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FORUM

Taking our lives out of their portfolios

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Abstract

Brett Christophers' *Our Lives in Their Portfolios* documents the rising dominance of asset managers in tangible assets that matter to society, such as housing and infrastructure. He rightly describes the social harm of asset managers who focus on short-term wealth extraction from assets that require long-term investment. Where Christophers focuses less is on another structural question raised: why are the financial assets of working people in public and union pension funds managed by these extractive asset managers in the first place? How do we take our lives out of their portfolios?

Keywords: assets; asset managers; corporate governance; pension funds

Introduction

> The picture that emerges of the asset management sector is . . . one of a distinctly centripetal force that takes the profits of real-asset investments and forcefully concentrates them, distributing them disproportionately inwards and upwards, and thus bolstering the wealth of the existing global elite. (Christophers, 2023: 217)

Christophers' detailed and fascinating diagnosis of how asset managers have become central to housing and the renewable energy transition is necessary for several reasons. First, assets under management reached $100 trillion in 2020 and continue to climb. Second, momentum in finance and nonfinancial corporations alike is shifting away from publicly traded equity and toward private markets, where less disclosure has meant less attention from researchers, the public, and policymakers. Finally, trillions of public dollars are flowing for the energy transition that could end up in the hands of asset managers. Christophers (2023: 45) defines asset manager society as one in which 'the wealth of societies . . . appears as an immense collection of investment funds'. Asset managers focused on real assets (as opposed to financial assets) are 'pure rentiers', as their purpose is to extract income from assets and prep them for sale: the goal for an asset manager is asset appreciation over a limited period, not the long-term productivity or income earned from an asset like housing or infrastructure. This makes asset managers the worst kind of owners for an inherently long-term good or service because they have no incentive to make sacrifices in the short term for long-term innovations or even maintenance.

In this forum contribution, I build on Christophers' analysis and point out several policies that would move us away from asset manager society to build new ideologies from the bottom up: through discrete policy proposals as well as a different theoretical framework for understanding the differences between shareholding and investment. We need to widen the aperture and look at where the money is coming from as well as where it is going. To pose my original question in a different way: can we imagine a different method of organizing the financial assets of public pension funds such that they are directed toward investments that serve the true interests of the economic beneficiaries of such funds, as well as the interests of society? As Jim Kane (2023: 105) notes, if we understand what is happening as 'an ideological project to present finance as capable of filling the 'gap' between public investment and public needs', then along with diagnosis, we need to construct an alternative framework that centers the public interest. After describing specific policy mechanisms to change the relationship between the financial assets of public sector workers and physical investment, I also draw attention to the need to end the frameworks that enable asset manager society: the corporate governance paradigm of shareholder primacy and the myth that shareholders are always investors.

The construction of asset manager society

The focus of *Our Lives in Their Portfolios* is on the asset managers that hold assets that are not publicly traded but are our 'most essential physical systems and infrastructure' (Christophers, 2023: 17). Christophers shows that we must understand the business of asset management beyond the management of index funds and financial assets (the focus of other excellent work on asset managers, such as Braun's (2022) analysis of asset manager capitalism). While it does not seem necessary to posit different market segments as more or less important (i.e., the line he is drawing between 'asset manager capitalism' and 'asset manager society' seems too stark to me), the private side of the markets has been neglected. The purpose of the real-world assets that he focuses on is not, for most of us, capital appreciation – housing and physical infrastructure matter for the quality of our lives and our communities. The problem is that asset managers care about selling, not maintaining, our essential infrastructure; the focus is necessarily short term given the setup of the way that funds holding physical assets are managed. The book tells a comprehensive story of the evolution of these major asset managers, including the structure of the funds, the different actors at play, and the fee structures for the compensation of the different players. While Christophers documents in detail the negative impacts of asset managers' extractive practices on housing and infrastructure, it is equally necessary to look at the impact on where the money is coming from: whose financial assets are under management, making purchases in real-world assets? The business model of asset management is simple: they use very little of their own assets to make purchases, instead directing the assets of others, principally institutional funds.

One of the largest types of funds that choose to direct their collective financial assets to asset managers is public pension funds: the money that public sector workers do not get in their paychecks and is instead pooled to provide retirement security for teachers, sanitation workers, and all the other civil servants. Roughly 6,000 state and locally administered public pension funds in the United States provide retirement security for 11.2 million current retirees, with 14.7 million future beneficiaries who are currently working – 14% of the total US workforce (Public Plans Data, 2022). Such funds are clearly critical for the retirement security of the public sector workforce and are sometimes analyzed only from the perspective of financial returns without understanding the feedback loops of how their funds are channeled. Without public pension funds, asset managers would not be able to make the trades that have made them powerful and extractive. Public pension funds in the United States are major pools of financial assets, including $827 billion in the Thrift Savings Plan of federal employees and $4.5 trillion in

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state and local pension funds. The public sector workforce is the only segment of the labor market that maintains nearly universal pension coverage. While private and union multi-employer pension plans are equally consequential, the fact that public pension funds are public money invested through private asset managers is particularly salient when analyzing the extractive practices of asset managers.

To understand the role that they play in Christophers' narrative, it is necessary to identify the policy reforms that enabled asset managers to use these funds for private portfolio projects historically. Public pension funds have transformed over decades from fiscal mutualism to financial assets (Vanatta, 2023).[1] Most public pension fund assets are used to purchase publicly traded equities and bonds, which means that they are bound up in the 'shareholder primacy' paradigm that governs the relationships between production-oriented corporations and the networks of institutions holding and trading equities issued by these companies in the financial markets (Palladino, 2022). Pension funds became central actors in promoting corporate governance to discipline corporate management and focus on shareholder returns (Braun, 2021). It was the rise of modern portfolio theory that caused changes in the understanding of prudence and adjusting of risk across the entire portfolio. This move greatly benefitted asset managers, and 'prudence' became tied to the behavior of the asset manager and fund manager, rather than the perceived riskiness of the asset.

Public pensions shifted into equities only in the 1980s after amendments were made to state pension law (following the 1979 amendment to the Employee Retirement Income Security Act [ERISA], which governs corporate and multi-employer plans), causing the sudden entrance of public pension funds like California Public Employees' Retirement System (CalPERS) into shareholder activism (Gelter, 2013). Ivashina and Lerner (2018) documented a global shift by public and private pension funds into alternatives from 2008 to 2017 totaling $1.8 trillion. Aubry, Chen, and Munnell (2017: 1) analyze how increasing reliance on alternatives has affected fund returns for public pension funds since 2001, finding that 'the performance of pension funds since 2001 has fallen short of actuarial expectations and the increasing reliance on alternatives certainly has not helped'. Allocations to 'alternatives' went from 9% of portfolios on average in 2001 to 34% in 2022 (with some plans holding over 50% in alternatives, while only 5% of plans held less than 10%); they passed fixed income in 2015. Since traditional equities declined in the financial crisis, alternatives appeared more robust, and public pensions moved into them. However, in the decade since then, 'relative to traditional equities, holding ten percent more of the plan's portfolio in alternatives is associated with a 33-basis-point decrease in the return from 2010–2022' (Aubry, 2022: 4).

In addition to the real assets that Christophers focuses on, the broader category of 'alternatives' has had real-world consequences on low-income communities and workers who often make up the same communities and households as public sector workers. Public pension funds are increasingly channeled into private equity funds, despite evidence that private equity does not perform equity traded on public markets while fees are substantially higher.[2] Private equity companies are often highly destructive for the workforce of companies that become part of private equity portfolios (Appelbaum and Batt, 2014). One particularly harmful type of 'alternative investment' is marginalized debt – in other words, predatory subprime debt. As Abbye Atkinson (2022: 773) explains, 'marginalized debt is a valuable investment because its characteristically high interest rates and myriad fees engender higher returns'. The debtors are disproportionately those from historically marginalized communities, whose financial hardship becomes an asset for public sector retirement security.

Taking our lives out of their portfolios

Investment funds and the financial intermediation chain itself are just legal creations, encoded in law like all other 'capital', in the words of Katharina Pistor (2019). Policy reforms that change the scope of decision-making or establish new institutional options can point the way forward. What would reduce the power that asset managers have over our housing and infrastructure and enable us to achieve the kind of decarbonized transformation of our economy that we so desperately need? What would enable public pension funds to support both the retirement security and the need for a strong social infrastructure that public sector workers need? Here, I focus on two discrete areas for reform in the US context: how our community infrastructure is constructed by refocusing on public ownership and public options for housing and utilities and changing how public pension funds are managed by establishing a public asset manager. In the final section, I suggest the broader need to end shareholder primacy as the way in which we understand the relationship between productive activity and the financial sector and acknowledge the myth that shareholders are always investors (Palladino, 2022).

One way to reduce the power of private asset managers is to publicly own our social infrastructure, either fully or by establishing public options for sectors like housing and infrastructure. Public ownership has a long history in the United States and is more common than many realize, though decentralized control of publicly owned entities means that the United States does not have the same kinds of nationally controlled state-owned enterprises or federal public equity stakes that exist around the world (Hanna, 2018; Palladino, forthcoming). Publicly owned utilities provide a significant proportion of the nation's electricity, and water systems are municipally owned throughout the United States. Sectors like housing should see the establishment of public options for social housing available to all alongside market-based housing provision. As described by Paul Williams (2021), the only way to solve America's structural housing crisis is for the public sector to 'become the developer' to plan, spend, and build our way out of the crisis.

Utilities – and particularly energy generation, transmission, and distribution, which must transition quickly to renewable energy – are a good example of a sector that should be fully or majority publicly owned and for which private asset managers should be taken fully out of the equation. Currently, the investor-owned companies that comprise a portion of America's electricity network have prioritized shareholder payments over the renewable energy transition; such companies have made $250 billion in payments to shareholders, mainly in dividends, which is 86% of the industry's earnings (Lusiani, 2022). Publicly owned utilities have a long history in the United States, with the Tennessee Valley Authority being perhaps the most famous example – a central New Deal project that continues to provide power to 10 million Americans (and over half of its workforce is unionized). Organizers have been developing proposals for new public ownership: for example, the Climate and Community Project has proposed the Federal Public Power Program. This program would 'inject straightforward, public investment into the electricity system' (Bozuwa et al., 2023: 7). Rather than tweaking the incentives for private asset managers, as the tax incentives in the Inflation Reduction Act focus on, the real solution to asset manager society is to make our infrastructure a public system.

A more specific way to directly counter the extraction by private asset managers would be to establish a public asset manager that would serve public pension funds and serve as a public option for asset management for other financial asset pools (Palladino, 2023). A public asset manager could enable public pension funds to channel their financial assets toward *socially useful* investment because its fiduciary duty under law would be to serve the public interest, rather than to maximize profits for its shareholders.[3] Asset managers exert control-based power in nonfinancial corporations due to their holdings of the publicly traded financial instruments that these companies issue and the corporate governance

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framework of shareholder primacy. Just a few asset management companies manage nearly all passive equity funds in the United States and act as a quasi-public regulator toward the companies whose assets they hold (Lund, 2021). Instead of ceding the crucial role of intermediation between large pools of financial assets, what gets built in the real world, and how it is managed, a public asset manager could act to ensure the interests of society and that public pension fund beneficiaries are being served, rather than for-profit private financial institutions. While there is plenty of complexity of institutional design for a public asset manager, it would not face the conflicts of interest and motivation to sell rather than strengthen the assets that it manages. It could even choose to invest in physical projects like housing and infrastructure that have tangible social benefits.

What kinds of projects could we imagine under a scenario where a public asset manager focused on the actual interests of public pension fund beneficiaries? Union pension funds have for decades channeled financial assets into socially useful investments that often also benefit their members. Unions in New York City were once the leading developers of co-op housing, of which 40,000 units that still stand today, such as Penn South, Amalgamated Housing, and Amalgamated Warbasse, built by the United Housing Foundation and the Amalgamated Clothing Workers Union (Forman, 2018). The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) launched the Building Investment Trust in 1988 to 'provide a vehicle for qualified pension funds and retirement plans to invest in commercial real estate', all of which is built with union labor (Heartland Network, 2020). The International Brotherhood of Electrical Workers (IBEW) pension plans invested more than \$6.25 billion in nearly a thousand real estate projects from 2012 to 2020, which resulted in \$3.9 billion of income for construction workers in wages and benefits. The main defense given for the centrality of private asset managers is that they have unique expertise as market actors to understand these complicated deals and investments. Yet a public asset manager could build its own expertise in conjunction with the areas of the government that already contain deep sectoral knowledge.

Moving beyond the myth that 'shareholders are always investors'

The final point to make in response to this excellent book is more in the spirit of building an alternative theoretical framework to support the policies proposed above. Christophers' argument directly points out the harms of extractive asset managers but does not directly take on shareholder primacy as the operating model for the economy. Shareholder primacy fundamentally misunderstands the purpose of productive assets by centering the shareholder as the recipient of the gains from productive activity (Lazonick, 2018; Palladino, 2021). This myth is so powerful in the United States because we have built our retirement security around it (Palladino, 2022). Though it is normally associated with publicly traded corporations, this ideology shapes the entire economy and is so deeply embedded that it can be hard to see. Shifting our economy away from shareholder primacy requires centering productive activity and understanding the social conditions that enable innovation (Lazonick, 2018). It also requires being precise with our language and distinguishing between investment that serves a socially productive purpose and shareholding, which can be done solely for purposes of asset appreciation for the shareholder, regardless of whether the underlying asset is built up or destroyed (Palladino, 2022).

Purchasing real assets for the sole purpose of selling them for a higher price by reducing costs is not an actual investment: how is it an investment to buy something that already exists and simply make it worse? The asset manager can control the asset without actually improving it or investing in it in a productive sense. Yet control is not an investment.[4] One place where this is clear in the sectors on which Christophers is focused

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is in the distinction between 'greenfield/brownfield' assets and 'secondary' assets. In the case of the latter, asset managers are simply purchasing existing assets, which does not have a productive impact and should not be seen as an investment. Still, I would push Christophers and all readers of his book to go further and see that unmaking asset manager society requires undoing shareholder primacy as the operating principle of our society.

Notes

1. There is also a debate as to whether public pensions are underfunded, as the actuarial methods for determining funding ratios are contested (Sgouros, 2018).
2. Research by Begenau and Siriwardane (2022) shows that fees paid to private equity by public pension funds vary widely, which in their analysis is based on observable factors of size and experience but also unobserved factors such as bargaining power.
3. Public pension funds and private asset managers should also change their fiduciary duties. I have written about this elsewhere (Palladino and Alexander, 2021).
4. Christophers (2023: 26) quotes Stephen Schartzman, CEO of Blackstone, to illustrate why it is desirable to own firms outright: 'you have complete control'.

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