

## Conference on Public Pension and Sovereign Funds

*The fifth annual conference of CJEB's Program on Public Pension and Sovereign Funds*

*Live Webinar*

*Day 1: November 4, 2020*

*Day 2: November 19, 2020*



*David E. Weinstein, Takatoshi Ito, Keiko Honda*

*This conference was held on background according to the Chatham House Rule; the following summary is primarily without attribution.*

In response to the COVID-19 pandemic, the fifth annual Conference on Public Pension and Sovereign Funds (PPPSF) was held virtually across two days. The first session, titled “Pension Funds and ESG Investing,” was held on November 4, 2020, and the second session, titled “Public Pension Funds in the COVID-19 Era,” was held on November 19, 2020.

On November 4, 2020, Professor David E. Weinstein, director of the Center on Japanese Economy and Business (CJEB), welcomed attendees to day one of the PPPSF conference and introduced Takatoshi Ito, professor at Columbia University’s School of International and Public Affairs (SIPA) and Director of the PPPSF, as well as the day’s speakers—Doug Peterson, President and CEO, S&P Global, and Anita George, Executive Vice-President and Deputy Head, CDPQ Global.

Professor Ito briefly explained the functions of the PPPSF. An aging population puts stress

on public pension systems; therefore, many countries are reforming public pension funds in order to finance future shortfalls in pension contributions. The PPPSF does research on Japan's Global Pension Investment Fund (GPIF) and other economies. Since 2013, GPIF has improved its organizational structure and developed a more sophisticated portfolio strategy, serving as a model for restructuring other pension funds in Japan and in other economies.

Professor Ito then turned it over to moderator Keiko Honda, Adjunct Professor and Adjunct Senior Research Scholar, SIPA; and Former CEO of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group.

### **Day 1: Pension Funds and ESG Investing**

Ms. Honda began with a brief overview of environmental, social, and governance (ESG) investing. She stated that so far, there is no agreed-upon definition of ESG investing, so she proposed the following: through ESG investing, investors aim to create higher financial returns by mitigating risks and unlocking opportunities by analyzing ESG factors. The Global Sustainable Investment Alliance attained data that showed Europe, the United States, Canada, Japan, Australia, and New Zealand had invested a total of \$30.7 trillion in ESG investing by the end of 2018, making it one of the fastest-growing areas in finance. Forty-eight percent of financial institutions interviewed by Ms. Honda responded that they are interested in ESG investing because they are seeking excess returns from ESG. Seventeen percent said that they are responding to stakeholders' expectations. Thirteen percent responded that they are preparing for upcoming regulatory changes. Nine percent responded that they are responding to customer or client demands. The two most prominent challenges that ESG investing faces are data

availability/accuracy/comparability and potential for ESG greenwashing. These responses aligned across European, American, and Japanese respondents.



*Anita George, Doug Peterson*

Ms. Honda then introduced panelists Anita George and Doug Peterson. The speakers first discussed how pension funds are engaging in ESG investing. One panelist responded that ESG investing is core to their organization's investment thesis and that their organization has been at the forefront of responsible investment since its founding. They have a dedicated team that looks at the ESG aspects for all investments. This team's input is central to the investment decisions made by their organization. One focus is on reducing carbon emissions from their portfolio by 25% by 2025 and increasing green investments by 80% by 2020. Currently, their organization has more than doubled clean investments and is leading a group of institutional investors referred to as the Investor Leadership Network. The Investor Leadership Network focuses on climate change, diversity, and inclusion, as well as increasing the capacity of infrastructure capability and expertise, especially for emerging markets. This is part of the stewardship that they have undertaken to ensure that other institutional investors focus on ESG factors.

The other panelist began by explaining that ESG investing is for long-term investments.

Pension systems invest in assets for the long term. Because of this, pension systems return capital to the economy over a long time horizon. A question that has been investigated for about 10 to 15 years in Scandinavia, and only more recently in Japan and the U.S., is: What are the long-term impacts of ESG factors on a pension system? The social factors are of interest, especially during the COVID-19 crisis. For example, asset owners are questioning asset managers about how their portfolio investment companies are treating their employees or supporting their communities. Climate and carbon initiatives have been around for many years, but there is increasing interest now. Therefore, ESG screens are becoming more important because investors are looking for sustainable approaches.

Ms. Honda then asked if ESG investing is in line with the fiduciary duty of pension funds. One panelist responded that ESG investing benefits everyone because they provide a stable and reliable return. Mainstreamed ESG strategy has the ability to provide better outcomes. ESG factors have the potential to benefit economies and society through investments in smart infrastructure projects.

Ms. Honda proceeded to ask one of the panelists how their company is supporting asset managers and asset owners conducting ESG investing. The panelist responded that their company's credit rating agency incorporates ESG factors into its ratings and now provides an ESG evaluation that looks at a company's or organization's ability to be prepared for the future based on an ESG approach. The company has also launched a special ESG index, which addresses the need for an index that incorporates ESG values while offering benchmark-like performance.

Ms. Honda then asked about the challenges of creating and managing an ESG index. One

speaker responded that the index team works behind a firewall and uses a clear and reliable criterion in combination with data and analytics in order to create the ESG index. The panelist noted there is growing demand from investors for ESG data and products while the trend toward passive investing continues.

The speakers moved on to discuss how they view initiatives to standardize data disclosure surrounding ESG investing. One panelist responded that it is promising that public and private organizations have started to talk to each other to align the way they think about standards, noting that the International Organization of Securities Commissions (IOSCO) is also looking at global standards on securities disclosure. The panelist encouraged investors to voluntarily disclose ESG data in order to promote the open sharing of such data.

Another panelist shared that their organization is already voluntarily disclosing many different aspects on many different parameters using already existing measures such as the Task Force on Climate-related Financial Disclosures (TCFD) and the Principles for Responsible Investment (PRI). Additionally, they are trying to encourage similar institutions to do the same, believing that in the very near future, they are going to see more and more institutions follow similar ESG standards.

Ms. Honda then asked the speakers to comment on the pros and cons of making data disclosure mandatory versus voluntary. One panelist responded that the exact E, S, and G standards are not clear, though there are many organizations that are doing this work. Asset owners are the ones that are looking for this information, and their pressure will push funds and companies to disclose more ESG information. That panelist believes that between the private

sector and the practice of voluntary disclosure, there will be an ecosystem that will move faster than the process of a government creating standards of mandatory disclosure. The other speaker added that one future step could be to come up with an internationally acceptable taxonomy that will allow investors the ability to measure, monitor, and compare standards.

The final point of discussion on day one of the PPPSF conference was whether the purpose of big corporations is changing. One speaker noted that according to the Business Roundtable, the purpose of a corporation has shifted to take a wider range of factors into consideration with the goal of having a sustainable organization. The other panelist added that many companies could no longer only focus on their bottom line, but they need to go beyond that. Company purpose will play a key role in attracting and retaining high-quality talent from the younger generation.

Ms. Honda concluded day one of the fifth annual Conference on Public Pension and Sovereign Funds by thanking the panelists and audience for their time and participation, and thanking CJEB sponsors for their continued support.

## **Day 2: Public Pension Funds in the COVID-19 Era**

On November 19, 2020, Professor Ito welcomed participants and attendants to day two of the fifth annual Conference on Public Pension and Sovereign Funds. This session addressed macroeconomic conditions and challenges that public pension funds have been facing because of the COVID-19 pandemic. Professor Ito briefly explained why he organized this panel—specifically to investigate the concept of “low for long.” Due to consistently low interest rates and the resulting “lower for longer” macroenvironment, long-term investors, such as public

pension funds, find it difficult to manage their portfolios to achieve their desired returns.



*Dr. Catherine L. Mann, Masataka Miyazono, Geoffrey Rubin, Ángel Ubide*

Professor Ito then introduced each of the panelists. Dr. Catherine L. Mann is the Global Chief Economist at Citibank. Masataka Miyazono is President of Government Pension Investment Fund (GPIF). Geoffrey Rubin is Senior Managing Director and Chief Investment Strategist at CPP Investments. Ángel Ubide is a Managing Director and Head of Economic Research for Global Fixed Income at Citadel.

One panelist began by describing the current shape of the global economic outlook and the current strategy for recovery. Additionally, they spoke about the potential risks associated with “low for long.” Current projections show the United States and China getting out of the “COVID hole” in fairly good time—China is anticipated to reach this benchmark in Q3 of 2020, and the U.S. is expected to reach this benchmark in Q2 of 2021. Other countries are expected to take longer—Japan will reach this in Q2 of 2022, Europe Q3 2022, Mexico Q4 2024. This shows a weakening of global prospects.

This panelist went on to discuss if the economy was projected to rebound or recover. Rebound simply meant a definite increase, while a recovery meant that losses would be recovered as well. The speaker explained that while retail sales and industrial production had

increased in the months following the initial onset of the COVID-19 pandemic, it was not sufficiently robust to recover what was lost during the time of decreased sales and production.

The panelist continued by discussing the three potential financial risks of “low for longer.” The first is that while many companies can be lean for the coming months, the macroeconomic implication is that not all companies can operate in that way for an extended period. The second risk is in regards to bonds. There are currently a rising number of outlook negative bonds. These outlook negatives could translate into downgrades, and those downgrades will fall out of investment portfolios. This could later affect the exposure of portfolios that are not allowed to carry high-risk or high-yield bonds. And finally, while there was a collapse in GDP, house prices are on the upturn, resulting in a disconnect. There are people moving out to the suburbs, but also high-income earners are using excess income to buy houses.

The next panelist spoke of public pension funds in the COVID-19 era as they relate to Japan’s GPIF, specifically, the three-tiered nature of Japan’s public pension system. While there are multiple predicted scenarios for Japan’s public pension fund over the next 100 years, many scenarios demonstrate that the reserve fund will not be spent down in the next 50 years or so.

While COVID-19 is still ongoing, the economic impacts of this pandemic are slowly becoming clearer each day. Therefore, careful market monitoring should be done to measure the evolving situation. Alternative assets have different risk-return profiles from traditional assets such as listed equities and bonds and are less affected by price volatility in the public market. In consideration of these profiles, the inclusion of assets in GPIF’s portfolio is expected to improve investment efficiency and contribute to the stability of pension finance.

Because of its very large fund size and widely diversified portfolio, GPIF considers itself to be a universal owner. Additionally, because it has an investment horizon of as long as 100 years, it considers itself a cross-generational investor. Therefore, ESG considerations are vital to ensure the portfolio's viability over a long period.

Another panelist discussed three key ideas. The first was the importance of fundamentally expressing the organizational needs of funds in context. Specifically, how can you manage pension funds over a long horizon without undue risk? The “low for long” thesis is a vital one for organizations that want to maximize growth over a long period. “Low for long” is a challenge for developed economies, but emerging markets have brighter growth prospects. The second point made by the panelist was regarding diversifying the role of developing market government bonds and fixed income. The panelist believed that there is an opportunity to get both return and diversification at a fixed income profile, but it is going to take more work and require more agility than the G7 bond bucket. The final point the panelist made was in regards to the performance and real assets of the portfolio at their organization. Real assets have remained an important part of their organization’s portfolio over a long period of time because they provide diversification to listed equities. They also have exposure to rates because of their predictable cash flows. However, the panelist also emphasized that even predictable real assets are subject to variability, especially during the COVID-19 pandemic.

Another panelist spoke on how hedge funds have to be more alert to the near-term trends than the aforementioned pension funds, noting that pension funds must also be aware of mid-term trends on the horizon. They then provided an overview of how they see the world in the

very near term, as well as the next three to five years, and the implications of that. The speaker explained that their position is not that the economy has recently undergone a recession but rather an induced economic coma. Therefore, when economies reopen in the summer, if the correct economic policies are in place, the consequences of the coma will not be too large.

This can be seen in the stronger than anticipated rebound in European economies in the summer of 2020. One of the near-term trends that are being watched closely is the development of COVID-19 vaccines. With multiple vaccines, there is a diversified risk of failure. Vaccines could lead to significant economic reopening by summer 2021. The panelist added that increased monetary policy and fiscal activism have led to the conditions for a strong rebound coupled with low inflation. The environment is such that risky assets can do quite well over the next few years, but fixed income is going to be reasonably stable.

Professor Ito then transitioned to the Q&A portion of the event, asking the speakers how they were accounting for the prospect of a K-shaped recovery and residual structural changes resulting from the pandemic. One panelist responded that the residual structural changes would lead to a loss in GDP compared to the projected trajectory from January. The burden of lost GDP is similar to that of the global financial crisis (GFC). The loss of GDP during the GFC led to a step down in investment rates, lower productivity growth, a stall in globalization, and rising inequality within and across cohorts. The panelist went on to explain that while a vaccine could be on the horizon, it is unlikely to be adequately distributed by the summer of 2021 in order to recover the economy sufficiently. Additionally, these structural changes will likely have a significant burden on a younger generation who will be struggling to contribute to a federal pension plan and federal

and state taxes. The bottom line is that the productivity numbers encapsulate a lot of the structural slowdown, even within a K-shaped recovery.

Another speaker disagreed with the previous panelist's response in two ways. They stated that policies that are currently in place would help minimize the long-term effects of this problem. However, they noted that there needs to be an effort to understand the structural and fiscal policies of each country.

Professor Ito then asked another panelist if they still expected COVID-19 to be a short-term experience or if they sensed a structural change that they wanted to adapt to have a different trend. The panelist responded that they did agree with the analysis of a K-shaped recovery discussed by both previous panelists, as this would allow for some organizations to diversify in a way to potentially avoid the "bottom leg" of the K. The panelist presented the recent Asian regional trade pact as one example of how a regional trade block could continue growing in ways that are less affected by a deglobalization trend or an east-west trade construct. They continued, explaining that productivity growth is a longer conversation that underpins what long term investors need to appreciate as they build out their portfolios over time. Therefore, they explained, coming out of COVID, attention will need to be paid to productivity rates in both established and emerging markets.

Professor Ito then asked a speaker how they see and adapt their portfolio to the "low for long" environment. The speaker responded that first and foremost, they should follow their preset asset mix of 25% foreign equities, 25% domestic equities, 25% foreign bonds, and 25% domestic bonds. Additionally, because they have a long investment horizon, they would prepare

to play their role in the Asian finance system, and since alternative assets are long-horizon assets, they are expected to make use of their position as a long-term investor.

Professor Ito asked a different panelist if they had views on private equity infrastructure alternatives and how public pension funds should look at them. The panelist responded that they required a large amount of due diligence from the managers. That being said, alternatives were expected to be a significant part of an investment portfolio because interest rates would be low, and they interacted with policy.

Professor Ito posed a final question regarding how we should think about fiscal policy as government debt piles up, especially as it relates to their need for revenue going forward. One speaker responded that we need to consider both debt and GDP. Specifically, fiscal policy needs to shift from being seen as a “life preserver” to being used as a strategy that incentivizes the private sector to undertake capital investment.

Professor Takatoshi Ito concluded the second night of the fifth annual Conference on Public Pension and Sovereign Funds by thanking CJEB sponsors for their support, as well as panelists and the audience for their time and participation.