Retirement News Highlights

Friday, October 14, 2022

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BlackRock Flows Remain Strong Despite ESG Criticisms

By Bridget Hickey
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October 14, 2022

BlackRock's business has not been impacted by its position on environmental, social and governance investing, as clients are attracted to the firm's position on "choice," chief executive Larry Fink said in an earnings call Thursday.

The world's largest asset manager reported $65 billion in long-term net inflows to its products for the third quarter, despite recent criticism from the right and left over its climate policies. Those inflows were driven in part by the firm's institutional clients, even as several U.S. states say they are pulling state money from the firm.

BlackRock reported $48 billion in institutional net inflows, with $71 billion in flows to active strategies offset by net outflows of $23 billion from index products.

Active flows were led by fixed income and multi-asset strategies and bolstered by several significant outsourced chief investment officer, or OCIO, mandates, BlackRock said. Index outflows "primarily" came from equity strategies as clients sought to de-risk or rebalance in the current market environment.

In the U.S., BlackRock brought in $84 billion in the third quarter and $258 billion over 12 months in long-term net inflows from both institutional and retail clients.

"I think our flows for the year, our flows for the quarter, here in the United States, speak volumes about what's really happening," said Fink, responding to a question about whether the firm's position on ESG has led to lost business or impacted its reputation.

"Clients who have views, whatever those views may be, we provide them with product choice and product ideas," he said.

Fink pointed to the firm's proxy voting choice program, which went live earlier this year and is being expanded, allowing investors in separate accounts and certain pooled vehicles to vote their shares.

“I’m here to tell our shareholders today that choice is resonating,” Fink said.

Nevertheless, the flows came in behind some analysts’ expectations.

"Net inflows of $65.2 billion into long-term assets under management were impressive, considering the ongoing disruption in the equity and credit markets, but still worse than our forecast for more than $100 billion,” wrote Greggory Warren, a sector strategist at Morningstar, in an analyst note.

BlackRock’s assets under management fell to $8 trillion, down from $8.5 trillion in June and $9.5 trillion for the same quarter last year, largely due to falling markets.

The firm said Thursday it would cut spending and pause discretionary hiring. “We are continuing to pursue critical hires that support our near-term growth but are pausing the balance of our hiring plans for the remainder of 2022, said Gary Shedlin, BlackRock’s chief financial officer, during the call.

BlackRock has been weathering a storm of criticism from U.S. state officials on both sides on the political aisle, with New York City’s comptroller threatening to reassess the firm’s business with the city’s pension funds over the manager’s “nebulous” net-zero policies just weeks after an official in Texas blacklisted BlackRock and other managers for allegedly “boycotting” energy firms.

The firm has lost more than $1 billion in asset management business from U.S. Republican states, the Financial Times reported.

Earlier this week, South Carolina’s State Treasurer, Curtis Loftis, announced plans to divest $200 million from BlackRock funds by the end of the year over the money manager’s sustainable investing policies.

Loftis has been working to remove BlackRock from state funds’ investment portfolios for the past five years, a spokesperson for the Treasurer said by email, adding that a dollar amount was not available.

Last week, Louisiana State Treasurer John Schroder wrote to Fink, declaring his intention to pull $794 million from BlackRock funds and strategies by year-end due to the firm’s “blatantly anti-fossil fuel policies,” as reported.

Schroder said the state has already redeemed $560 million from BlackRock exchange-traded funds, mutual funds and money market funds.

Utah State Treasurer Marlo Oaks said last month that he had liquidated $100 million in BlackRock funds, while Arkansas has reportedly pulled $125 million this year.

BlackRock set up a new webpage to counteract criticisms, noting that the firm has invested $170 billion in U.S. public energy companies.

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ESG Bluster Leads to No Effect for Three States’ Retirement Systems

By Noah Zuss
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October 13, 2022

SEVERAL STATE RETIREMENT FUNDS continue to operate as nonpolitical entities for public employee participants, despite clashes with BlackRock over the suitability of sustainable investing.

Three state pension funds—Alabama, Indiana and Kentucky—have not changed investment strategies to put sustainable investments on the shelf, according to state pension officials.

The AGs' eight-page dispatch in August blasted BlackRock for "using state pension fund assets in environmental, social and governance investments to "force the phase-out of fossil fuels, increase energy prices, drive inflation and weaken the national security of the United States."

Despite the letter—written by 19 Republican state attorneys general—that outlined how the group believes BlackRock is using "the hard-earned money our states' citizens to circumvent the best possible return on investment"—nothing has changed at the Alabama, Indiana and Kentucky state pensions, according to officials.

"It had no change at all," explains David Eager, executive director, Kentucky Public Pensions Authority. "We are focused on retirement assets and retirees and our fiduciary responsibility, and that letter had no impact on us."

Under Kentucky state laws, any investment strategy or allocation to an ESG investment must pass muster on its own merits. The state retirement system is guided and governed by an investment policy statement, that "all investments are made for the exclusive benefit of retirees," Eager adds.

"We would look at each investment and say from an opportunity and risk standpoint 'is this an attractive investment,' we wouldn't avoid a security unless the ESG factors would adversely affect their operations and financial future," he says. "We wouldn't, for example, ban all energy stocks: We'd look at each energy stock on its own merits."

Marc Green, CIO, Retirement Systems of Alabama, agreed that the state attorney generals' letter has not affected the state defined benefit pension and supplemental defined contribution plan.

"We don't have any actual restrictions or policies in place that guide us as far as ESG investing," he says. "[ESG is] something that we're aware of but it doesn't really drive the bus here."

Green adds, "we manage all of our assets internally with the exception of one small sleeve, and from a staffing perspective and the subjective nature of ESG, we're aware of what's going on out there but it's not something that we're going to alter our process for in [the] very near future by any stretch," he explains.

Indiana pension fund participants cannot select ESG investments, according to a spokesperson for the Indiana Public Retirement System.

"ESG investments are not and have never been on the investment menu for the [defined benefit] plan or available for members to choose for their [defined contribution] investments," says the statement.

“INPRS’s investment policy statement clearly outlines the way the funds entrusted to investment managers must be invested, and that is to reach the organization’s pecuniary goals by using monetarily based investment principles to achieve its risk-adjusted rate of return of 6.25%.”

While the ESG controversy—sparked by Republican-led states—has not changed how three operate, in Louisiana, the state treasurer doubled down by banning BlackRock from state investments.

In a letter to CEO Larry Fink, Louisiana Treasurer John Schroder, says the state removed $794 million from BlackRock funds and that divestment is necessary to protect Louisiana’s fossil fuel sector from harmful actions and policies.

“Your blatantly anti-fossil fuel policies would destroy Louisiana’s economy,” the letter states.

“[Y]our support of ESG investing is inconsistent with the best economic interests and values of Louisiana,” Schroder wrote. “I cannot support an institution that would deny our state the benefit of one of its most robust assets. Simply put, we cannot be party to the crippling of our own economy.”

Legal Layers

State retirement systems are not governed by the Employee Retirement Income Security Act as employer-sponsored 401(k) plans, yet they are governed by state laws that similarly mandate fiduciary duties to participants of loyalty, prudence and care.

Ditching ESG factors completely could add to the litigation risks faced by state plans and bring heightened vulnerability to challenges based on breach of fiduciary duty claims, explains Josh Lichtenstein, partner and head of ERISA Fiduciary Practice at Ropes & Gray.

“From the direct legal consequences, [states] run the risk of challenge[s] that they’re making investment decisions that do violate prudence,” he says. “[For] pretty much every state, their state pension statute directly copies the ERISA fiduciary standard and so while the states don’t generally have a lot of decision authority or regulatory authority in interpreting exactly what their standards mean, there’s a lot of federal court precedent on interpreting what the fiduciary standard means when the exact same words were used in ERISA.”

State pension funds that decide to completely remove ESG factors from consideration may be courting unnecessary fiduciary risks and litigation, he adds.

“[States] do run the risk of allegations of breach of their fiduciary duties and in some states that can mean [a] constitutional breach because sometimes these are built into the constitutions or breach of statutory obligations where they’re built into the statute,” Lichtenstein says. “It’s a real risk that they run that somebody can allege—if we’re talking about limitations in an investable universe—if they’re finding both that the number of investments they can make is limited and if they’re thereby getting lesser returns than other similarly situated plans that have a broader universe of investments. You can imagine how somebody argues that making an investment without considering those economic

ramifications would itself be a breach of fiduciary duties and can look to the body of case law on ERISA to draw some interpretive strength to that argument."

The largest effects of the GOP state pushback to ESG investments and BlackRock, at least initially, could be to investment managers and advisers, rather than state retirement plans, adds Doug Davison, partner with global law firm Linklaters.

"It kind of causes a shockwave through the investment adviser world," he says.

He adds, "It almost feels like a lose-lose to some clients, not a win-win."

The State Level

For Kentucky, sustainability factors, which may affect the financial outlook, reputation and riskiness of an investment in addition to liabilities and assets on a company balance sheet "would be a judgment call" for the state retirement system to allocate assets, according to Eager.

"It could be [a bad environmental record], sure but our internally managed investments are indexed, and we don't pull stocks out of the index for any reason," he says.

In addition to indexed internally managed investments, Kentucky partners with myriad third-party investment managers that oversee portions of the state pension funds.

Notwithstanding the state attorneys' general dispatch to BlackRock blasting ESG investments as not appropriate for state workers, the Kentucky Public Pensions Authority—an apolitical entity—does not need to reconcile the two as competing forces, Eager says.

The state's fiduciary duty to participants is ensured through the structure of the Kentucky system, which intentionally mitigates political influence, according to Eager.

Eager explains that Kentucky invests the assets of workers under the confines and allowances of state fiduciary law.

"We are governed by a retirement board that is elected by members and appointed by the governor, independent of state influence beyond that," he notes.

He adds that Kentucky state retirement plan trustees recognize the importance of responsible investing.

"Accordingly, the trustees acknowledge that integrating environmental, social and governance policy principles that engage the issue of risk, opportunity and fiduciary duty perspective will enhance the investment result," he says. "The overriding consideration for the trustees will continue to be investing to maximize long-term returns for plan beneficiaries.

By Eager's description, in Kentucky, there is room for ESG investments in the Kentucky state plan, although he cautioned that maximizing investment returns for participants is the goal.

He adds, "the last statement is the overriding consideration: looking for attractive investments," he says.

“What’s particularly unique for the [state] plans is many of the trustees are political appointees, so the fiduciary standard is quite broad and can be interpreted in different ways. That’s what we’ve seen play out,” says Davison.

Green, of Alabama, explains that, for the state pension and supplemental DC plan, generating the optimal investment returns are the highest goal for the state plan, “to hit our actuarial assumed rate of return over the course of time so we can pay our beneficiaries.”

Similarly to Kentucky, the state does consider ESG factors, including board compensation and company governance, he adds.

“If we have an issue with a stance that management is taking, we do vote against management or against management recommendations quite often and that’s nothing new,” Green explains. “ has always been an issue here.”

Despite the political positions taken on ESG by several state officials, it will remain to be seen exactly what long-term effects will manifest, if any, according to Lichtenstein of Ropes & Gray.

“In Florida, they now have a policy of very broadly excluding investments based on ESG, but it’s not clear that’s going to actually lead to divestitures or that it’s actually going to lead to firing of managers in lieu of other managers. The impact of that very well may just be that the state pension boards are more careful about which particular funds that a manager offers [and] they may invest in or which particular strategies,” he says. “And they may document their investment decisions a little bit more to explain in greater detail exactly what their economic rationale is and that they’re not really investing based on the ESG rationale at all. But it’s not clear that they’re going to actually force divestiture from all ESG investments.”

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Federal Retirees Are Set to Receive the Highest COLA in Decades, But Some Will Get Less Than Others

By Erich Wagner
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October 13, 2022

For the second year in a row, federal retirees will see the largest annual increase in benefits payments in decades, as the Social Security Administration announced Thursday that the annual Social Security cost-of-living adjustment for 2023 will be 8.7%. Not all federal retirees will get the full 8.7%, however, prompting renewed calls for parity between the federal government’s retirement systems.

Social Security cost-of-living increases are calculated based on the annual change in the third quarter consumer price index for workers. The Civil Service Retirement System also calculates enrollees’ annual annuity increases on that basis, meaning retirees enrolled in CSRS will see an 8.7% increase to their annuity payments in 2023, the largest COLA since 1981.

Last year, Social Security and CSRS annuitants received a 5.9% cost of living adjustment, which marked the largest increase since 1982.

But former federal workers who are enrolled in the newer Federal Employees Retirement System, which came into being along with the 401(k)-style Thrift Savings Plan, will only receive a 7.7% increase in their annuities.

That's because FERS operates on an extrapolation of the Social Security and CSRS cost-of-living adjustment. Each year, if CSRS sees an increase of under 2%, FERS retirees receive the full COLA. If the adjustment is between 2% and 3%, FERS enrollees only receive a 2% increase. And if the CSRS COLA is 3% or more, FERS retirees receive the Social Security and CSRS COLA, minus 1 percentage point.

The formula reducing the annual increase in defined benefit payments for FERS participants has been a pain point for organizations representing federal workers and retirees. Earlier this year, Sen. Alex Padilla, D-Calif., introduced legislation that would standardize the annual cost-of-living adjustments that federal retirees receive across both retirement systems.

"While CSRS annuities and Social Security benefits will be going up 8.7%, the January 2023 COLA unfortunately will be 7.7% for those who retired under the Federal Employees Retirement System," said Ken Thomas, national president of the National Active and Retired Federal Employees Association. "This inequitable policy, enacted in the 1980s with the creation of FERS, fails to fully protect the earned value of FERS annuities, which decrease in value year after year—exactly what COLAs are intended to prevent."

Thomas also renewed his organization's call for the government to shift the economic metric used to calculate the annual increase in retirement annuities to one that more closely aligns with the spending of retirees: the consumer price index for the elderly. During the 2020 presidential campaign, President Biden endorsed this idea, although thus far, it has not come to fruition.

"Seniors spend more on health care than any other segment of the population, and those who enroll in Federal Employees Health Benefits plans for 2023 will see an average increase of 8.7% in their share of premiums, the biggest jump since 2011," Thomas said. "For years, NARFE has urged Congress to address the inequity of COLAs that don't keep up with rising health care costs by passing legislation requiring the [Bureau of Labor Standards] to calculate COLAs based on the consumer price index for the elderly (CPI-E) instead of the consumer price index for workers (CPI-W)."

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