Retirement News Highlights

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Debt-ceiling apocalypse could offer opportunities as well, observers say

By Douglas Appell
Pensions & Investments
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The ongoing debt-ceiling standoff between Democrats and Republicans could result in buying opportunities for institutional investors as long as widespread faith that the two sides will eventually do whatever is necessary to avoid a U.S. debt default proves well-founded.

If not, all bets are off.

For now, even as the "X-date" where the government won't be able to cover all of its Treasury bonds and bills coming due approaches— as early as June by some estimates — most market participants say they're confident key players in the unfolding political drama remain rational actors, intent on avoiding the economic debacle a default would unleash.

In that telling, the critical mass of uncertainty that would ensue — including a full-blown banking crisis, millions of layoffs and the need for higher interest rates going forward to support demand for Treasury bonds that suddenly look less than risk-free — remains the best guarantee that a default won't occur.

"The mutually assured destruction of debt default is exactly what keeps it from happening," said Charles Van Vleet, assistant treasurer and CIO of Providence, R.I.-based Textron Inc.

Funding for national parks, construction projects and research may be suspended but "I do not think we would ever default on debt," said Mr. Van Vleet, who oversees $13 billion in Textron defined benefit and defined contribution retirement assets.

"It would be apocalyptic to not reach an agreement in some reasonable amount of time, and who wants to be the one that carries the blame for that," agreed Jim Jackson, co-CIO of San Antonio-based Victory Capital Management Inc.'s fixed-income business.

For some observers, that reasonable amount of time could include a few hours of default but not much more.

While Washington's ever-more visceral political discord provides reasons to think this latest in a long series of debt-ceiling standoffs could end up being "relatively contentious and drawn out," a government default on its debts for a period of weeks or months remains "almost unimaginable," said Jay Love, Atlanta-based U.S. chief investment strategist with Mercer Investments LLC.

Some observers aren't willing to go that far.

Deborah B. Goldberg, Massachusetts state treasurer, at a May 2 investment committee meeting of the $89.4 billion Massachusetts Pension Investment Management Board, expressed concern that "nobody really believes that Congress will allow the country to go into default," effectively downplaying a "thoroughly unpredictable" political backdrop now.

"I think today there is a distinct possibility of a default — unimaginable as it is," agreed Cynthia Steer, investment committee chair of Washington-based MissionSquare Retirement, which reports $68 billion in assets under advisement for public sector employees, including $34 billion in assets under management.

"The polarization of the U.S. has reached a point where it is at least a 5% to 10% possibility, rather than zero," Ms. Steer said. "There are no adults in the room," she added.

Mercer's Mr. Love, by contrast, pegged the possibility of default at a mere 0.1%, and declined to raise the odds to two-tenths to reflect Washington's descent into incivility. "I do think there's still some rationality and sanity even if it's hidden behind bare knuckle" political strife, he said.

Most analysts, meanwhile, contend that there's very little institutional investors can do to protect their portfolios from such a low-probability, high-risk scenario.

"We do not expect institutional investors to make large, pre-emptive repositioning in advance of the X-date," said Simon England-Brammer, London-based senior managing director and head of EMEA and Asia-Pacific global client group with Nuveen.

"At the margin, we expect investors to position more defensively and to hedge against heightened volatility, but not to make material changes to overall asset allocations," he said.

Elizabeth Burton, chief investment strategist, client solutions group with New York-based Goldman Sachs Asset Management, said for the big public pension clients she focuses on the debt ceiling isn't top of mind, either because they know there's not much they can do to prepare for it or they've got bigger concerns now, such as how to manage liquidity.

A default is "a very, very small probability risk to take a lot of potential reward off the table for," agreed Mr. Love. "The calculus for doing so doesn't work," he added.

And while the latest round of turmoil may leave market participants hoping the dominant roles played by the U.S. dollar and Treasuries in their portfolios give way to greater "multi-polarity" down the road, that remains a far off prospect — even if an argument can be made that this debt-ceiling "kabuki" will serve as an "accelerant" for that future, noted Amar Reganti, managing director, broad markets investment products and strategies with Boston-based Wellington Management Co.

As a former deputy director of the Treasury Department's office of debt management, Mr. Reganti was involved in managing the debt ceilings of 2011 and 2013.

"There's no alternative safe asset," noted Andrew Palmer, CIO of the $64.6 billion Maryland State Retirement & Pension System, Baltimore. "I guess we could buy some gold, but we couldn't buy enough to provide … real protection. We pretty much have to trust the authorities to make good decisions," he said.

Political theater

Adherents to the belief that everything will work out in time take solace in the fact that debt-ceiling standoffs have practically become a staple of the American political scene and even the most contentious of past episodes — in 2011, when it took a market plunge sparked by an S&P downgrade of U.S. debt to AA+ from AAA to forge a compromise — have ended without a default.

The current standoff, then, should be seen as "more of the same" rather than something new, said Victory's Mr. Jackson. "There's always a lot of hype around it … by intent," with both sides seeking to push their policy proposals through "by using the debt ceiling as a hammer," he said. "They're incentivized to really heighten the level of fear as far as not agreeing on something," Mr. Jackson added.

Meanwhile, market sell-offs have a crucial role to play in that political dance, money managers say.

So far, signs of stress have been limited to corners of the financial markets most people don't pay attention to — such as the recent four-week Treasury bill auction and credit default swaps for U.S. Treasuries — rather than markets followed closely by the public, such as U.S. stocks, noted Wellington's Mr. Reganti.

Investors have yet to see the kind of broad reaction across all markets that has served as a "forcing mechanism" pushing policymakers toward compromise in previous standoffs such as 2011, he said.

The T-bill market is "certainly pricing in some level of risk," said Victory's Mr. Jackson, with the T-bill that matures May 30 yielding about 4.3% while the one maturing the next day yields about 5.3%.

As the day of reckoning draws near for covering outstanding Treasury debt coming due, signs of capital market stress are likely to become broader and deeper, market participants say.

"We expect markets to react as we get closer to the 'X-date,'" including a sell-off of risk assets and a widening of spreads, said Nuveen's Mr. England-Brammer.

The closer the Treasury comes to defaulting, "the higher the stakes go" and the greater the chances of the kind of broad market sell-offs that will bring opposing political players to the table, Mr. Reganti said.

Even if most market participants continue to believe the current debt standoff will follow the pattern of prior episodes, they concede there are reasons to be a bit more on edge this time around.

High on the list of concerns is the vulnerability of Republican House Speaker Kevin McCarthy, reflecting a razor-thin majority for his party in the House of Representatives that leaves him with relatively little room to maneuver in extracting concessions from his members.

"I'm a little more concerned this time," conceded Mercer's Mr. Love. While an agreement that avoids default remains his base assumption, "I think they can take it up to the edge" this time, he said.

It seems "sadly predictable that brinksmanship will go to the final hour" but this time there's a real risk it continues beyond the point where the Treasury runs out of cash, forcing the government to prioritize debt payments to avoid financial chaos, said Neil Mehta, a London-based portfolio manager with RBC BlueBay Asset Management.

Meanwhile, some investors warn that, just as past performance doesn't guarantee future returns, the successful conclusion of previous debt-ceiling negotiations shouldn't spawn overconfidence regarding the way forward now.

"I think markets to some degree have been a little bit inoculated after the 2011 and 2013 and 2015 debt ceilings and to some degree they are complacent," leaving room for miscalculation, noted Wellington's Mr. Reganti.

Maryland's Mr. Palmer said while he continues to expect some resolution, he's concerned about the brinksmanship. "Every time you play one of these games, if somebody doesn't blink then you start a fire that's a little bit harder to put out."
In the analogy of a high-stakes poker game, "there's bluffing going on and people are holding certain cards (and they) can miscalculate," in an environment where a misstep can have enormous spillover effects for capital markets and the economy, said Mr. Reganti.

Impact to escalate

If there's an actual default, market participants say they expect things to be made right in very short order. How much time they have to do so would be in question, however.

"Almost every hour after that missed coupon or principal payment, things start becoming a train wreck pretty rapidly," noted Wellington's Mr. Reganti. With hundreds or thousands of federal payments coming in and out, "the longer you're delaying on one of them, it starts rapidly piling up," fast becoming an "operational nightmare," he said.

Even without a default, the backdrop of debt-ceiling negotiations could set the stage for heightened volatility that significantly impacts big public funds' asset allocation plans going forward, GSAM's Ms. Burton said.

For example, if the market sells off in June, hitting public pension funds' fiscal year and long-term returns through June 30, it could affect their ability to put money into private markets for 10 years, she said.

It could be the difference between board discussions around trimming risk, if returns were good, or adding risk if a portfolio is suddenly trailing its benchmark by 200 basis points, she said.

If there's a sell-off, a fund's liquidity will determine how much of a buying opportunity it could prove, she said.

For sell-offs sparked by the ongoing debt-ceiling standoff, Wellington's Mr. Reganti said if there is a last-minute deal to avert a default, the volatility in the run up to that deal should provide opportunities for investors.

"If it's going well past the X-date and there is a technical default and there's ensuing confusion in capital markets, I think you have to probably be a little more careful in terms of the economic fallout, and the longer it goes on, the more likely it is to spread into the real economy … eventually (showing) up on things like valuations and default rates."

Sophie Baker and Brian Croce contributed to this article.

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Less Covid, More ESG: Here's Which Industry Risks Are Top of Mind

Risk factors disclosed in publicly traded asset manager annual reports showed Covid-19 becoming less of a concern, managers are worried about geopolitical tensions, political blowback and cryptocurrencies.

By Michael Taffe
FUNDfire
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The political backlash against environmental, social and governance investing and Russia's war against Ukraine are the top threats asset managers are bracing for, according to an analysis of public filings by 30 of the largest asset managers and wealth management firms.

These two risk factors spiked in the last year – along with cybersecurity and geopolitical tensions – while the industry placed less emphasis on Covid-19.

In fall 2020, the Securities and Exchange Commission expanded its rule on significant risk factor disclosures to mandate disclosures on material risks to a company's stock performance.

Asset managers cited ESG in their latest annual reports at twice the rate as the previous year.

Carlyle Group, for example, stated that "increasing scrutiny from stakeholders on ESG matters, including our ESG reporting, exposes us to reputational and other risks."

State Street, which did not mention ESG as a risk factor in last year's filing, included 17 references of the investment strategy as a potential pitfall, including that "Political pressure may also be placed upon governmental clients not to use service providers, such as us, if the legislators or governmental officials in such jurisdictions believe our ESG-related positions are not consistent with the views of such legislators or officials."

Russia's war against Ukraine shot up the list of material business risks, not because of its effect on global supply chains, but due to the U.S.-imposed sanctions the financial industry had to navigate.

Federated Hermes linked the conflict to rising cybersecurity risks, stating that the "Russian invasion of Ukraine has increased, or created the possibility of increased, cybersecurity attacks."

Cyber risk, already mentioned 16 times on average in risk factor disclosures in last year's annual report, was cited 9% more often this year.

Mentions of inflation ticked up 42% since last year. References to risk posed by recruiting needs fell by 10%, aligning with the spate of layoffs that have dominated workforce trends in 2023.

Regulators are not prescriptive on what risks they want to see on this list, rather they want to see the methodology – the right taxonomy and materiality level, said Stephan Erni, partner at Bain & Company's banking practice.

"How do you think about supply chain risks status, or interest rate risks? I may have a different view on it, but they typically enter into an alignment – to make sure that the right risks are on paper," he said.

The amount of detail and explanation for each risk the firm identifies generally correlates to its severity, said Michael Mallory, head of the SEC accounting advisory practice at FTI Consulting.

Mentions of the pandemic fell by more than half compared to last year's annual reports.

"I would expect that many resident registrants still had Covid-19 type risks [in] their disclosures up to now, but I would expect that we'll see that drop off," Mallory said. "But supply chain issues still seem to be an issue for some organizations."

New liabilities are also on the horizon.

Eight firms said cryptocurrencies have the potential to siphon off revenues, up from just four in last year's filings.

The number of firms mentioning China, both in relation to sanction compliance and market competition, rose from nine to 15 in this year's slew of annual reports.

Climate change also made the list of risk factors for 25 of the 30 firms examined by FundFire.

St. Petersburg, Florida-based Raymond James, for instance, disclosed that its "operations could be adversely affected by hurricanes or other serious weather conditions, including extreme weather events caused by climate change."

Risk factor disclosures provide more of a read on the firm's view of the potential obstacles they'll face, rather than an exhaustive list.

"Nobody can do crystal ball reading," Erni said. "As long as you have sound, objective, justified processes in place, and you come to a conclusion."

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3 NYC pension funds sued over fossil fuel divestment

By Robert Steyer
Pensions & Investments
May 12, 2023

Four participants of three pension funds within the New York City Retirement Systems sued the pension funds claiming their divesting of fossil fuel investments violated their fiduciary duties.

"This unlawful decision to elevate unrelated policy goals over the financial health of the plans is flatly inconsistent with the defendants' fiduciary responsibilities, and jeopardizes the retirement security of plan participants and beneficiaries," said the lawsuit filed electronically May 11 in a State Supreme Court in New York City.

"It must be enjoined," said the complaint in Wong et al. vs. New York City Employees' Retirement System et al.

The city pension system consists of five pension funds each with separate, independent boards. Three of the pension funds are defendants because they have divested fossil fuel holdings: New York City Employees' Retirement System; Teachers' Retirement System of the City of New York; and Board of Education Retirement System of the City of New York.

They account for 73% of the $243.2 billion in total pension system assets.

Pension funds representing police and fire departments declined to divest fossil fuel holdings.

"While we don't comment on pending litigation, we take our fiduciary duty very seriously," a spokeswoman for city Comptroller Brad Lander wrote in an email. Mr. Lander is the fiduciary for the five pension funds.

"The trustees of all three funds voted in 2021 to exclude fossil fuel reserve owners from their portfolios, in accordance with their fiduciary duty following a deliberative process that began in 2018, with the goal of protecting beneficiaries from the financial risks of investing in fossil fuel reserves," the spokeswoman added.

The plaintiffs are a subway train operator, a former city public school teacher now a part-time teacher in a parochial school, an occupational therapist in a city elementary school and a school secretary in the city's Department of Education.

The latter three are members of Americans for Fair Treatment Inc., an organization that advocates "all public sector employees should have the freedom to choose to join a union or to abstain from joining a government union, an employee association, or other group," according to its website.

The organization, also a plaintiff in the lawsuit against the pension funds, contains information about quitting union membership. "To get started, fill out the form on this page and we will get in touch with you about your best options to leave your union," the website says.

The lawsuit said the three pension funds have divested about $4 billion in fossil fuel holdings, actions initiated in January 2021 during the tenure of former Mayor Bill de Blasio and former Comptroller Scott M. Stringer. Both were term-limited and left office at the end of 2021.

Mr. Lander is "continuing the strategy of using that office to advance an environmental agenda at the expense of retirement security," the lawsuit said.

"In April 2022 Lander announced that the three New York City pension systems had increased their investments in 'climate solutions' to more than $7 billion," the lawsuit said. "For Lander and the trustees, the pension plans are a tool to promote their climate agenda at the expense of plan participants' financial interests."

The lawsuit also attacked the employees and teachers pension funds for their votes earlier in 2023 for adopting a net zero emissions strategy for investments.

Referring to the employees pension fund trustees' vote, the lawsuit said this action "shows just how completely the Trustees have allowed non-pecuniary, climate-related objectives to become the lodestar in their management of plan assets."

The lawsuit accuses the three pension funds of violating New York state common law and insurance regulations. Both require "actuarially funded public retirement systems" to follow "stringent duties of loyalty and care," the document said. "Defendants breached those duties by subordinating the retirement security of plan participants to the trustees' pursuit of a 'green' climate agenda."

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Americans' lack of retirement savings could cost governments $1.3 trillion – Pew

By Margarida Correia
Pensions & Investments
May 12, 2023

As Americans with insufficient retirement savings leave the workforce over the next 20 years, they will severely strain state and federal budgets to the tune of $1.3 trillion, according to a study released Thursday by the Pew Charitable Trusts.

The study estimates that the federal government will get hit with $964 billion in additional costs to fund public assistance programs for financially vulnerable retiree households. At the state level, the cost over the 20-year window between 2021 and 2040 is projected to be $334 billion.

"Many of these retiree households that will have a shortfall in their annual income will need social assistance in one form or another," said John Scott, director of Pew's retirement savings project, during a media briefing on the study.

The study projects that the share of financially vulnerable elderly households — those with less than $75,000 in annual income — will jump 43% to 32.6 million in 2040 from 22.8 million in 2020.

The greater share of people 65 or older struggling in retirement will put greater pressure on public spending and increase taxpayer burdens as the cost of public assistance rises and tax revenues fall, Pew said in the report.

The report also warned that the growth of the older population is outpacing the working age population, putting even more pressure on taxpayers. In 2020, the ratio of senior households to working-age household was 37 to 100, meaning 100 working-age households supported 37 senior households. By 2040, they'll be supporting 54 senior households, according to the study.

"The same share of working-age households will in effect be supporting a growing share of elderly households in the future," Mr. Scott said during the media briefing.

States can help mitigate the projected cost burden by providing state-facilitated retirement savings programs for workers who lack workplace-sponsored plans, according to the report. Eleven states have adopted automated, payroll-deduction programs, which provide "retirement savings opportunities for workers who currently lack them," Mr. Scott said.

Mr. Scott noted that participants in state automated savings programs save an average of $105 to $190 per month, which he said could help alleviate the retirement savings gap.

If financially vulnerable individuals upped their savings by $140 a month it would close the retirement savings shortfall over 30 years and avoid some of the projected state and federal cost increases, Mr. Scott said.

"State-automated savings programs are leading the way to increasing retirement savings opportunities for workers without workplace plans," Mr. Scott said. "That's the hopeful sign to this story."

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Maryland Gov. Wes Moore signs bills aimed at helping veterans and their families

By Sam Janesch
Baltimore Sun
May 12, 2023

In an airport hangar home to the state's Air National Guard, the first veteran to serve as governor of Maryland in 36 years signed into law a half-dozen measures aimed at helping retired and active service members and their families Friday.

The bill signing was Gov. Wes Moore's sixth such event as he moves through the process of finalizing more than 800 bills state lawmakers passed during the annual 90-day legislative session that finished last month.

Deviating from the routine ceremonial signing events at the State House in Annapolis, this group of bills became law with a backdrop of military aircraft and uniformed members of the Army and Air national guards at Martin State Airport in Middle River.

"It's not just that they deserve our support. It's that they've earned it," Moore, a Democrat, said Friday. "We need them to keep serving and to keep calling Maryland home, and the best way to do that is to show our veterans that they're appreciated."

Moore, who served as a U.S. Army captain, sponsored two of the bills on the agenda — one that offers new health care coverage for members of the Maryland National Guard and another that expands tax cuts for retired veterans.

Moore has called that pairing "the most aggressive push" to support those communities in "generations," though lawmakers scaled back the benefits he originally proposed and publicly lobbied for.

The Keep Our Heroes Home Act (House Bill 554 and Senate Bill 553) was one of three bills the governor sponsored and personally testified in support of on two separate occasions during the session.

It will allow Maryland residents earning military retirement income to exempt up to $20,000 of that income from state taxes if they are age 55 or older and up to $12,500 if they are younger than 55. Previous law exempted $15,000 for the older age group and $5,000 for the younger one.

State officials estimate the change will benefit about 33,000 military retirees and cost the state about $11 million in the next fiscal year and slightly more in the following years. Moore's original proposal called for exempting up to $40,000 of military retirement income from state taxes regardless of age, which would have cost the state about $31 million in the first year and $50 million annually afterward, according to an initial legislative fiscal analysis.

The Health Care for Heroes Act (Senate Bill 554), the other Moore-sponsored bill on the agenda, will establish a program to reimburse Maryland National Guard members up to $60 per month for premiums paid under health care and dental plans for its members.

Just 8% of the roughly 5,600 eligible Maryland National Guard members are enrolled in the TRICARE Reserve Select health care plan that's available for certain non-active duty service members and their families, according to a legislative fiscal analysis that estimates the rate could increase to around 15%

and ultimately cost the state about $616,000 per year under the new program. Moore's original plan called for full health care and dental coverage reimbursement.

Four other bills made their way into law as the governor, House Speaker Adrienne A. Jones, Senate President Bill Ferguson and others gathered at the airport Friday.

One of those (Senate Bill 286 / House Bill 480) will require the Maryland Department of Veterans Affairs to provide free burial services to a veterans' spouse or eligible dependent, including a child or parent. The department already covers the burial costs for veterans.

"It helps the families. They want to be buried with their spouse and it gets expensive at times," said Sen. Bryan Simonaire, an Anne Arundel County Republican who sponsored the bill in the Senate.

Simonaire said there was a strong bipartisan effort in Annapolis this year to support military families, and it's especially meaningful that his bill was signed on National Military Spouses Appreciation Day.

The other new laws will require a study be conducted on an existing process that expedites state licenses for military personnel, veterans and their spouses; require state income tax returns to mark a spot allowing a contribution to a trust fund for veterans; and require children with autism who receive care through a state waiver program continue to receive eligible care if the child's family is relocated out of state for military service.

Ferguson, a Baltimore Democrat, called the focus on veterans "strategic" for helping retain the roughly 378,000 veterans who live in Maryland — and who he said own nearly 7,400 businesses — and the nearly 48,000 active military personnel who work in the state.

The General Assembly session ended April 10, and Moore has already signed more than 600 of the 810 bills, including the other top priorities in his own 10-bill package. At least one other bill signing is scheduled before the end of the month, when the governor faces a deadline to sign, veto or let bills pass without his signature.

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