the poverty line. Efforts to alleviate poverty include social welfare programs and financial inclusion initiatives. Reducing income inequality is crucial for sustainable development. The job market faces the dual challenge of creating sufficient employment opportunities and enhancing job quality. Skill development programs and labor market reforms are essential to address these issues.

Agriculture remains a cornerstone of India's economy, employing about half of the workforce but contributing less than 20% to GDP. Modernizing agriculture through technology, better irrigation, and supply chain improvements is vital for enhancing productivity and farmer incomes. The 'Make in India' initiative aims to boost manufacturing, increase exports, and create jobs. However, the sector needs better infrastructure, streamlined regulations, and access to finance to thrive. The services sector, particularly IT and business process management, has been a global success story. Continued investment in education and digital infrastructure is necessary to maintain this momentum.

India's future economic prospects hinge on continued reforms, infrastructure development, and inclusive growth strategies. Leveraging digital technologies will likely drive efficiency, transparency, and financial inclusion. Expanding internet access and digital literacy are critical for a thriving digital economy. Addressing environmental challenges through sustainable practices is essential. Investments in renewable energy, waste management, and green technologies may promote eco-friendly growth. Strengthening trade relations and participating in global value chains should enhance India's economic resilience. Policies that support innovation, entrepreneurship, and competitiveness are vital.

India stands at a crossroads, with immense potential for growth and development. Balancing economic progress with social equity, environmental sustainability, and good governance will be key to realizing this potential. Continued reforms, targeted investments, and inclusive policies can help India achieve its goal of becoming a leading global economy. ◆

Alison Adams *joined Meketa in 2021 and has been in the financial services industry for 19 years. She serves as a research consultant where her responsibilities include global macroeconomic research and writing thought leadership materials. She is also a member of Meketa's Global Macroeconomic Investment, Investment Policy, and Strategic Asset Allocation/Risk Management Committees, and the Defined Contribution Practice Group.*

Ms. Adams earned her Ph.D. from Harvard University Faculty of Arts and Sciences in history. Prior to joining the firm, she was an Associate Consultant at RVK, Inc. Previously, Ms. Adams was employed as an analyst at Fidelity Management & Research and as a case researcher at Harvard Business School.

Do You Know Who's Voting Your Proxies?

By: Simon Zais, Egan-Jones

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There are only three ways proxies get voted, each fraught with operational peril and ripe for exploitation. Executed properly, the proxy lever for exerting influence on corporate governance is a beautiful thing: a virtuous combination of values alignment and shareholder democracy. Unfortunately for large asset owners and their beneficiaries, there can exist real misalignment and conflict between various stakeholders.

The most obvious way a proxy gets voted is directly by the asset owner. Asset owners looking to keep third-party bulls out of their corporate china shops often choose this option. Far from being a panacean remedy however, the costs associated with this solution can be significant. Even beyond erection of the associated operational and compliance scaffolding, for large institutions with diversified equity portfolios, the associated personnel demand can be staggering. These are valuable man hours that could be spent developing investment theses, performing manager diligence, or even golfing. Not to say corporate governance isn't valuable—it obviously is—but it battles in the hyper-competitive arena for allocator attention.

"So, I'll let my managers vote their portfolio proxies on my behalf," says this allocator after reviewing her organizational capabilities against the aforementioned structural hurdles to vote proxies herself. Whether operating from an SMA or pooled vehicle, delegation of this authority is an invitation to conflict and risk, both regulatory and headline.

These managers often have their own priorities when it comes to the way portfolio companies should be run. The most visible and politicized example is climate and emissions prioritization. Via the Net Zero Asset Managers initiative, over 300 asset managers collectively managing over $57T in assets have committed themselves to both pressure their asset owner clients into decarbonization goals, and develop "escalating" stewardship and engagement strategies against portfolio companies. Are these directives in the best interests of the companies, shareholders, funds, or beneficiaries? Do they drive long term returns? Or are these conflicted managers instead interpolating public policy into boardrooms?

"Luckily I can outsource to a proxy advisor." This manager will finally say, with a sigh of relief. "Surely they will consider only the best interests of my beneficiaries." Unfortunately, stemming from the market concentration and centrality, the agency problems highlighted with asset managers can actually be amplified with proxy advisors if asset owners do not carefully choose and closely monitor these partnerships.

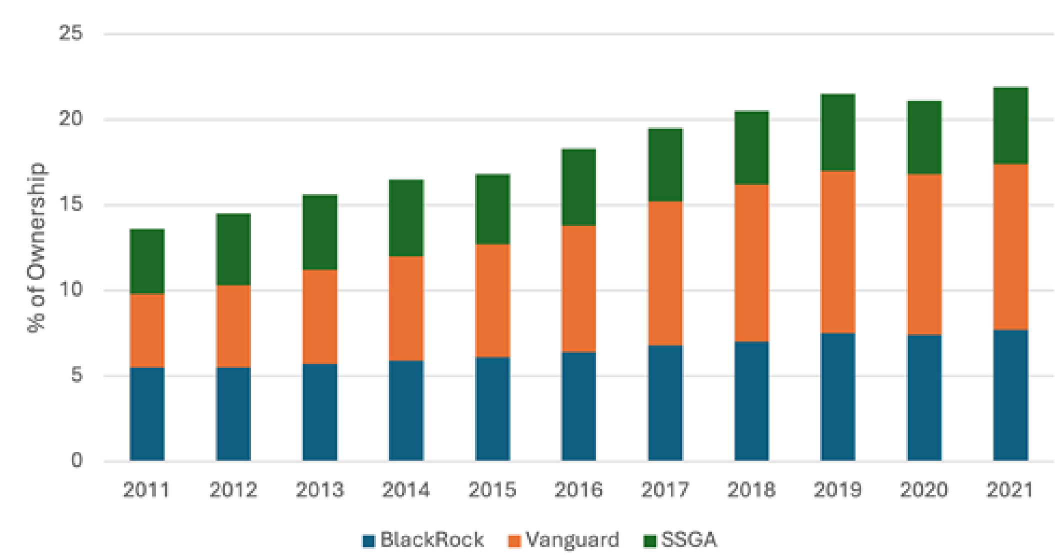
Returning again for illustrative simplicity to the climate example, even custom or hybrid policies may not be enough to guarantee alignment. Advisors' slippery contract language and deep climate religiosity can introduce uncertainty in a best-case scenario, or backdoored activism at worst. In fact, two of the top three proxy advisors have dedicated to using their size and scope to make the world greener through their boardroom influence.

As asked above, how much daylight is appropriate to exist between the goals, objectives, and values of a plan and its beneficiaries, and the political activism of the proxy advisors paid to exercise proxy voting authority?

Even more troubling, however, is the practice by some proxy advisors of providing corporate consulting to the very companies in which they will be voting shares. This is an extreme conflict that has been called out repeatedly by regulators, academics, and industry participants. There is no information firewall or control set that empowers these interlocking and supplemental activities to safely live within one organization. The demand that service providers provide unconflicted advice is supremely reasonable and in the highly visible and scrutinized world of corporate governance, should be table stakes.

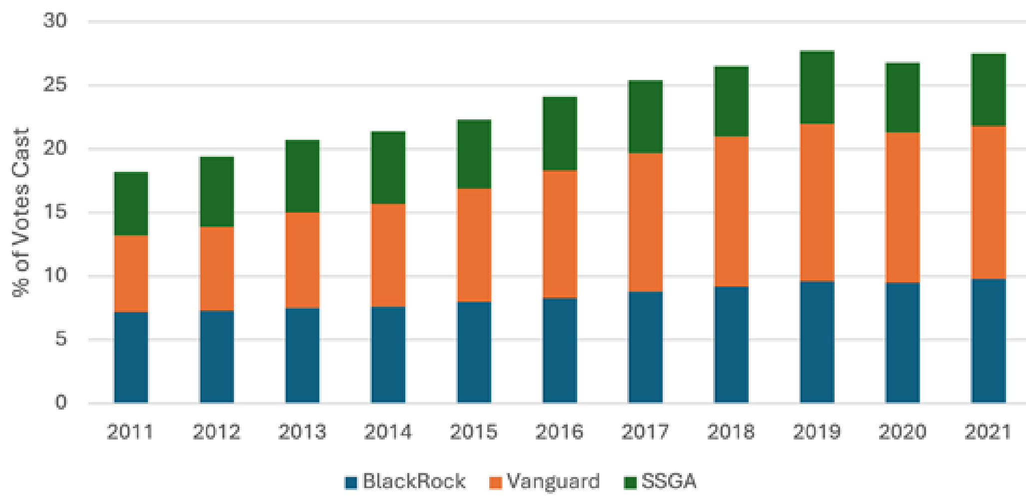
The way a company is managed is important and causal to its outcomes. The owners of a company should get to decide how that company is run. If an asset owner has a company in the portfolio, they should want better outcomes for that company. Starting from these three truisms leads to the conclusion that asset owners need to be invested in the proxy process. Whether owning the process outright or outsourcing certain activities, identifying and mitigating conflicts, and managing tradeoffs is the jumping-off point to doing right by beneficiaries and stakeholders. More and more attention is being paid to corporate governance. It's time for asset owners to ***really*** know, who's voting your proxies? ◆

Median % Ownership of S&P 500 Companies by the Big 3



Graph Souce: Big Three Power and why it Matters

Median % of Votes at S&P 500 Company Annual Meetings Cast by the Big 3



Graph Souce: Big Three Power and why it Matters

As a Senior Manager at Egan-Jones Proxy, ***Simon Zais*** *works with asset owners, asset managers, and wealth managers across the proxy landscape to ensure alignment between values and effective corporate governance. He lives in Connecticut with his wife, kids, and dog, who are all very tired of hearing about proxy voting.*

Endnotes:

1 Signatories – The Net Zero Asset Managers initiative
2 The Troubling Case of Proxy Advisors

Private Infrastructure Debt: A Growing Asset Class for Public Pension Investors

By: Brian Collett, I Squared

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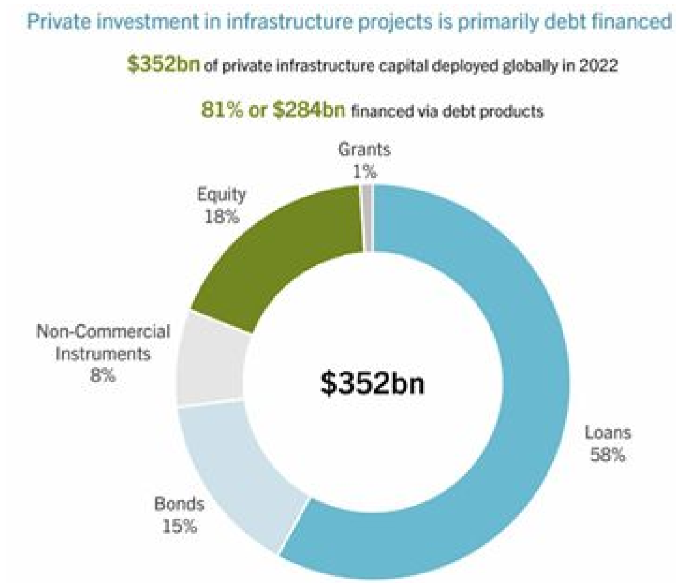
Private infrastructure debt is emerging as an attractive investment opportunity for public pension investors seeking diversification, steady income, and downside protection. This asset class bridges the gap between the significant need for infrastructure funding and the limited capacity of traditional financial sources to meet this demand. This article explores the growth of private infrastructure debt, its benefits, and its role in portfolio construction for public pension investors.

Private infrastructure debt is emerging as an attractive investment opportunity for public pension investors seeking diversification, steady income, and downside protection.

Growing Demand and Supply-Demand Imbalance

The global infrastructure funding gap is substantial. By 2040, the estimated infrastructure expenditure needed worldwide is $94 trillion, yet current spending projections fall short by about $18 trillion. This shortfall highlights the growing opportunity for private infrastructure debt to fill the void left by traditional financing sources, such as commercial banks and capital markets. Regulatory changes have tightened capital requirements for banks, reducing their capacity to finance infrastructure projects. As a result, private market participants have stepped in to address the imbalance, offering more flexible and tailored financing solutions.

Growing Opportunity set for Infrastructure Debt



Source: Global Infrastructure Hub: Infrastructure Monitor 2023.

The graph above illustrates the significant opportunity set for Infrastructure debt with over $284 billion financed via debt in 2022. This underscores the growing recognition of infrastructure debt as a viable standalone investment vehicle, attracting a substantial amount of capital from investors seeking stable and reliable returns.

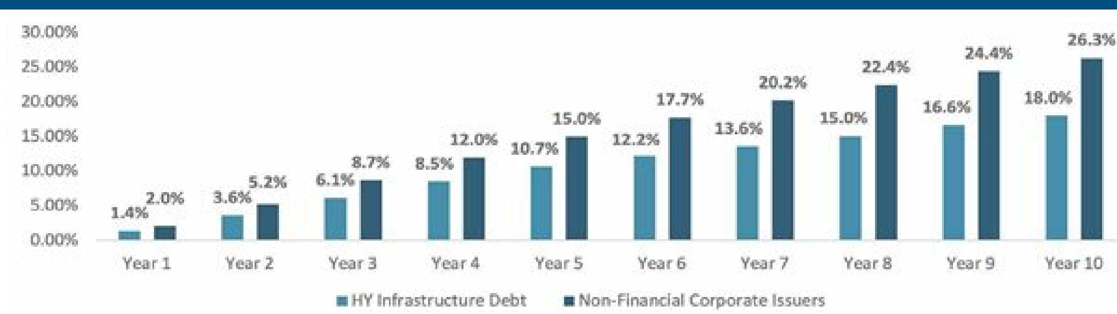
Key Characteristics and Benefits of Infrastructure Debt

Infrastructure assets are vital for social and economic development. They typically generate stable, long-term cash flows that are often inflation-linked, providing a natural hedge against inflation for investors. Additionally, infrastructure debt usually involves secured lending, which offers higher protection compared to corporate debt.

Reduced Risk and Downside Protection

Infrastructure projects generally operate under long-term contracts or regulated environments, ensuring revenue visibility and reducing volatility. This stability is attractive for investors looking for reliable returns. Historical data supports the lower risk profile of infrastructure debt compared to corporate debt, with infrastructure credit showing lower default and loss rates over the past decades.

Average BB/B cumulative default rates, 1983-2021



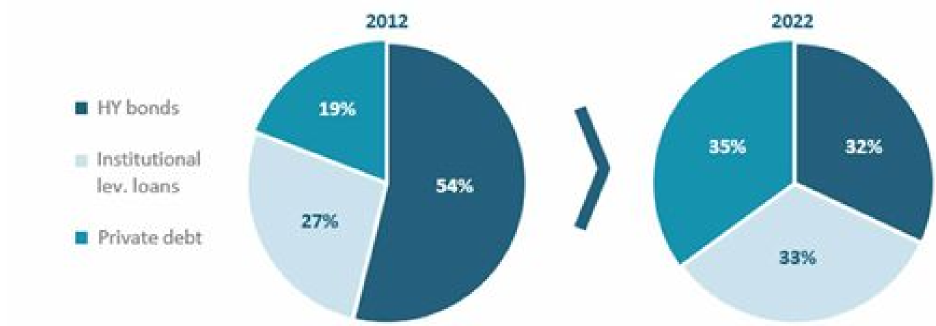
Source: Moody's, September 2021.

The graph above shows the significantly lower default rates for infrastructure debt compared to corporate debt over nearly four decades, reinforcing its lower risk profile.

Attractive Yields and Risk-Adjusted Returns

Despite lower risk, infrastructure debt can offer competitive yields. This is particularly true for private infrastructure debt, which benefits from less competition compared to corporate direct lending. Investors can achieve strong risk-adjusted returns, making infrastructure debt a valuable addition to diversified portfolios.

Annual debt issuance by type



Source: IMF, Deutsche Bank, May 2023.

The comparison between 2012 and 2022 demonstrates the shift in debt issuance, with private debt surpassing high yield bonds and leveraged loans for the first time. In 2022, private debt issuance reached $500 billion, significantly outpacing high yield bonds and institutional leveraged loans, which stood at $350 billion and $450 billion, respectively.

The Role of Private Infrastructure Debt in Portfolio Construction

Private infrastructure debt can enhance public pension portfolios by providing several key benefits:

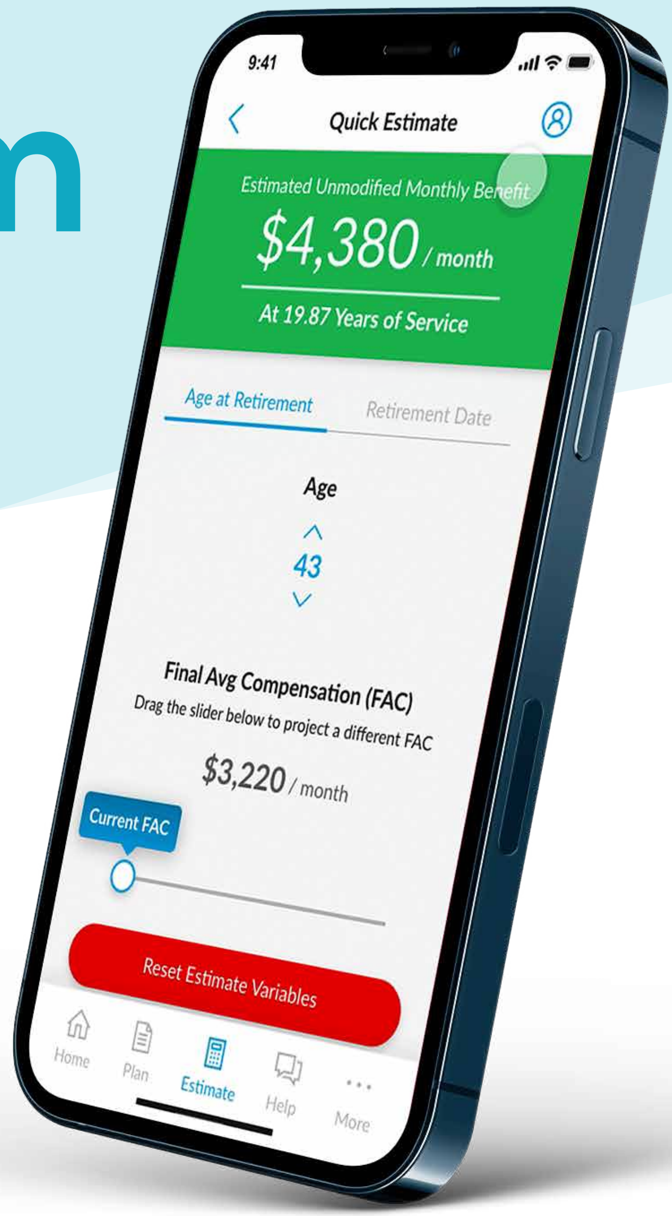
- **Incremental Downside Protection and Portfolio Resilience**: The essential nature of infrastructure assets means they are less sensitive to economic cycles, offering stability and resilience.
- **Attractive Cash Yields**: Infrastructure debt investments typically generate higher yields compared to traditional fixed-income securities.
- **Enhanced Diversification**: Adding infrastructure debt to a portfolio can improve diversification, reducing overall portfolio risk.
- **Improved Risk-Adjusted Returns**: The favorable risk-return profile of infrastructure debt can enhance the overall performance of a portfolio.

Conclusion

The infrastructure sector's evolution and the increasing role of private infrastructure debt present significant opportunities for public pension investors. The ability to provide inflation-linked income, downside protection, and attractive risk-adjusted returns makes private infrastructure debt a compelling addition to public pension portfolios. As traditional financing sources continue to face challenges, private infrastructure debt will play an increasingly vital role in funding essential infrastructure projects, driving economic growth and stability. ◆

Brian Collett, CFA, CAIA*, currently serves as the Managing Director of Strategic Engagement at I Squared Capital. Previously, he was the Chief Investment Officer at Missouri Local Government Employees Retirement System (LAGERS), where he successfully managed a multi-billion-dollar portfolio. At LAGERS, Brian implemented innovative investment strategies and robust qualitative risk management practices, consistently achieving top-decile performance. With over 25 years of experience in asset allocation and investment structuring, Brian has held significant positions at South Carolina Retirement System and Russell Investments. He is an expert in private debt, private equity, hedge funds, public markets, and asset allocation. Brian holds an MBA in Finance from Butler University and a BS in Mathematics from Marian University.*

NCPERS PensionX Digital Platform



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