PERSist

The Voice for Public Pensions

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NCPERS Message

Public Pension Funding Ratios Increased in 2022, NCPERS Study Finds

Public pension funds' average funding ratio increased to 77.8 percent in 2022, with nearly 70 percent of pensions' revenue coming from investment returns, according to an annual study conducted by NCPERS.

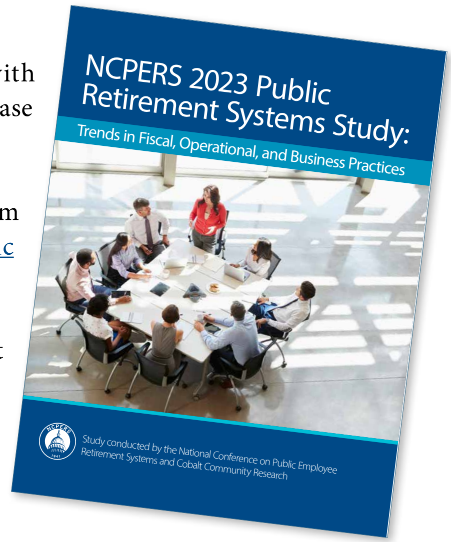
Now in its 12th year, NCPERS 2023 Public Retirement Systems Study: Trends in Fiscal, Operational, and Business Practices provides a benchmark for public retirement systems while tracking funds' fiscal conditions. A record 195 state and local government pension funds responded to the survey, which was conducted in the fall. These funds represent more than 19.6 million active and retired members with combined assets exceeding $3 trillion.

Public pension funds saw, on average, one-year returns of around 11.4 percent, down from 14 percent the year prior. Looking at asset allocations, real estate and private equity saw the largest average returns, at 19.2 and 33.7 percent respectively. There was not a significant shift in asset allocations year over year.

The study's findings highlight public pensions' resiliency in the face of volatile markets, rising interest rates, and disruption in the workforce during the COVID-19 pandemic. Despite the many unprecedented challenges that public pensions have faced in recent years, fund confidence remains high. Surveyed funds were asked, "How satisfied are you with your readiness to address retirement trends and issues over the next two years?" The average rating was 7.8 on a 10-point scale, down only slightly from the year before.

In addition to the report, an interactive dashboard (login required) is available exclusively to NCPERS members. Pension funds can use this tool to filter survey data in a number of ways to compare their performance, assumptions, and expenses to peer groups. Watch a tutorial here to take full advantage of the dashboard's features.

If you need assistance with your login credentials, please contact info@ncpers.org.



Among the key findings from the NCPERS 2023 Public Retirement Systems Study:

- The average investment assumed rate of return for pension funds was 6.86 percent.
- Both administrative and investment expenses were higher than the year before, with the average expense for all respondents increasing to 64 basis points.
- While investment returns are by far the most significant source of pension fund revenue at 68 percent, the average member and employer contributions each rose by one percentage point to 9 percent and 24 percent respectively.
- The aggregated average cost-of-living adjustments (COLAs) offered to members was 2.0 percent, which was slightly above the 1.7 percent COLA offered the year before.
- About 54 percent of the funds that participated in the survey said that environment, social, and governance (ESG) factors are somewhat or very important in their investment decisions.

Last month, NCPERS hosted a webinar to review the key findings. Watch on demand for additional insights from the study's lead researcher, William SaintAmour, Executive Director of Cobalt Community Research. ◆

In This Issue

Ready or Not – Revised ASOP No. 4 Is Here

By: Piotr Krekora, ASA, EA, FCA, MAAA, PhD, GRS Consulting

The Actuarial Standards Board (ASB) provides guidance regarding appropriate actuarial practice for a broad range of actuarial services through a series of Actuarial Standards of Practice (ASOPs), including actuarial services related to pension and retiree group benefit obligations. In December 2021, the ASB adopted revisions to ASOP No. 4 entitled *Measuring Pension Obligations and Determining Pension Plan Costs or Contributions*. The revised standard is effective for any actuarial report with a measurement on or after February 15, 2023 that is issued on or after that date.

Actuarial practice is constantly evolving with changing needs of users of actuarial services and changing environments in which those services are performed, which is particularly evident in the area of retirement practice. This evolution has been reflected through multiple revisions to ASOP No. 4, first adopted in 1990 under the title "Recommendations for Measuring Pension Obligations".

For public plans, the most recent ASOP revisions can be placed in two categories: (1) Low-Default-Risk Obligation Measure (LDROM) calculation and disclosure, and (2) other revisions.

LDROM had already garnered considerable attention both within and outside the pension actuarial community. It can be thought of as the value of the plan's liabilities using an interest rate, or rates, derived from low-default-risk fixed income securities. In terms of the current practice, this would be a liability determined for a plan investing all its assets in such securities. This disclosure needs to be accompanied by commentary to help the intended user understand the significance of LDROM with respect to the funded status of the plan, plan contributions, and the security of participant benefits. The rationale for the LDROM disclosure was included in the ASB's transmittal memorandum to the revised ASOP No. 4:

The ASB believes that the calculation and disclosure of this measure provides appropriate, useful information for the intended user regarding the funded status of a pension plan. The calculation and disclosure of this additional measure is not intended to suggest that this is the "right" liability measure for a pension plan. However, the ASB does believe that this additional disclosure provides a more complete assessment of a plan's funded status and provides additional information regarding the security of benefits that members have earned as of the measurement date.

Other ASOP revisions of significance and interest to public plans are the calculation and disclosure of a reasonable actuarially determined contribution, additional considerations regarding amortization policy, and additional assessments of the implications of the plan's funding policy. These new requirements are generally intended to promote good actuarial practices and as such should not affect many public plans significantly as their reports may already comply with many of the other ASOP No. 4 revisions.

LDROM had already garnered considerable attention both within and outside the pension actuarial community.

While it is difficult to determine if the new requirements were shaped or influenced by comments from parties outside the actuarial profession, many revisions were inspired by a desire within the actuarial community to better address various types of risks affecting retirement systems (although ASOP No. 4 does not directly require risk assessment disclosures). As actuaries begin implementing the new requirements during the upcoming valuation season, many trustees and stakeholders will scrutinize the new information in their reports. Careful communication and commentary will be critical to meeting the goal of helping the intended users better assess long-range health of their retirement systems. ◆

Note: The views expressed in this article are those of the author.

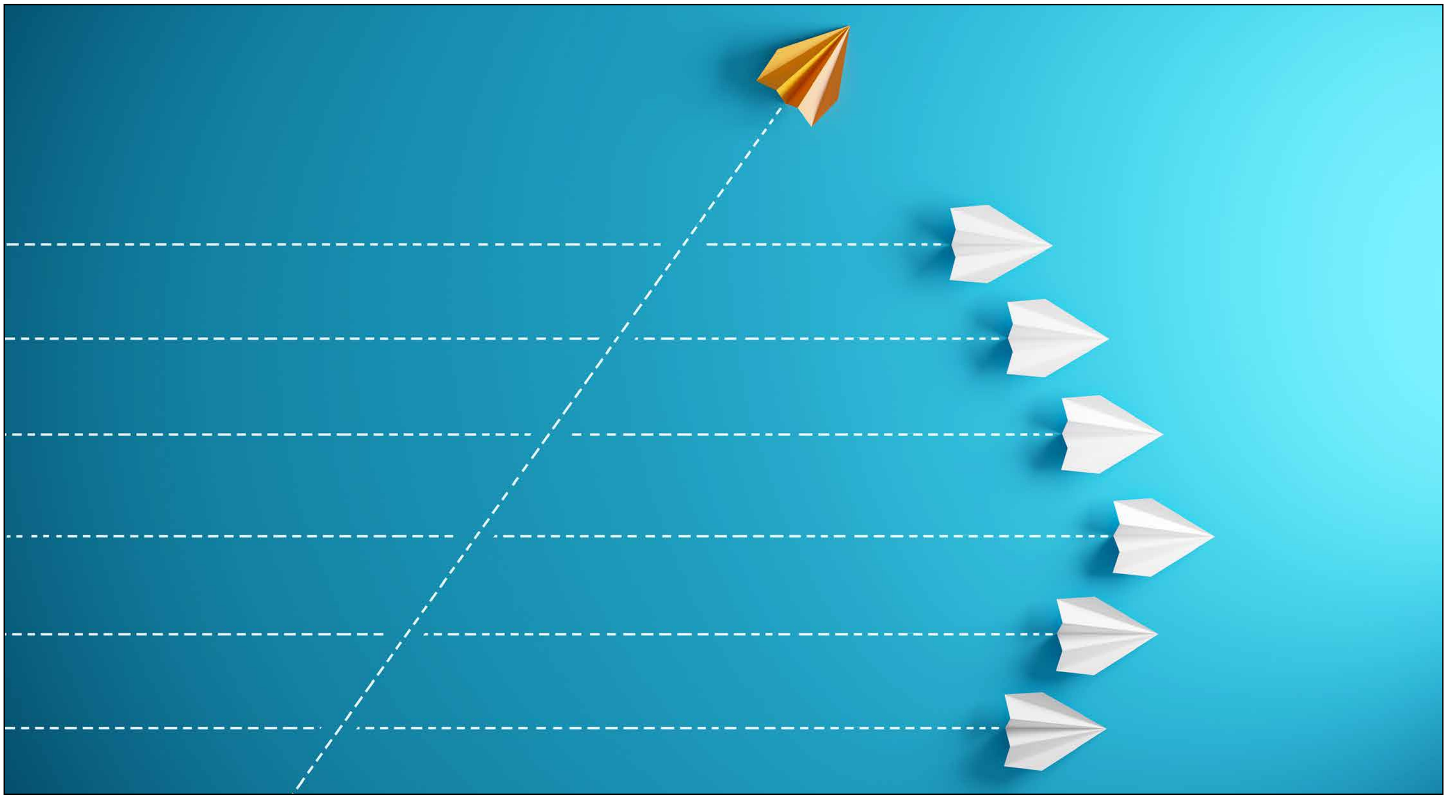
__Piotr Krekora, ASA, EA, FCA, MAAA, PhD__ is a Senior Consultant in GRS' Fort Lauderdale, Florida office with more than 15 years of actuarial and consulting experience.

Piotr is a member of the GRS Office of the Chief Actuary. In this capacity, he provides strategic thought leadership to public sector clients as well as ensuring that service is being provided at the highest level by all GRS employees.

Piotr's actuarial expertise covers all aspects of public sector pension and retiree health plan design and operation, including pension and OPEB valuations, asset simulation and cash flow studies, pension and retiree health care studies, cost analyses of proposed plan changes, liability and contribution projections, and designing and implementing cash balance plans as well as other alternative designs.

Navigating a Paradigm Shift

By: Bryant VanCronkhite, CFA, CPA, Allspring Global Investments



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What is the biggest risk that equity investors face today?

In my view, the most underappreciated development for equity markets today is the paradigm shift that has taken place in monetary policy following the pandemic. The Federal Reserve has a dual mandate of supporting price stability and full employment. Other central banks have similar competing objectives. The fundamental challenge today is that pursuing both goals will require increasingly different policy prescriptions going forward. Something will have to give, and I think this fact is still dawning on markets.

What changed? In the decades leading up to the pandemic, inflationary pressures created by massive liquidity injections and ultra-low interest rates were offset by deflationary megatrends, such as the offshoring of production to low-cost centers. Today, some of the deflationary trends related to globalization have been reversed, and markets are now coming to terms with structurally higher prices and a growing recognition that central banks may be unwilling or unable to step in and spur growth as they had in the past. Everyone is talking about this now, but I think few have fully comprehended the end game.

In my view, the most underappreciated development for equity markets today is the paradigm shift that has taken place in monetary policy following the pandemic.

So how does this shake out?

There are many zombies masquerading as viable businesses that will soon be exposed as growth inevitably slows in 2023. To see why, consider that the prescription for survival in this environment is the ability to relocate supply chains, secure scarce energy supplies, and invest in further automation and efficiency solutions that can sustain production. These are all costly investments that only companies with financial strength can make. Second, companies will need to raise prices to protect margins and sustain free cash flows, and only companies that hold a strong competitive position will have the ability to do so. The upshot is that, sooner rather than later, you will likely see a growing stratification of markets into winners and losers.

There are many zombies masquerading as viable businesses that will soon be exposed as growth inevitably slows in 2023.

How should equity investors respond?

Active approaches will likely present a much stronger value proposition to investors going forward. Many of the factors that allowed weak companies to keep pace with better-run companies in the years leading up to the pandemic also allowed broad index-tracking strategies to flourish. Everyone won in that environment, which diminished the importance of individual stock selection. Today, that dynamic has flipped. As fundamentals take the leading role in driving return dispersion, I think investors can respond by allocating to investment strategies that actively exploit divergence in fundamentals.

As for our brand of active management, we have long discussed how balance sheet strength foretells the level of flexibility a company has to react to change—to make accretive acquisitions and capital expenditures, invest in research and development, or generate yield by returning cash to shareholders. We use our process to gain confidence in a company's competitive advantage; to ensure it has the willingness and ability to raise prices to offset increased investment needs; and to determine it is making the right investments that will allow success and separation from the pack over the next one, three, or five years. This focus has served us well in prior market cycles, and I think it will do so again in the face of the structural challenges I described. ◆

Disclosures:

Bryant VanCronkhite *is a managing director, co-team leader, and senior portfolio manager for the Special Global Equity team at Allspring Global Investments. Prior to this, Bryant was a senior research analyst on the team, which he joined in 2004 before the acquisition of Strong Capital Management. He began his investment industry career in 2003. He earned a bachelor's degree and a master's degree in professional accountancy from the University of Wisconsin, Whitewater.*

How to Prepare for Your New Pension Administration Solution

By: Laurie Mitchell, Tegrit Software Ventures, Inc.

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Replacing or reinventing your pension administration solution (PAS) is a significant undertaking for any sized pension plan. It is both a financial burden and a source of stress for staff that typically lasts several years. Being fully prepared before you begin can reduce stress, cost, and delivery time. Here are a few pre-RFP activities that will help your staff and your vendor be successful sooner:

1. Evaluate the condition of your data – is it accurate? Current? Do you have multiple, fugitive data sets that need to be combined? Depending on what your evaluation shows, you may want to hire a data management vendor to cleanse your data before starting the project. Your data vendor will need about six months effort before your PAS vendor can start.

2. Decide which subject matter experts (SMEs) will support what types of functionality (e.g., wages, service, payroll, member statements, etc.). Ensure that your SMEs fully understand their current processes, are aligned with the leadership in terms of how much change to the current processes you are willing to tolerate, and are authorized to provide candid feedback during requirements review. When SMEs are empowered to make decisions, the requirements process moves faster.

Being fully prepared before you begin can reduce stress, cost, and delivery time.

3. If current processes are not documented, write them down. This doesn't need to be extensive; it just needs to be articulated clearly so everyone understands your 'As Is' process. This avoids the need for your vendor to affirm the As Is with your SMEs before starting on the 'To Be' process.

4. Collect, review and update the forms and letters that you send to your members regularly, including your Member Statement. Think about what you like and don't like about these letters before you enter requirements gathering.

5. Consider budgeting for temporary staff who can step in behind your permanent staff and keep the wheels on the current bus while your permanent staff builds the new

bus. This is most helpful during requirements gathering. Knowing their customers are being served gives your staff relief and allows them to focus on the new work without being overwhelmed. Your staff will be grateful that you considered their wellbeing and will be able to focus better on your new solution.

6. Ensure that there is time and space reserved for collaboration. This would be a room/area (physical or virtual) that is set aside for team members to gather as needed to look at a design, discuss a requirement or document an issue.

7. Plan for milestone celebrations. For example, when a major release is deployed, take time to celebrate all the hard work with the project team (your internal staff, your consultants and your vendor). That brief pause before starting the next phase lets the team recognize their collective accomplishments. Celebrating together supports healthy team dynamics and fuels collaborative energy.

8. Change management is critical for success. Help your team adapt to new processes and the new system by scheduling frequent hands-on opportunities to view and play with the new system. Your staff – even those who aren't involved in the new development – will feel more engaged and more enthused about the project when they can touch it regularly. It would be ideal to plan for this time at the start of your project and announce it to your staff so they know their concerns were considered from the beginning.

9. COVID and other viral illnesses will remain a challenge for on-premise activities for you and your vendor. Ensuring that you have the equipment necessary for your team members to conduct project work remotely is ideal and could avoid a project delay while equipment/training is established. ◆

__Laurie Mitchell__ has worked in the pension industry since 2003 when she joined the Michigan Office of Retirement Services. There she served in many roles, including leading portions of their pension replacement project, and served eight years as their Customer Service Director. After retiring, she joined Tegrit where she brings an agency perspective to their RFP responses and project implementations.

Five-Year Market Outlook: How Slow Growth Transitions and Inflation Recalibration Impact Pension Plans

By: Bob Parise, Northern Trust Asset Management

With below-average returns expected over the next five years, getting asset allocation right will be paramount in maintaining funded status. We expect slower economic growth and higher interest rates to result in below-average five-year returns for most asset classes used by pension plans (**Exhibit 1**). Equity returns are challenged by a lower valuation ceiling and profit margin compression because of higher interest rates. Below-average returns would create hurdles for pension funds looking to build cost-efficient, lower-risk portfolios with adequate performance over the next five years.

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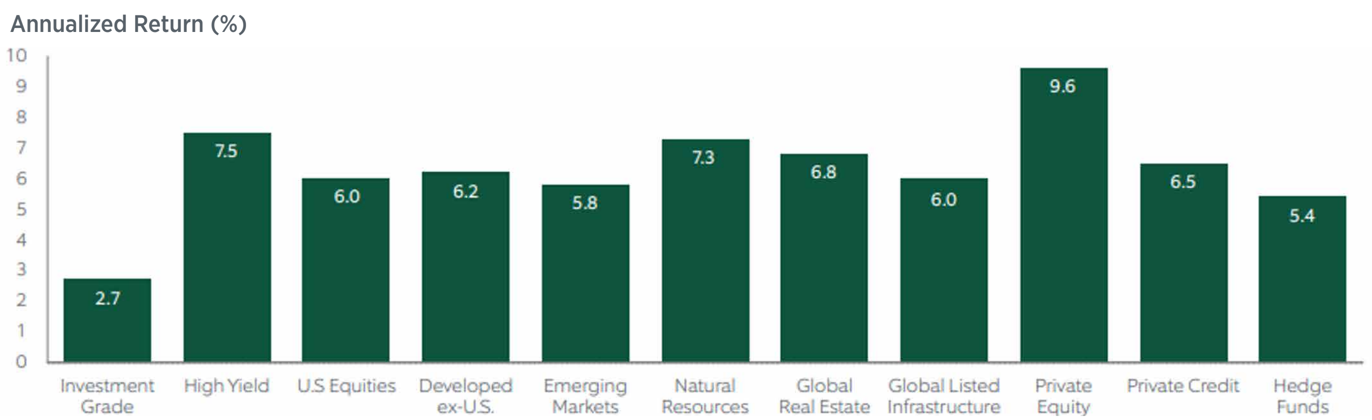
Slow Growth Transitions

The shifts from pandemic to endemic, globalization regionalization and fossil fuels to renewable energy represent economic challenges for a global economy already facing high debt and changing demographics.

Key Considerations for Pension Plans

As slow economic transitions unfold over the next five years, market volatility and uncertainty will likely remain high, due to slower growth expectations. Various economic factors, including weakened economic growth and lingering supply chain issues, are new to investors and add to the potential for negative market surprises given this combination of market concerns is historically

EXHIBIT 1: FIVE-YEAR FORECASTS FOR KEY ASSET CLASSES



Northern Trust Asset Management, Bloomberg. Annualized return data in local currency from 6/30/2017 to 6/30/2022. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Past performance is not indicative of future results.

unprecedented, especially given the push towards economic globalization in recent decades. Lower volatility equities have historically demonstrated asymmetric returns, meaning they tend to capture more upside when equities gain than downside when equities fall, as shown in **Exhibit 2**. This has increased the chance of outperformance amid turbulent markets.

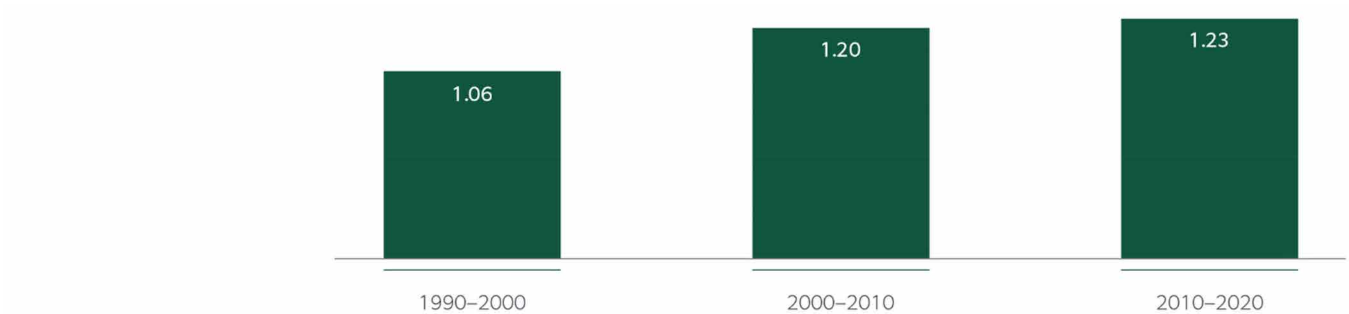
Inflation Recalibration

Post pandemic global supply chain complications and worker shortages left a bigger mark than expected on inflation. Still, many investors and policymakers believed inflation was "transitory" and would eventually revert to normal levels. This all changed with the

EXHIBIT 2: THE ASYMMETRIC RETURN PROFILE OF LOW VOLATILITY STOCKS

Over the past three decades, the ratio of upside capture to downside capture in the Russell 1000 Index has increased, a return profile that makes outperformance more likely during turbulent markets.

Up/Down Capture Ratio of Low Volatility Equities[1]



	1990–2000	2000–2010	2010–2020
Up Market Capture Ratio	82%	66%	84%
Down Market Capture Ratio	78%	55%	68%
Up/Down Capture Ratio	**1.06**	**1.20**	**1.23**

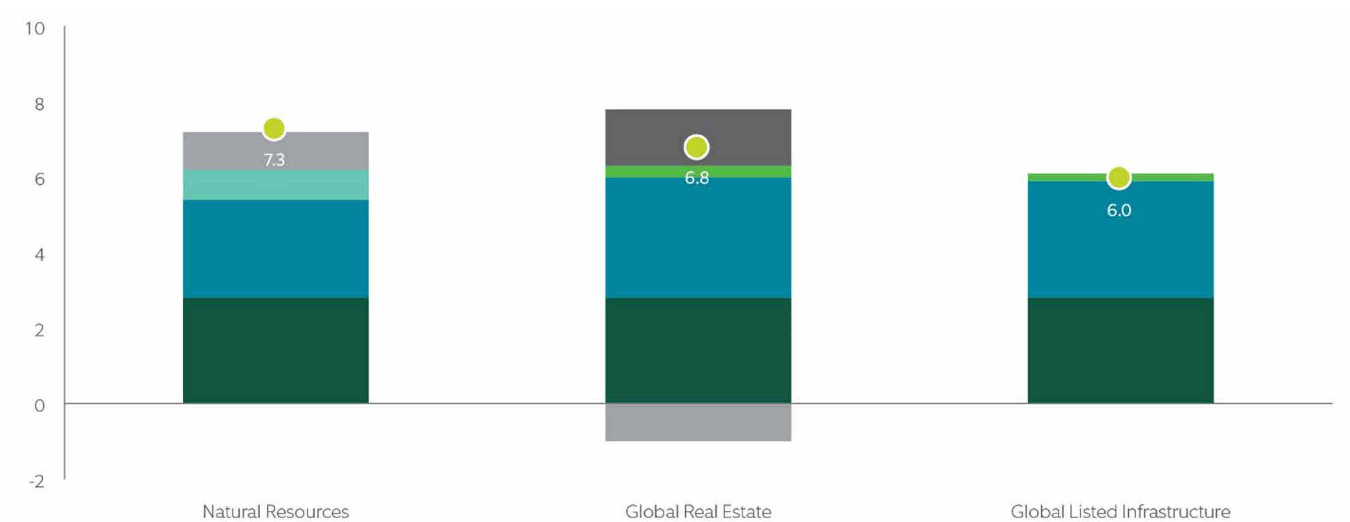
[1]Low Volatility research portfolios are formed by selecting the bottom 30% of securities ranked by trailing 1-year daily volatility. Research portfolios are capitalization weighted and rebalanced quarterly.

Source: Northern Trust Asset Management, FactSet, Russell 1000 Universe, 12/31/1989 through 12/31/2019. For illustrative purposes only. Past performance is no guarantee of future results. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

EXHIBIT 3: DIVERSIFICATION ON DISPLAY

Real assets should shine in a more uncertain and higher inflationary risk regime.

Northern Trust Five-Year Annualized Real Assets Return Forecast (%)



Source: Northern Trust Asset Management, Bloomberg.

war in Ukraine, which triggered soaring food and energy prices. The inflation genie escaped the bottle and putting the genie back will take some time. Still, we believe the worst has passed and we expect inflation to moderate gradually.

Key Considerations for Pension Plans

With likely elevated inflation for a while, plans need to reassess the risks inflation creates in their portfolios. Real assets can provide protection against unexpected inflation, while real estate and listed infrastructure offer additional risk exposures for portfolio diversification and higher yields than traditional equities.

__Bob Parise__ is managing director, head of sales and relationship management, and practice lead for public funds and Taft-Hartley plans for the institutional client group at Northern Trust Asset Management. He is a member of the Business Leadership Council. Bob collaborates across sales and client relationship management to establish business strategy and lead the delivery of investment solutions in the equity, fixed income and alternative asset classes. Bob has more than 25 years of industry experience. He holds a bachelor's degree in business with an emphasis in finance from Western Illinois University and an MBA from DePaul University.

Final Thought: Be Creative With Risk

We anticipate some deterioration in the challenging equity environment ahead with developed market corporate profit margins at historically high levels. Plans will need to be nimble and dynamic with their risk budgets in order to hit their short- and long-term return targets. Given slow growth and elevated inflation, plans can look to private markets or low volatility strategies to close the forecasted return gap from their equity allocations over the next five years.

To learn more about how to position your portfolio to achieve your plan's objectives over the next five years, contact Bob Parise. ◆

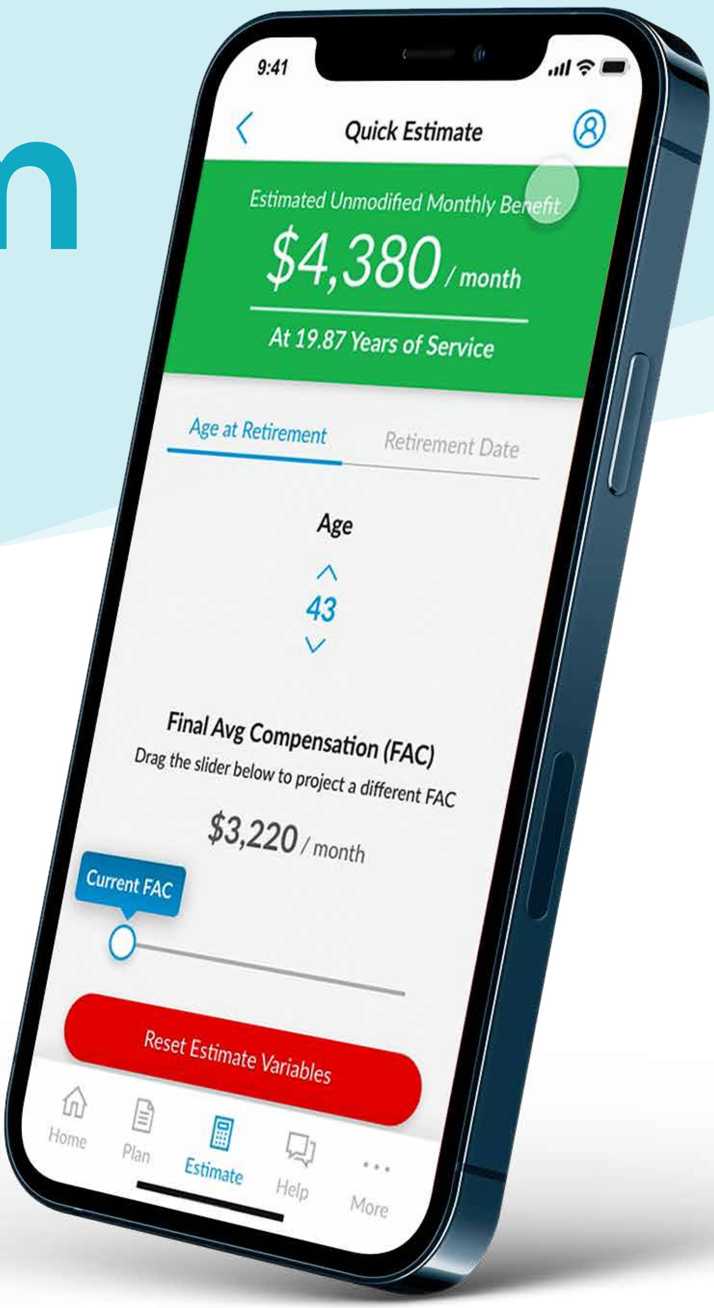
Disclosures:

For more information about disclosures, please view page 7 of *the full paper*.

Pension Industry Careers: Job Listings, Hiring, and Retirement Announcements

Brought to you by NCPERS

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.

pensionX

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

Balancing Costs of Retiree Healthcare with the Retiree Experience

By: Trevis Parson, WTW

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Plan sponsors and participants are both under increasing financial pressure.

Costs are on the rise. As the nation experiences the effects of inflation on fuel, food and housing, retired Americans on fixed incomes especially feel the pinch.

While these increases may feel modest, larger cost increases on other major budget items leave little room for healthcare expenses and may force seniors to forgo necessary healthcare. For many retirees fortunate enough to have coverage from their former employer, especially those in plans with fixed-dollar benefit caps, the costs have become so great that retirees are waiving former employer coverage altogether.

In 2023, healthcare costs are projected to increase

4.8% Up from 3.6% in 2022 for Pre-Medicare retirees

2.7% Up from 2.1% in 2022 for Medicare-eligible retirees

Sponsors are looking for ways in which they can balance economic pressures with the need to best attract and retain talent, while honoring commitments to healthcare retirees value.

Retiree medical plan sponsors feel the pressure, too. Not only from rising fuel prices driving up input costs, but also from rising interest rates that squeeze investment opportunities and tight labor markets that pressure the workforce balance. Sponsors are looking for ways in which they can balance economic pressures with the need to best attract and retain talent, while honoring commitments to healthcare retirees value.

Unfortunately, many sponsors struggle to find the balance and offer that value as the retiree healthcare landscape continues to respond to economic and legislative change.

49% say that benefits are **too expensive** to maintain,

33% feel the need to **reduce the burden** of benefit administration, and

36% seek to **reduce financial risks**.

63% of sponsors recently surveyed plan to make changes to their retiree healthcare benefits over the next three years, even as 37% have already implemented some degree of changes in the past three years.

Opportunities exist for plan sponsors to improve the value of retiree healthcare benefits.

For Medicare-eligible retirees, Medicare Advantage plans can provide incremental financial value above and beyond traditional Medicare. This has driven Medicare Advantage enrollment to nearly half of all Medicare members. The great majority of these Medicare Advantage enrollees are in individual products — many purchased with the help of a private marketplace. Others enroll through group Medicare Advantage plans sponsored by their former employer. With respect to prescription drug benefits, the Inflation Reduction Act is improving Medicare Part D by eliminating catastrophic cost sharing and implementing a maximum out-of-pocket limit of $2,000 per person per year beginning in 2025.

For Medicare-eligible retirees, Medicare Advantage plans can provide incremental financial value above and beyond traditional Medicare.

In the absence of Medicare, costs for health plans for retirees not yet 65 are much greater to many of those retirees and their employers. Some employers couple their Pre-Medicare retirees with their active employee populations to spread the higher retiree cost and risk over a larger population. However, in a tight labor market and with affordability a key concern, employers need more effective solutions.

Fortunately, recent legislation has provided cost-effective alternatives. Recent legislation established federal premium tax credits to reduce premiums for individual health insurance. These premium tax credits have fueled enrollment growth in individual plans, which is driving increased carrier participation and premium stability in the individual health insurance market. As a result, employers are looking to shift scarce financial resources away from their current group plan for retirees and toward the purchase of health insurance through an individual marketplace.

1 in 5

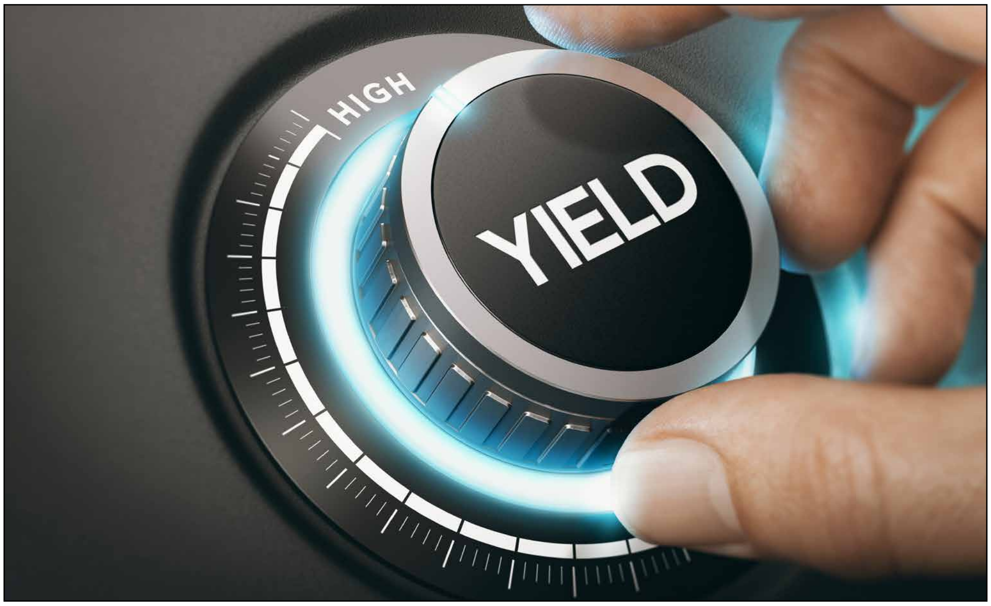
plan sponsors (22%) have moved or are considering moving away from their Pre-Medicare group plan.

The current economic environment is challenging to both plan sponsors and participants to find new value in retiree healthcare benefits. Today's market offers many new opportunities to both provide retirees more benefit security and provide sponsors the flexibility to more affordably offer retirees the benefits they value.◆

Trevis Parson, FSA, MAAA, FCA *is an expert on exchange-based healthcare offerings and has worked with many employers to redesign their retiree medical plans to reduce benefit and administrative costs while providing retirees enhanced choice and value. He currently serves as Chief Actuary of the Individual Marketplace for Via Benefits by WTW.*

High Yield: A Compelling Risk-Reward Picture for Long-term Investors

By: Chris Sawyer, Adrienne Butler, and Scott Roth, Barings



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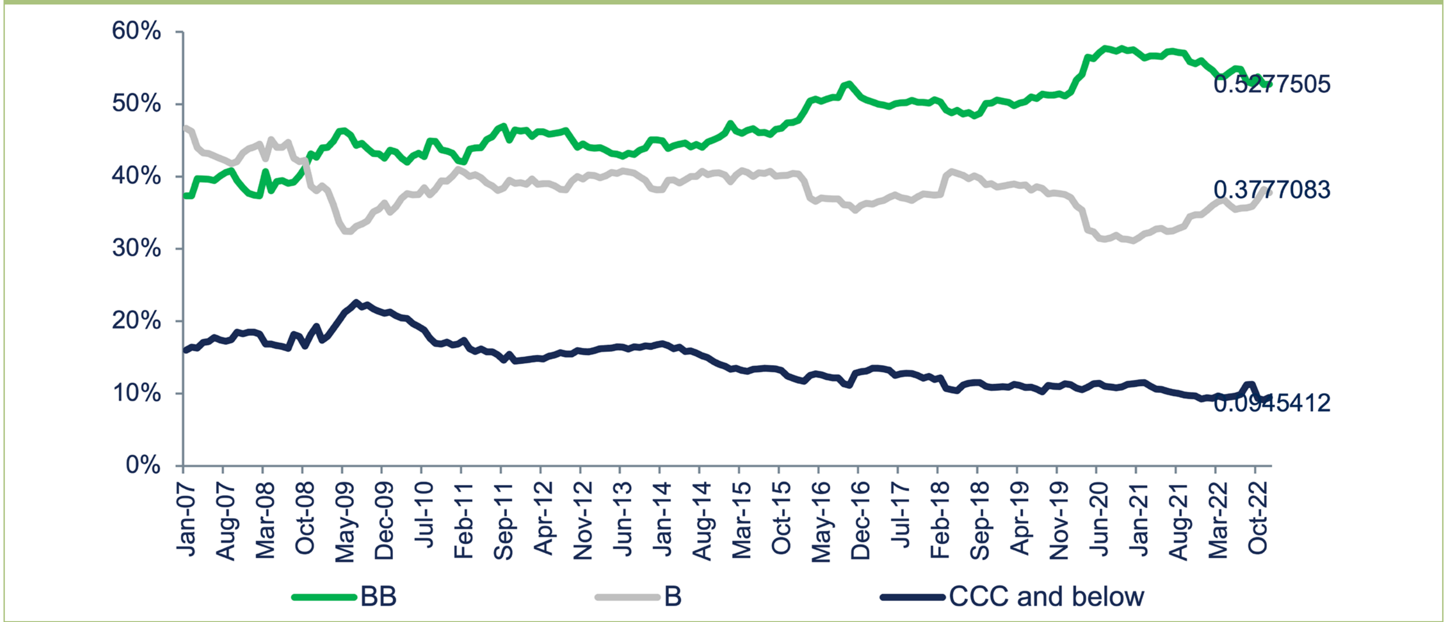
The list of factors driving uncertainty across financial markets is long. But for longer-term investors, high yield bonds and loans continue to present compelling total return opportunities.

Earnings in Focus

If 2022 was the year of interest rate volatility, corporate earnings will likely take center stage in 2023. As inflation climbed last year, many companies maintained enough pricing power to pass higher costs through to their customers; earnings, as a result, remained more durable than some market participants were expecting. Looking across the high yield universe today, the fundamental picture seems to be darkening. For one, the lagging effect of 2022's rate hikes has started to stress parts of the economy and is beginning to impact aggregate demand. Compounded by still-elevated labor costs, the ability of companies to pass through higher prices is starting to deteriorate, which will likely lead to some contraction in earnings going forward.

A HIGHER-QUALITY HIGH YIELD MARKET



The technical picture has also remained challenging for high yield, particularly loans, against a backdrop of more challenging liquidity and retail outflows in the U.S. Compounding this, there has been a continued lack of new collateralized loan obligation (CLO) issuance, which has historically accounted for a large portion of loan demand.

On the positive side, most high yield issuers still have the flexibility to continue to service their debt through a period of economic weakness and remain in a stronger financial position today than they would have been before the pandemic. At the same time, the credit quality of the high yield market has improved considerably over the past 15 years—BB issuers comprise 53% of the market, while single-B companies make up 38%.

> *While the difficult macroeconomic environment is unlikely to fade anytime soon, mild recessions have not necessarily been bad environments for high yield markets in the past.*

Attractive Total Return Potential

While the difficult macroeconomic environment is unlikely to fade anytime soon, mild recessions have not necessarily been bad environments for high yield markets in the past. Investors who stayed invested in high yield through periods of volatility, and even economic decline, have historically been rewarded with attractive, long-term returns. This is partly because high yield, unlike equities, does not require strong economic growth to perform well. Rather, what matters more is an issuer's ability to continue to meet the interest payments on its outstanding debt obligations. Slow GDP growth, or even a short period of mildly negative growth, is unlikely to drive significant increase in defaults—particularly across a higher-quality market with solid underlying fundamentals.

In the event of a recession, the potential downside in credit is also likely to be more limited given how challenging 2022 was for most financial markets. While spreads would likely experience some widening from current levels, we do not expect material widening to the extent that total returns would turn negative—particularly given the higher quality of the market and solid fundamental backdrop.

Focusing on the Long Term

In the current environment, investors do not need to take on excessive risk to earn potentially attractive returns. In higher-rated parts of the bond and loan universe, the risk-reward picture remains compelling. However, a credit-intensive approach is crucial—to not only avoiding additional downside, but also identifying issuers that can withstand today's headwinds. ◆

Adrienne Butler *is Co-Head of Barings' U.S. High Yield Investments Group and Head of U.S. CLO Funds. She is also a member of the U.S. High Yield Investment Committee. She is responsible for new CLO marketing and formation as well as existing CLO portfolio management. Adrienne has worked in the industry since 1990 and her experience has encompassed sell-side relationship banking, media and telecom specialty lending, and CLO portfolio management. Prior to joining the firm in 2002, she was part of the acquisition of First Union Institutional Debt Management ("IDM"), where she was a senior analyst in IDM's Loan Research Group. Before IDM, she was a vice president/relationship manager at First Union Corporation and worked in corporate banking at First Union National Bank of South Carolina. She also served as a loan officer at NationsBank. Adrienne holds a B.A. from Furman University and an M.B.A. from University of Notre Dame's Mendoza College of Business.*

Scott Roth *is Co-Head of Barings' U.S. High Yield Investments Group, Chair of the U.S. High Yield Investment Committee and a member of the Global High Yield Allocation Committee. His responsibilities include portfolio management for various high yield bond total return strategies. Scott has worked in the industry since 1993 and his experience has encompassed fund management, underwriting, leveraged loans and high yield. Prior to joining the firm in 2002, he was a vice president at Webster Bank and was a high yield analyst at Times Square Capital Management. He also served as an underwriter at Chubb Insurance Company. Scott holds a B.B.A. from Western Michigan University, an M.B.A. from the Ross School of Business at University of Michigan and is a member of the CFA Institute.*

Chris Sawyer *is Head of Barings' European High Yield Investments Group as well as a member of the firm's European High Yield Investment and Global High Yield Allocation Committees. Chris is responsible for the portfolio management of several loan, high yield bond and multi-credit strategies. Chris has worked in the industry since 2005. Prior to joining the trading team in 2008, he was a member of the portfolio monitoring team where he was responsible for the ongoing credit analysis of individual portfolio assets. Chris holds a B.Sc. in Economics and Business Finance from Brunel University.*

Turning Points for 2023

By: Olga Bitel and Hugo Scott-Gall, William Blair

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Hugo: We've walked together through a tumultuous 2022, and now we're ready to peer into 2023. As you consider all the variables, what looks different to you this year in terms of where we might find growth?

Olga: The first trend reversal we need to talk about is the fed funds rate. The U.S. central bank is likely to stop tightening in 2023. The second likely big reversal is the depreciation of the U.S. dollar vis-à-vis other major currencies. Interacting with both of these potential shifts is China's reopening. As a result, we are likely to get not only a boost in production but perhaps also a short-term boost in consumption and growth in and outside of China.

Hugo: What's your model for how to think about investing around a weaker dollar?

Olga: The period that we look to be entering in the 2020s is most reminiscent of the last what I would call "normal" expansion that we experienced, which was 2003 to 2007. A lot of the changes that we're highlighting today are exactly the same macroeconomic setup as we experienced then. That period of economic expansion was extremely fruitful for equities. We saw equities markets returning around 15% on average during that entire time period, and virtually all of that performance was driven by earnings growth. Obviously, the types of companies that lead the charge this decade are likely to be different. But the broad macroeconomic environment may very well end up being similar.

Hugo: It was put to me that the next bull market will begin when the following conditions are met. The first is that the darlings of the previous bull market—big tech, high growth—are derated sufficiently, such that investors no longer view them as outperformers. The second is that there's some kind of credit event caused by this steep slope of Fed tightening. The third is that the dollar breaks.

Olga: We already have at least two of the three conditions, and possibly all three. In terms of a major credit event, these are devilishly difficult to forecast. Obviously, the more the Fed raises

The period that we look to be entering in the 2020s is most reminiscent of the last what I would call "normal" expansion that we experienced, which was 2003 to 2007.

rates from here, the greater the probability of such an event. We've had a series of smaller credit events in 2022, so some of the weaker sovereigns have already defaulted and have asked for IMF help. We've also had the crypto explosion; the value of the bitcoin trade is roughly a third of what it was at the beginning of 2022.

None of these feels like a whale. But I don't know if we need a credit event of the magnitude that people evoke when they talk about the 2008 global financial crisis.

The shakeout in the consumer-facing technology platforms that have been dominant in the past decade is definitely giving way to something. Now, what is that something? Are we on the cusp of another commodity supercycle? Maybe we need a lot more lithium and nickel, if we're all to be driving electric vehicles by the end of the decade. U.S. scientists recently announced a major breakthrough in nuclear fusion. COVID has exposed all sorts of vulnerabilities in the superefficient supply chains; we may see more duplication and production for the domestic markets that are closest to you. What underpins growth in virtually every sector today is semiconductor chips. The example that I've been thinking about a lot recently is 5G buildout. For now, I see no obvious candidates to lead the next bull market, but it almost certainly won't be the winners of the past decade.

The shakeout in the consumer-facing technology platforms that have been dominant in the past decade is definitely giving way to something. Now, what is that something?

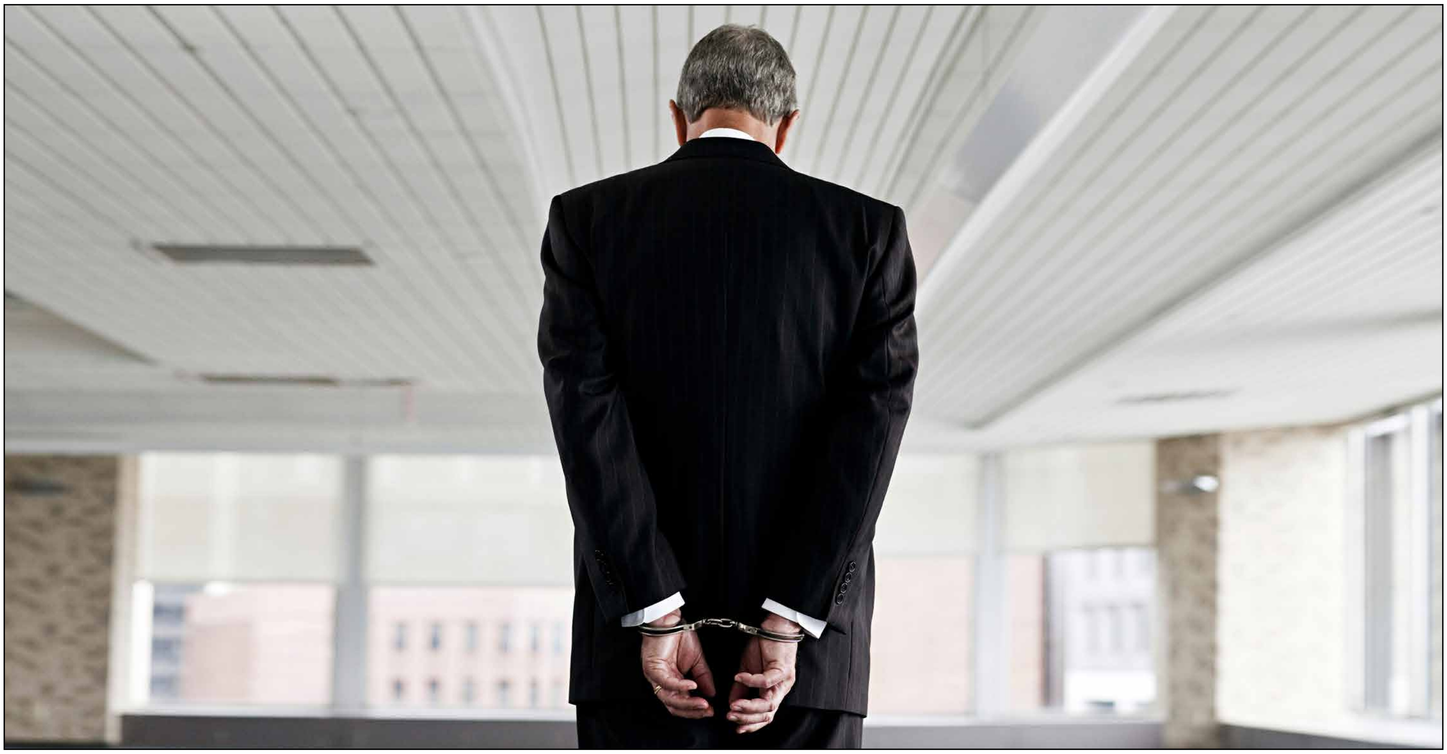
This article is excerpted from our blog, which you can [read in full here](). ◆

Olga Bitel, *partner, is a global strategist on William Blair's global equity team.*

Hugo Scott-Gall, *partner, is a portfolio manager and co-director of research on William Blair's global equity team.*

The Cost of Corporate Fraud

By: Domenico Minerva and Michelle Cooper, Labaton Sucharow LLP



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Researchers from the University of Toronto, the University of California at Berkeley, and the University of Chicago recently published a study using statistical analyses to determine the prevalence of corporate fraud.[1]

The researchers attempted to answer an important question: "is the fraud we observe the whole iceberg or just its visible tip?" Their study endeavored to answer this question by estimating the ratio of the "exposed tip to the submerged portion" to determine the "hidden prevalence of fraud."

To calculate that ratio, the study uses a few approaches previously employed by other academics. However, it also introduced a novel approach based on a natural experiment made possible by the demise of auditing firm Arthur Andersen (AA) in the wake of the Enron scandal in the early 2000s.

As background, the Enron accounting scandal came to light in 2001. Later that year, The New York Times ran an article with the headline "From Sunbeam to Enron: Andersen's Reputation Suffers," reporting that former AA clients were under enhanced scrutiny for fraud.

The researchers described their methodology, stating, "the simple idea is that after the AA demise, former AA clients were subject to vastly increased scrutiny" from new auditors and other fraud detectors—including "the media, investment intermediaries, short-sellers, and their internal gatekeepers"—with strong incentives to uncover any fraud committed by former AA clients.

The researchers attempted to answer an important question: "is the fraud we observe the whole iceberg or just its visible tip?"

Based on statistical analyses of former AA clients before, during and after this period of enhanced scrutiny, the researchers concluded that "fraud is indeed like an iceberg with significant undetected fraud beneath the surface." Indeed, they determined that:

- ***Two out of three*** corporate frauds go undetected,
- ***10 percent*** of large corporations commit securities fraud each year, and
- The costs borne by equity holders in companies involved in fraud totaled approximately ***$830 billion*** in 2021 alone. ◆

Footnotes:

[1] Alexander Dyck, et al., *How pervasive is corporate fraud?*, Rev. Acct. Stud., Jan 5, 2023.

Domenico "Nico" Minerva *is a Partner in the New York office of Labaton Sucharow LLP. A former financial advisor, his work focuses on securities and consumer class actions and shareholder derivative litigation, representing Taft-Hartley and public pension funds across the country. Nico advises leading pension funds and other institutional investors on issues related to corporate fraud in the U.S. securities markets.*

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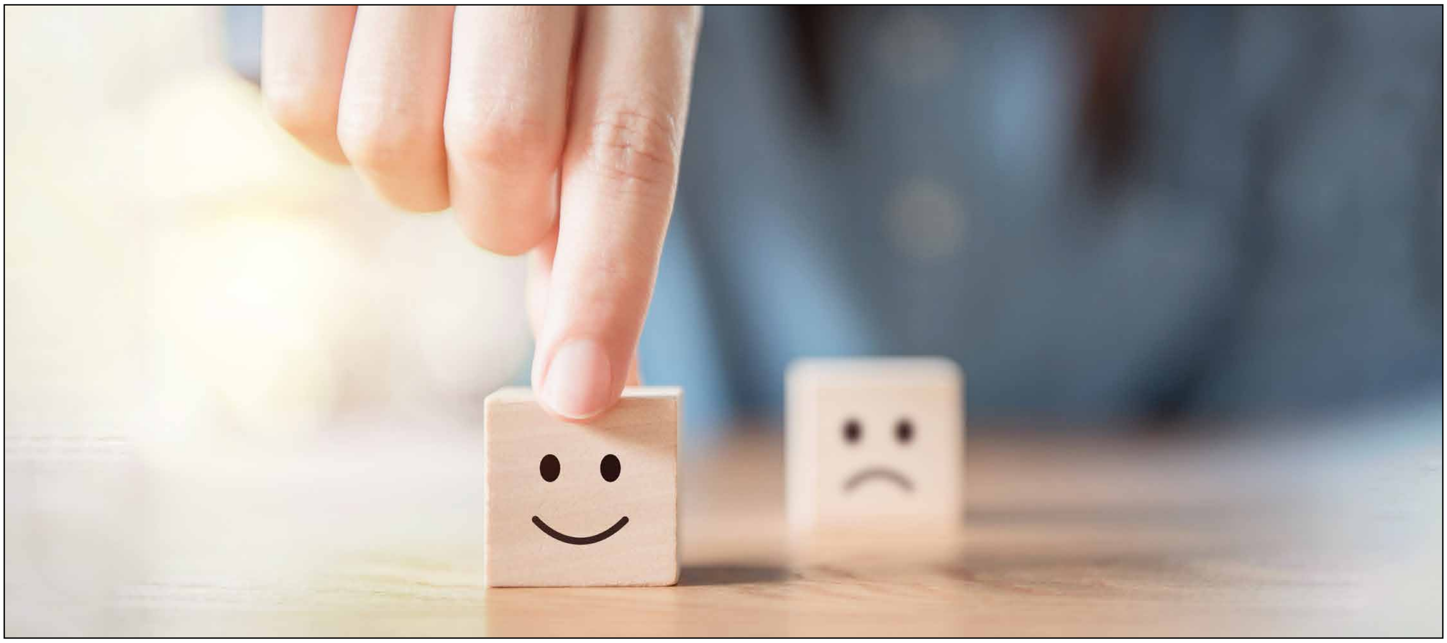
Are Higher Interest Rates a Silver Lining for Public Pension Funds?

By: Bill Hallmark, ASA, EA, MAAA, FCA, Cheiron



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The Federal Reserve is aggressively raising interest rates to tame high inflation.

The federal funds rate, set by the Federal Reserve, has risen from near zero in March 2022 to almost 5% in February 2023, and is expected to continue rising and remain above 5% into 2024.

As a result, mortgage and other borrowing rates have increased dramatically, slowing demand, and raising the possibility of a recession. But, there may be a silver lining for public pension plan sponsors. Higher interest rates make public pension plans less expensive because they increase the investment returns plans can expect.

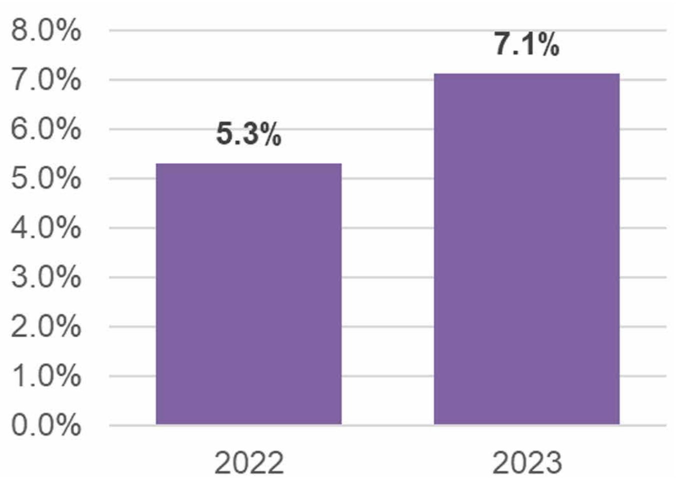
Impact of Higher Interest Rates on Public Pension Plans

Capital market assumptions for 2023 are significantly higher than 2022, reflecting the change in interest rates and their impact on asset valuations. If high interest rates persist, public pension plans will have the opportunity over the next few years to consider increasing margins for conservatism in assumed investment returns, reducing investment return volatility, and increasing their discount rates.

It isn't clear yet whether the higher interest rates will be temporary or represent a longer-term change. Plans are likely to take a cautious approach to any changes, as they did when interest rates dropped during the Great Recession.

10-Year Capital Market Expectations

75% Equity / 25% Bond Portfolio



Author's calculations based on average capital market assumptions for BlackRock, Callan, and JP Morgan

For 2023, there should be considerably less pressure to reduce discount rates than in the last several years, and some plans may even consider increasing their discount rate. Most plans, however, will likely wait to make sure the change in return expectations is not temporary before making any adjustment to their discount rates. If higher interest rates prove to be temporary, plans will have been prudent in waiting and avoiding the need to reverse course when interest rates come back down.

Historical Impact of Declining Interest Rates on Public Pension Plans

The situation today appears to be the reverse of what pension plans experienced over the last 15 years of declining interest rates. In 2007, the yield on the 10-year Treasury was higher than 5% but following the Great Recession it dropped to between 1.5% and 3% and with the onset of the pandemic it dropped to below 1%. While public plan discount rates are not tied directly to these interest rates, the median discount rate for public pension plans dropped during this period to 7% from 8%, increasing the measure of plan liability for a typical public plan by 12% to 15%.

Median Public Plan Discount Rate

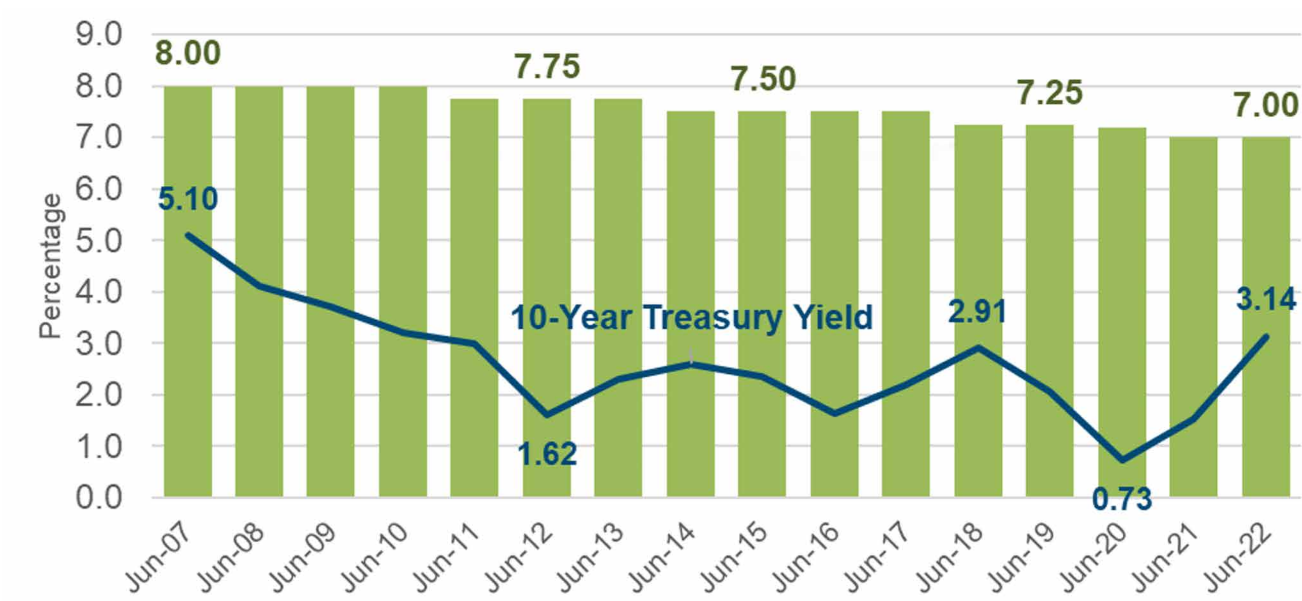
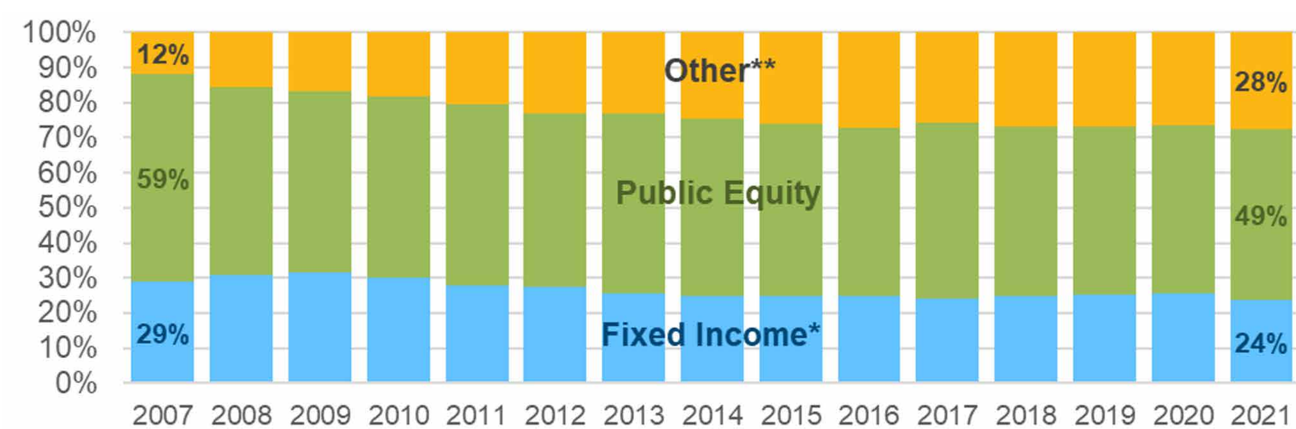


Chart from ***Cheiron Public Plan Data Tool*** *using data from the Federal Reserve and PublicPlansData.org*

Average Public Plan Asset Allocation



* Fixed Income includes cash

** Other includes hedge funds, private equity, real estate, alternatives and commodities

Chart from ***Cheiron Public Plan Data Tool*** *using data from PublicPlansData.org*

At the same time, public plans adjusted their investment strategies to improve the chance of achieving their expected returns in the low interest rate environment, boosting their holdings of hedge funds, private equity, real estate, and alternatives while reducing fixed income and public equity holdings. These changes raised investment return expectations but also increased the volatility of public plan investment returns.

In short, higher interest rates provide some welcome relief to public pension plan sponsors, immediately reducing the pressure to take additional investment risks or further lower the discount rate. If higher rates persist, some of the difficult trends of the last 15 years may start to unwind. ◆

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Global Securities Class Action Landscape: 2023 Outlook & Trends

By: Mike Lange, Esq., Emily Fortin, Esq., and Colin Holmes, Esq., Financial Recovery Technologies

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Now that 2022 has closed and 2023 is in full-swing, our in-house legal experts shared their insights into what impacted the global recovery landscape last year and trends expected in 2023 for U.S. Settled Securities and Antitrust, and Non-U.S. Litigation.

U.S. Settled Securities

In 2022, core U.S. securities class action filings were flat year-over-year (201 versus 200), while settlements were up 18% by number (144 vs 122). There were 103 matters disbursed. Among the 10 largest (shown below) were the Wells Fargo Fair Fund and a second FOREX antitrust payout.

Settlement	Disbursement Amount
(FX OR FOREX) FOREIGN EXCHANGE BENCHMARK RATES	$706,065,555
WELLS FARGO SEC FAIR FUND	$500,000,000
FIRST SOLAR, INC. SECURITIES LITIGATION (12CV00555DGC)	$350,000,000
SIGNET JEWELERS LIMITED, SECURITIES LITIGATION (16CV06728)	$240,000,000
SNAP, INC., SECURITIES LITIGATION (17CV03679) (FEDERAL CASE)	$154,687,500
DAVITA INC., SECURITIES LITIGATION	$135,000,000
TABLEAU SOFTWARE, INC., SECURITIES LITIGATION	$95,000,000
METLIFE, INC. SECURITIES LITIGATION	$84,000,000
WILLIS TOWERS WATSON PLC, SECURITIES LITIGATION (FEDERAL CASE)	$75,000,000
SYMANTEC CORPORATION, SECURITIES LITIGATION (18CV02902)	$70,000,000

SEC Fair Funds proved the most challenging matters for institutional investors last year. Those administrations run faster than for securities class actions, with shorter deadlines and stricter requirements including 100% remittance and 100% documentation. The latter requirement can be particularly difficult when claim periods go back further than the time that custodians and nominees must keep records.

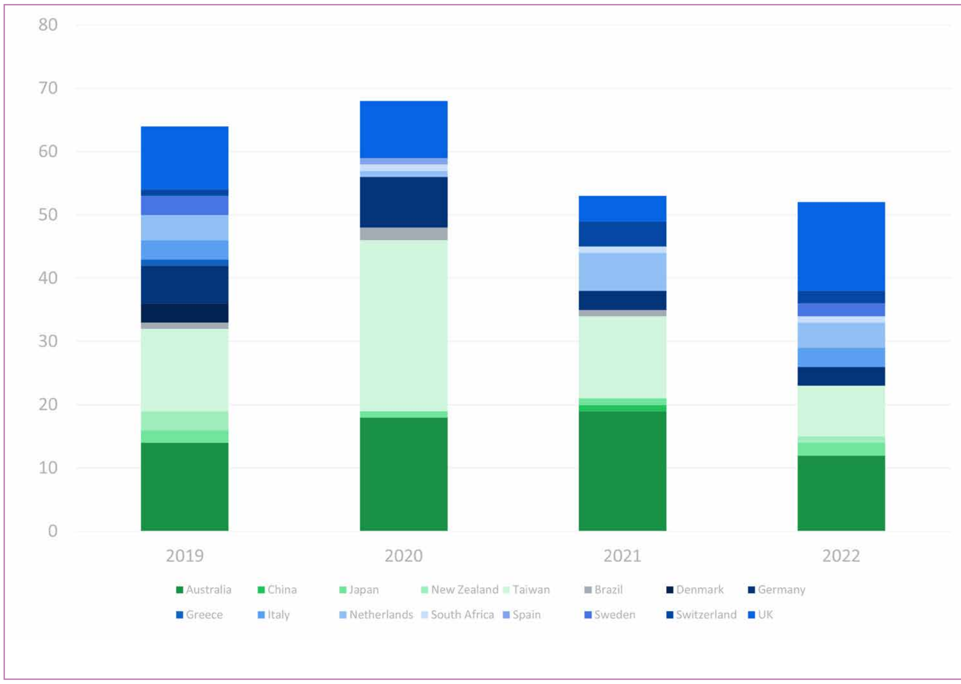
While hard to predict, for 2023, case filings are expected to be comparable or slightly higher than last year and settlements to also be comparable to last year, with the top ten accounting for roughly half of the total dollars recovered and the majority in number to be less than $100M.

Antitrust

In 2022, U.S. Antitrust settlements (including DOJ recoveries) involving investments continued at a steady pace, ranging in size from $500K to $300M. Most were partial or wrap-up settlements in cases with earlier partial settlements, like LIBOR, Euribor and Euroyen. Last year was another strong one for antitrust disbursements, with more than $700 million paid out, primarily from the $2.3B FOREX settlement.

Already in 2023, we've seen partial settlements including Wheat Futures and European Government Bonds., With $4 billion still in administration, including $1B more of the FOREX settlement, 2023 could be a very big year for antitrust payouts.

Case	Type	Settlement	Claims Filing Deadline
In re JPMorgan Precious Metals Futures	ANTITRUST	$60,000,000.00	08-08-2022
In re JPMorgan Treasury Futures Spoofing Litig.	ANTITRUST	$15,700,000.00	06-30-2022
(GOLD Fixing) Barclays Bank PLC, the Bank of Nova Scotia, Société Générale, and the London Gold Market Fixing Limited	ANTITRUST	$50,000,000.00	04-19-2022
(EURIBOR) Credit Agricole	ANTITRUST	$55,000,000.00	12-15-2022
(LIBOR Bondholders) Gelboim et ano. v. Credit Suisse Group, et al.,	ANTITRUST	$1,749,000.00	02-27-2023
(EUROYEN) Laydon v. Mizuho Bank, Ltd. et al	ANTITRUST	$22,500,000.00	04-28-2023
(SIBOR) Fund Liquidation Holdings LLC v. Citibank N.A. et al.	ANTITRUST	$155,458,000.00	01-20-2023
BBSW Rate Manipulation Settlement	ANTITRUST	$185,875,000.00	01-16-2023
The Bank of Nova Scotia Metal Spoofing DOJ Deferred Prosecution Agreement (DPA)	DOJ	$6,622,190.00	08-19-2023
JPMorgan Chase & Co. Metal Spoofing DOJ Deferred Prosecution Agreement (DPA)	DOJ	$311,740,000.00	09-24-2023
Tower Research Capital LLC E-Mini DOJ Deferred Prosecution Agreement (DPA)	DOJ	$32,600,000.00	10-24-2022
Deutsche Bank Metal Spoofing DOJ Deferred Prosecution Agreement (DPA)	DOJ	$1,223,738.00	01-06-2022
United States v. NatWest Markets Plc	DOJ	$6,761,967.00	02-21-2022
United States v. Credit Suisse Securities (Europe) Limited	DOJ	$0.00	02-28-2022
Propex Derivatives Pty Ltd E-Mini DOJ Deferred Prosecution Agreement (DPA)	DOJ	$464,300.00	01-21-2023



Non- U.S. Litigation

Last year there were 52 non-U.S. matters in 11 jurisdictions (counted by case organizers). Broken down by country, filings were down in Brazil and Germany, and up in the Netherlands and the UK.
In 2023, the number of matters are expected to be similar to last year (about 52-58), and it is expected that filings will increase in Australia the Netherlands, and the UK and decrease in Brazil, Germany, and Japan. Across all countries active in the securities litigation space, greater and more stringent demands from courts for claimant identification, authorization, and custodial confirmation documents, are expected to continue. ◆

In 2022, U.S. Antitrust settlements (including DOJ recoveries) involving investments continued at a steady pace, ranging in size from $500K to $300M.

__Financial Recovery Technologies, LLC__ helps institutional investors navigate the increasingly complex global recovery landscape, with cutting edge technological solutions and thought leadership. This article summarizes some of the topics covered in greater depth during the live webinar hosted in February by Mike Lange, Esq., SVP of Worldwide Litigation; Emily Fortin, Esq., Director of Legal Operations & Counsel; and Colin Holmes, Esq., Associate Counsel. For more information and to access on-demand the full webinar, please visit FRT at: https://pages.frtservices.com/2023ClassActionOutlook

The Growing Prominence of Continuation Vehicles

By: Mina Pacheco Nazemi, Barings Diversified Alternative Equity Group

In the last 24 months, the market has seen an increase in the number of continuation funds, which allow GPs to roll an asset (or assets) from an existing fund or multiple funds into a new investment vehicle with fresh or re-start capital, rather than selling the asset to an outside buyer. Historically, these vehicles served as a way to give these companies more time to deliver on expected returns. More recently, however, GPs are recapitalizing their higher-performing investments—the so-called "crown jewels" of their portfolios—as a way to maintain exposure while providing additional capital for growth initiatives.

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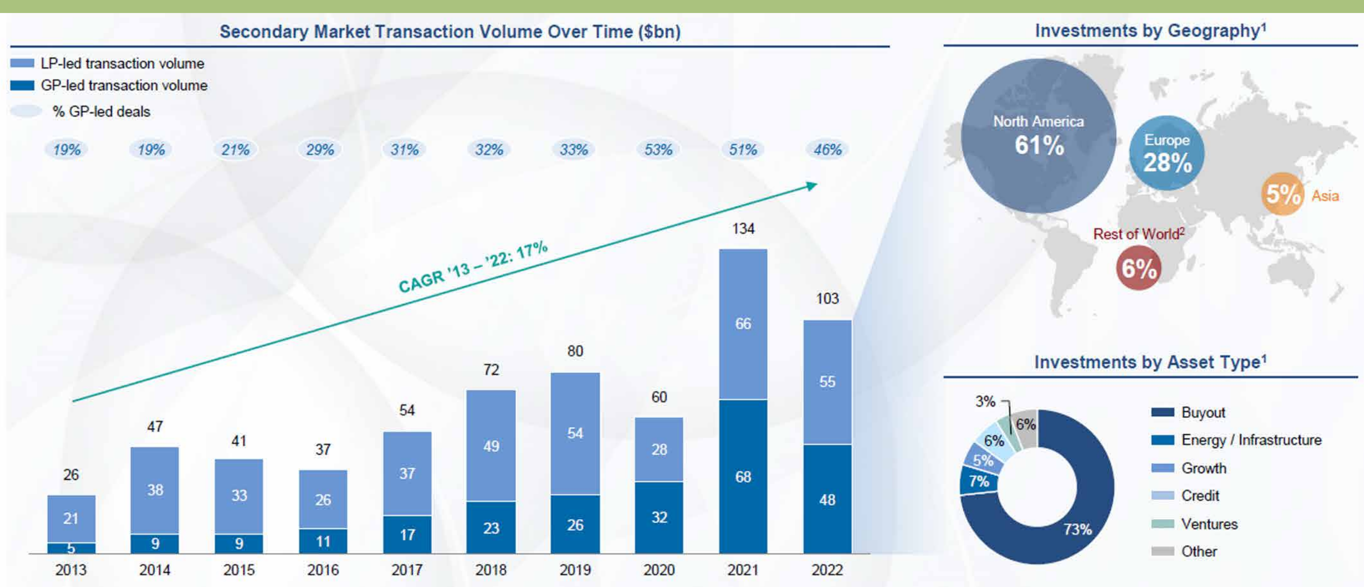
While there are certainly risks involved in these deals, namely around potential conflicts of interest and GP alignment, there can be benefits as well. GPs have the ability to continue managing a high-performing asset, and this comes with the benefit of a larger fee base and the resetting of the deal carry pool, which can re-incentivize the team for continued value creation. For LPs, assuming that the asset has been fairly priced and that the GP's motivations are properly aligned, these vehicles can provide an attractive opportunity to maintain exposure to a successful company at a lower fee/carry basis. In addition, some LPs have the ability to invest secondary capital into what may be perceived as a less risky opportunity (when compared to buying a new unknown asset). Over time, there is the potential for LPs to realize strong risk-adjusted returns, particularly with GPs and management teams that have worked together successfully in the past.



Source: Evercore 2022 Secondary Market Synopsis, January 2023.

Many LPs are currently not set up to participate in continuation vehicles, while others choose not to participate given structural constraints or the need for liquidity. Arguably, continuation vehicle transactions can force traditional fund LPs to be more involved co-investors, requiring them to undertake additional underwriting and monitoring processes. These dynamics ultimately cause most LPs to sell their positions instead of rolling their exposure into attractive continuation vehicle opportunities.

The decision to participate in a continuation vehicle involves a complex set of issues that are critical for an LP to understand. High-quality GPs typically have a strong value creation plan outlined on a particular asset or set of assets and will often commit a considerable amount of time and capital to each deal. A reasonable proxy to measure GP alignment is the amount of carried interest that the GP has created via the platform exit and any subsequent portion they may roll into the new vehicle. Additionally, it is critical for LPs to understand the business motivations and alignment of other LPs/LPAC members who may have to provide approvals to waive conflicts or approve the actions of the GP. There may be questions, for instance, around whether a given asset manager—with both primary and secondary businesses—would be more likely to approve a deal that benefits its secondary arm, even if that deal is potentially less advantageous for its primary fund investors that may not be in a position to participate due to structural and/or timing limitations.

With appropriate alignment, transparency, and governance in place, continuation vehicles are a very attractive investment option for LPs. ◆

__Mina Pacheco Nazemi__ is the Head of the Diversified Alternative Equity team and serves on both the investment committee and valuation committee. She is also responsible for originating, underwriting and monitoring primary fund, direct/co-investments, and secondary fund 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. Prior to joining the firm in 2017, Mina held several leadership and investment positions including Co-Founder and Partner at Aldea Capital Partners and Partner and Investment Committee Member at GCM Grosvenor Customized Fund Investment Group (formerly Credit Suisse CFIG). She is an alumna of Sponsors for Education Opportunity (SEO) and Robert Toigo Foundation. She also is a board member of the Pan American Development Fund and serves on the investment committee for the City of Hope. 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.

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Calendar of Events 2023

May

NCPERS Accredited Fiduciary (NAF) Program

May 20–21
New Orleans, LA

Trustee Educational Seminar (TEDS)

May 20–21
New Orleans, LA

Annual Conference & Exhibition (ACE)

May 21–24
New Orleans, LA

June

Chief Officers Summit

June 19-21
Denver, CO

August

Public Pension Funding Forum

August 20-22
Chicago, IL

October

NCPERS Accredited Fiduciary (NAF) Program

October 21-22
Las Vegas, NV

Financial, Actuarial, Legislative, and Legal Conference (FALL)

October 22-25
Las Vegas, NV

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