

State of Connecticut Retirement Plans and Trust Funds

Passive Manager Search

Background

- The State of Connecticut Retirement Plans and Trust Funds issued a passive panel Request for Proposal (“RFP”) in 2019, with submissions due January 17, 2020.
 - Six candidates are being considered for this mandate.
- The purpose of this RFP is to establish a roster of index providers to leverage for strategic allocations as well as tactical or interim solutions.
 - As a result, we evaluated the firms based on indexing capabilities across equity and fixed income as well as index-associated services (e.g., transition management).
- The following document provides an overview of the six finalist firms and highlights their capabilities.

BlackRock – Organization & Team

- BlackRock is a publicly-traded asset manager (BLK) and the largest in the world by assets under management. Its product lines span asset classes and geographies and include ancillary services such as LDI, transition management, and investment technology products among others.
 - As of December 31, 2019, BlackRock had over \$7.4 trillion in total assets under management, slightly under half of which is managed in risk-managed index strategies. BlackRock provides both passive and active access to virtually all common investment areas through a variety of vehicles including separate accounts, commingled funds, mutual funds, and ETFs.
 - BlackRock's client base is mostly institutional, with 60% of total firm assets under management being owned by either taxable or non-taxable institutions.
- Although BlackRock did have some passive investment capabilities dating back to its founding, its passive business grew substantially after the firm's acquisition of Barclays Global Investors (BGI) in 2012, one of the largest passive firms and ETF providers in the world at the time.
- BlackRock structures its passive efforts on a team basis with multiple portfolio managers dedicated to various asset classes and geographies with portfolio managers also occasionally being shared with enhanced indexing mandates.
 - In the underlying index teams, turnover tends to be relatively stable and new hires are a mix of external experienced hires and internal hires.

Northern Trust – Organization & Team

- Northern trust Asset Management is the wholly-owned asset management division of Northern Trust Corporation, a publicly traded (NTRS) bank holding corporation with asset servicing and wealth management divisions.
 - As of September 30, 2019, Northern managed approximately \$983 billion in assets with approximately \$581 million in equity mandates. The remainder is made up of a combination of fixed income and balanced mandates.
 - Northern's client base is mostly institutional, with 55% of total firm assets under management being owned by either taxable or non-taxable institutions.
- Northern Trust's process follows a team approach for passive mandates, with the index team consisting of 20-30 investment professionals at any given time, reporting up into the firm's wider global equity team along with active quantitative and fundamental teams.
 - The team is supported by shared quantitative equity researchers as well as product strategists and support specialists.
 - The level of experience within the team is generally high (i.e., greater than 10 years' experience among portfolio managers) and turnover is relatively stable.

Piedmont – Organization & Team

- Piedmont is an established investment management firm but is a new entrant (relative to larger indexing firms) in the passive investing space.
 - As of December 31, 2019, Piedmont managed approximately \$4.9 billion in assets with approximately \$2.6 billion in equity mandates. Of the \$2.6 billion in equity assets, approximately \$1.8 billion is passively indexed across a number of US equity mandates. Active fixed income makes up the remainder of firm assets, approximately \$2.3 billion.
 - Piedmont's client base is almost entirely institutional (there is a de minimis amount of high net worth assets). Public funds make up the largest portion of assets under management.
- Piedmont is currently a subsidiary of FIS Group, which acquired Piedmont in May 2018. Although employee-owned at acquisition, the firm has had various outside ownership interests since its founding including North Carolina Mutual, the CalPERS Management Development Program and Rosemont Partners.
- Given the size of the firm, the investment team is understandably small compared to competitors, with President and CIO Isaac Green and Co-CIO Sumali Sanyal primarily responsible for managing the passive portfolios.
 - Both Mr. Green and Ms. Sanyal have significant experience, with over 30 and 20 years in the industry respectively. The two worked together at Loomis Sayles prior to founding Piedmont.

RhumbLine – Organization & Team

- RhumbLine is a privately held women-, minority-owned business (53%) headquartered in Boston, MA. It is 100% employee-owned. RhumbLine focuses entirely on providing passive index investment management; it does not have any custody, brokerage, securities lending, transition management, etc. affiliates/subsidiaries, unlike larger firms in the space.
 - As of September 30, 2019, RhumbLine managed approximately \$60.5 billion in assets with approximately \$58.5 billion in equity mandates. Fixed income makes up the second largest portion of assets, approximately \$2.0 billion. RhumbLine only manages passive indexing strategies, with the exception of one legacy enhanced indexing strategy.
 - RhumbLine's client base is institutional. Public funds make up the largest portion of assets under management followed by corporate ERISA mandates.
- Given the size of the firm, the investment team is understandably small and has three main members.
 - In May 2016, RhumbLine hired Alex Ryer as Director of Investments and Co-CIO alongside Norman Meltz. Mr. Ryer has spent his entire career in passive management, starting his career at SSGA in 2000, working for RhumbLine as a portfolio manager from 2003-2005, and then following up with stints at both Northern Trust and BlackRock before returning to RhumbLine in 2016.
 - Jeffrey Kusmierz and Julie Lind, the firm's other portfolio managers, have both spent the majority of their careers at RhumbLine. Both display a deep level of knowledge on indexing topics and broader industry trends.

SSGA – Organization & Team

- SSGA is the wholly-owned asset management division of State Street Bank and Trust, a publicly traded (STT) bank holding corporation with a custody banking division (State Street Global Services) and broker-dealer division (State Street Global Markets).
 - As of December 31, 2019, SSGA managed approximately \$3.1 trillion in assets with approximately \$1.8 trillion in equity mandates. Cash and fixed income also each make up a significant portion of assets, \$465 billion and \$394 billion respectively. SSGA specializes in indexing strategies, which make up approximately 71% of total assets (\$2.1 trillion).
 - SSGA's client base is significantly institutional, with 75% of total firm assets under management being owned by either taxable or non-taxable institutions.
- SSGA's large size and interconnection with other parts of the financial industry allow for efficiencies of scale and offering a number of ancillary services (e.g. custody banking, securities lending, transition management)
- SSGA structures its passive efforts on a team basis with multiple portfolio managers dedicated to various asset classes and geographies with the overall Global Equity beta team led by Lynn Blake and fixed income by Venky Venkataramani, both knowledgeable individuals with decades of investment experience.
 - In the underlying index teams, turnover tends to be relatively stable and new hires are a mix of external experienced hires and internal hires.

T Rowe Price – Organization & Team

- Founded in 1937, T. Rowe Price Group (TROW) is a publicly traded, global investment management firm that provides a broad array of mutual funds, sub-advisory services, and separate accounts for individual and institutional investors, retirement plans, and financial intermediaries.
 - As of September 30, 2019, T. Rowe's total firm assets were \$1.1 trillion, approximately \$630 billion of which was in mutual funds. The firm manages a broad range of assets including equities, bonds, money market, and stable value products. Nearly 85% of the firm's assets under management are in stock and blended products with the remaining assets in fixed income.
 - The Structured Research strategy included in this search has approximately \$33 billion, a figure which has generally trended down in recent years, usually due to outflows to traditional passive products.
- The US Structured Research Equity strategy, an enhanced index product, uses an analyst-driven approach to security selection. Although T. Rowe Price has more than 160 equity research professionals worldwide, only 30 analysts manage the U.S. Structured Research portfolio.
 - The analysts working on the portfolio are generally very experienced. Many have been with T. Rowe for a large part of their careers.

Investment Philosophies and Processes

- Most traditional passive respondents (BlackRock, Northern Trust, Piedmont, Rhumblin, and SSGA) focus on tracking error minimization. While the actual implementation will vary between full replication and sampling based on mandate, the overall objective is to match the benchmark return as closely as possible within cost limitations.
- T Rowe's Structured Research product seeks a moderate excess return over the benchmark.
 - The process is analyst-centric, with individual sector analysts responsible for buy and sell decisions within their sector. While there is a Portfolio Oversight Committee of five individuals, it largely serves to manage analysts and ensure the portfolio's risk constraints are followed as opposed to a more traditional portfolio management role.
 - Although analysts have a large degree of control within their sectors, the sector and industry constraints are such that tracking error will remain fairly low.

Established Capabilities

	Traditional Passive Management Capabilities								Index-Associated Services		
	US Equity	Global Equity	Emerging Equity	US Fixed Income (Inv. Grade)	US TIPS	US HY	Global Fixed Income	EM Fixed Income	Overlay	Transition Management	LDI
Blackrock	X	X	X	X	X	X	X	X	X	X	X
Northern Trust	X	X	X	X	X		X		X	X	X
Piedmont	X										
Rhumblin	X	X	X	X	X						
SSGA	X	X	X	X	X	X	X	X	X	X	X
T Rowe	X ¹										

- Services listed are not exhaustive; several respondents are capable of managing additional mandates provided there is sufficient scale and operational capacity.

¹ T Rowe's enhanced index strategy within large cap U.S. equities is being considered for this search.

Indicative Pricing

		Domestic Equity	Domestic FI	Global Equity	EM Equity	EM FI	HY	TIPS	MFN
Passive Public	Blackrock	0 to 100M 2.75 bps 100 to 500M 2 bps >500M 1.25 bps Min Fee \$125K	0 to 100M 4.55 bps 100 to 500M 3.90 bps >500M 2.60 bps Min Fee \$200K	0 to 100M 6 bps 100 to 500M 5 bps >500M 4 bps Min Fee \$175K		0 to 100M 15.75 bps 100 to 500M 14.25 bps >500M 12.75 bps Min Fee \$312.5K	0 to 100M 13.5 bps 100 to 500M 12.0 bps >500M 10.5 bps Min Fee \$225K	0 to 100M 4.50 bps 100 to 300M 3.00 bps >500M 1.5 bps Min Fee \$150K	N
Passive Public	Northern Trust	0 to 500M 3 bps 500 to 750M 2 bps 750 to 1B 1.5 bps >1B 1 bps		0 to 500M 3 bps 500 to 750M 2 bps 750 to 1B 1.5 bps >1B 1 bps					
Passive Public	Piedmont	0 to 500M 1.5 bps >500m 0.5 bps							Y
Passive Public	RhumbLine	0 to 1B 1 bps 1B to 2B 0.75 bps >2B 0.5 bps Min Fee \$15K	0 to 500M 1.75 bps >500M 1 bp Min Fee \$15K	0 to 250M 5.5 bps 250 to 500 4.5 bps >500M 4.0 bp Min Fee \$15K	0 to 250M 6.0 bps >250M 5.4 bps Min Fee \$15K				Y
Passive Public	SSGA	0.75 bps	2 bps	2 bps				1.5 bps	Y
Enhanced Index	T Rowe	21 bps over 3B							Y

Summary

- These respondents are all potential candidates to include on a panel of passive management capabilities.
 - All firms have a reasonable amount of passive management capability to merit discussing potential mandates.
 - While a greater number of products are available from larger firms (by AUM), particularly in less-commonly indexed asset classes (e.g., high yield, emerging market debt), it is possible smaller firms may be capable of managing the mandates as well.
- Passive pricing is generally quoted on a mandate-by-mandate basis so we recommend the CRPTF negotiate fees consistent with mandate type and size as well as existing relationships when initiating or renewing specific mandates.