PRI Principles for Responsible Investment

IN SEARCH OF SUSTAINABILITY

PRIVATE RETIREMENT SYSTEMS AND SUSTAINABILITY:

UNITED STATES

FINANCE UNEP INITIATIVE

United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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INTRODUCTION

The US is the world's biggest funded pension market. More than 700,000 private sector workplace retirement plans cover 136 million participants – active members and retirees - and roughly 6,000 state and local public sector plans serve 14.5 million active (working) members and 10.3 million retirees.[1,2] More than 5 million people are covered by the federal employees' retirement system, and just over half of members are active.[3] Some 46 million US households own at least one personal retirement savings account in the form of an Individual Retirement Account (IRA) and total US retirement system assets are estimated at over $30 trillion (Tables 1 and Figure 2).[4,5]

At first glance, the US retirement system appears fragmented. However, there is a relatively high degree of concentration among public and private sector workplace plans and their service providers. Conversely, the personal retirement market is fragmented, with individual account holders employing a large number of local advisers, albeit with the brokerage and custody arms of the market serviced by large domestic and multinational firms.

The policy environment in the US is considerably less supportive of responsible investment than those in Australia and the UK. This is one of the factors behind the low number of private sector signatories to the Principles for Responsible Investment.

1 EBSA Private Pension Plan Bulletin December 2018, Public Plans Database

2 Publicplansdata.org

3 Federal Employees' Retirement System, Summary of Key Trends, Congressional Research Service 02/2018

4 ICI Research Perspective, Vol. 25 No. 10, December 2019

5 ICI Quarterly Retirement Market Data, 2Q 2019; excludes annuities

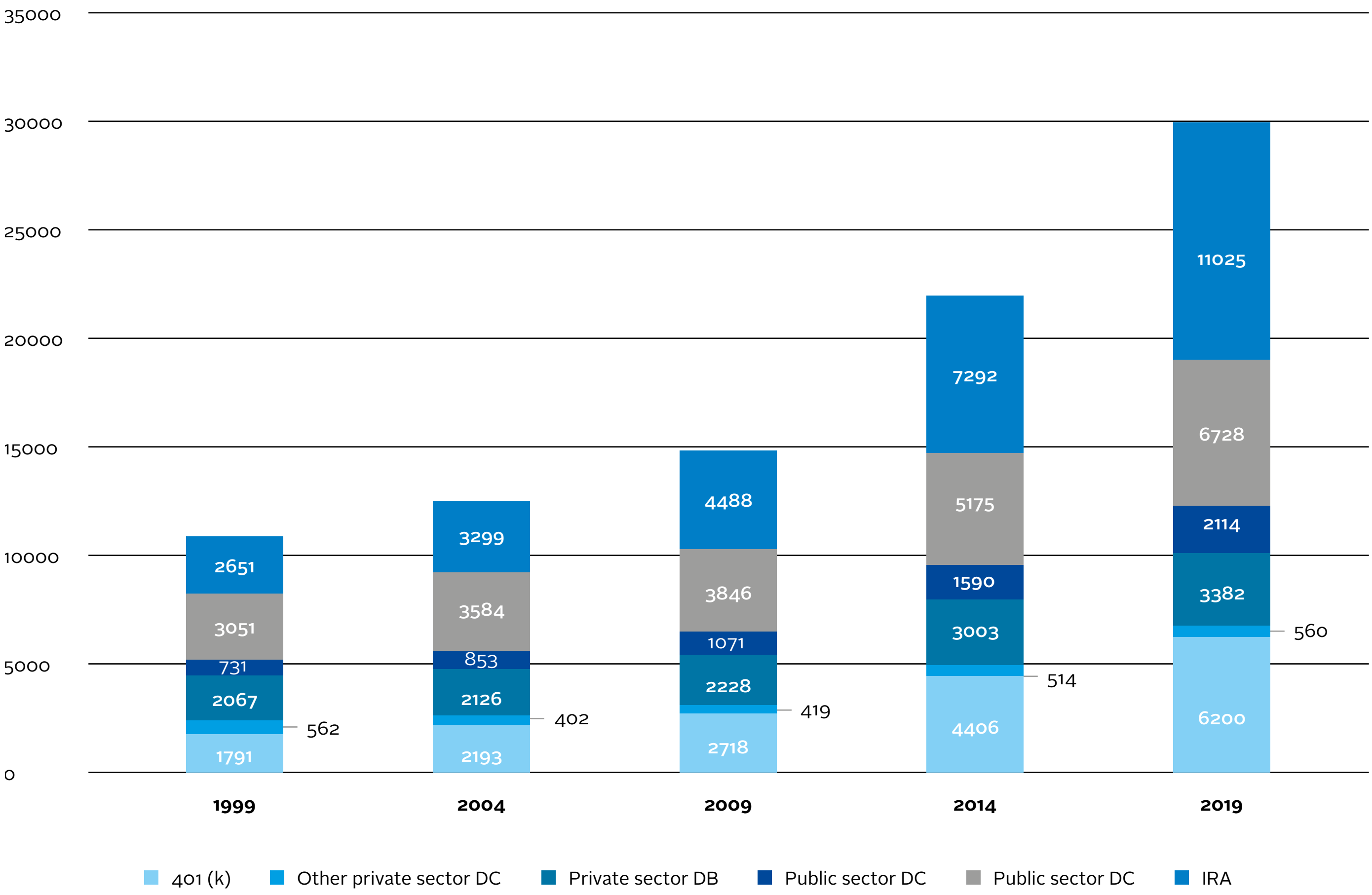
Table 1: US Market Structure. Sources: multiple

	PUBLIC SECTOR		PRIVATE SECTOR			IRAs
	DB	DC	DB	401(K)	Other DC	
Total assets ($ billion)	State and local 4,819 Federal 1,909	403(b) and 457 plans 1,460; Thrift Savings Plan 654	3,382	6,200	560	11,025 est
PRI signatories as % total assets	23%		DB = 0 401(k) < 1			n/a (non-institutional asset ownership)
Sector concentration	Top 10 = 34% of assets		Top 100 funds = 50% of assets	Top 801 funds (0.15%) have 42% of assets		Highly fragmented
Service provider concentration	Top 10 investment consultants dominate tax-exempt institutional advisory market Increasing concentration among recordkeepers					Increasing concentration among recordkeepers
	Asset Managers: top 10 asset managers for DB have >20% of assets, top 10 for DC have >50% of assets					
Regulator	Federal, state or county		DOL (EBSA), Treasury Department, SEC for pooled investment vehicles and investment advisers			Treasury for operation of IRAs, SEC for funds and advisors, DOL
Governance structures	Fiduciary board or trustees		Employer is a plan sponsor. Trustees administer and manage the plan, unless a separate committee is designated for investments. All are fiduciaries.			Advisers usually operate under “Suitability standards”
Asset allocation (median data, individual plans may vary widely)	Equity 48% Fixed Income 22% Real Estate 8% Hedge Funds 7% Other 15% Note: Predominately growth assets		Equity 31% Fixed Income 49% Other 20% Note: De-risking activity accelerating	Equity 43%, TDF 21% Balanced 3% Fixed Income 7% GIC 9% Other 17% Note: balanced and TDF include the other asset classes		(Saver in their 30s) Equity 51% TDF 20% Balanced 7% Fixed Income 5% Other 16%
Key barriers to system sustainability	Legal interpretation Board structure and composition Lack of consensus on implementation		Prioritisation/ DB end game Trustee capability	ERISA/fiduciary responsibilities Focus on cost Restrictions on defaults		Education, choice

Sources: Investment Company Institute, The US Retirement Market Fourth Quarter 2019; PublicPlansData.org; Milliman 2019 Corporate Pension Funding Study; other sources as mentioned throughout text

Defined benefit plans still dominate public sector retirement provision. However, since 1992 over 50% of US retirement assets have been held in individual account-based retirement savings plans, including private sector employment-related defined contribution plans and IRAs. IRAs and 401(k) plans are the fastest-growing components of the US retirement system in terms of assets.

Figure 1: Assets in US retirement system, year-end, $ billion (excluding annuities). Source: Investment Company Institute, The US Retirement Market Fourth Quarter 2019



Public sector = Plans for federal, state and local government employees including TSP.

PUBLIC SECTOR PENSION PLANS

Although their share of the overall pension system is declining, federal, state and local government employee plans represent a substantial asset base of over $8.8 trillion.

FEDERAL PLANS

Federal employees generally benefit from a combination of an annuity (funded by employer contributions and interest) and retirement savings built up in the Thrift Savings Plan (TSP). TSP has assets of over $650 billion, making it the largest retirement plan in the US. It is similar to a 401(k) and consists of low-cost building block funds that can be combined into lifecycle strategies. The characteristics of the funds offered by TSP are defined by law and its board must seek Congressional approval for any changes to the investment instruments permitted in the plan. With that in mind, introducing responsible investment practices could be a complex process.

STATE AND LOCAL GOVERNMENT PLANS

State and local retirement assets are held in trust funds that are fed by employer and employee contributions. Total DB assets held in state and local government plans were $4,819 billion at the end of 2019.[6]

Despite the large number of individual plans, the public sector retirement system is relatively concentrated. The sector is dominated by the two big California state systems, the California Public Employees Retirement System (CalPERS) and the California State Teachers Retirement System (CalSTRS), with combined assets of more than $500 billion.[7] Nationwide, the top 10 plans by assets make up 34% of total state and local DB assets and 35% of active members (Table 2). The Principles for Responsible Investment count the top three state plans amongst their signatories. Signatories account for 23% of state and local DB assets, even though there are only 19 signatories among the 190+ plans in the Public Plans Database.

Table 2: Assets and participants, top 10 state and local plans, 2018. Source: Public Plans Database, UN PRI Signatory database

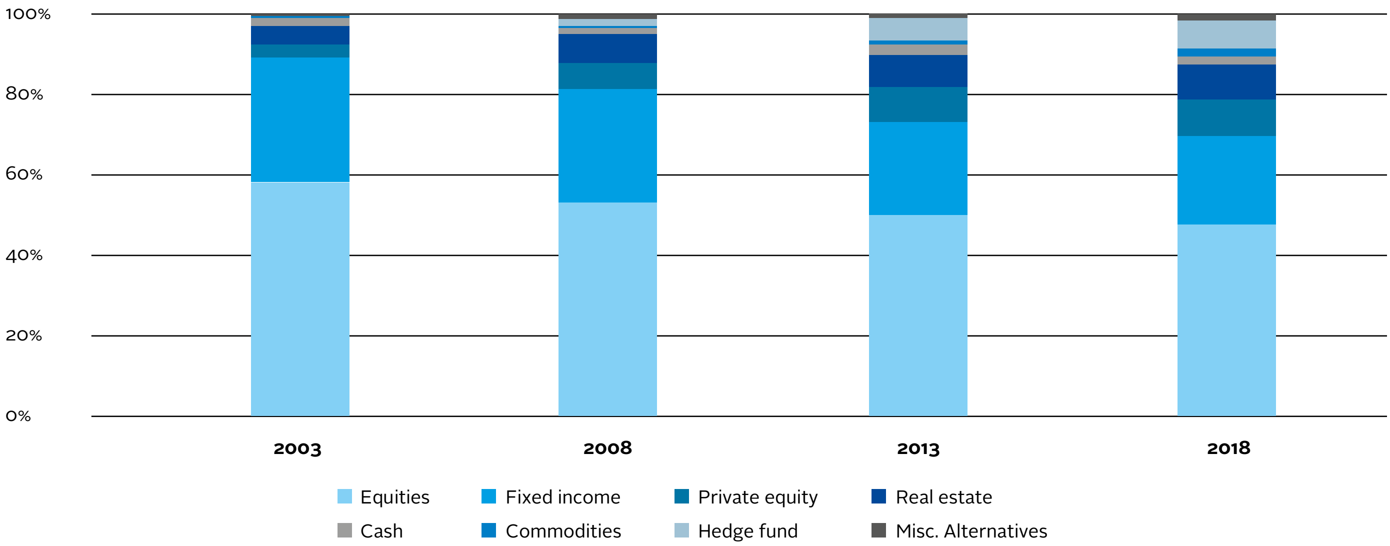
RANK	PLAN NAME	ACTUARIAL ASSETS $ MILLION	ACTIVE PARTICIPANTS	PRI SIGNATORY YES/NO
1	CalPERS	326,182,000	865,290	Yes
2	CalSTRS	190,451,000	449,595	Yes
3	NY State and Local ERS	168,246,000	500,945	Yes
4	Florida RS	156,104,350	516,825	No
5	Texas Teachers	154,051,000	872,999	No
6	New York State Teachers	117,859,500	264,590	No
7	Wisconsin RS	101,410,500	256,933	No
8	Ohio PERS	84,267,000	292,547	No
9	Georgia Teachers	75,024,364	226,039	No
10	Virginia RS	73,204,795	331,959	No
Total		**1,446,800,509**	**4,577,722**	
Top 10 as share of total state and local government DB		**34%**	**35%**	**PRI signatories represent 23% of total assets and 21% of total participants**

6 Investment Company Institute, The US Retirement Market Fourth Quarter 2019

7 These plans can only serve the employees of their state, so fund size can reflect state population size

In principle, public plans are well-placed to introduce responsible investment practices. In contrast to private sector DB plans in the US and to public sector DB plans in other countries, US state and local plans have not been through a process of de-risking since 2008, so they have a higher exposure to asset classes in which responsible investment, historically, has seen more traction. Allocations to equities have fallen, though they remain higher than in private sector DB plans. Weightings in private equity and real estate have increased (Figure 2). One note of caution; the data is weighted by plan size, so reflects the concentration in the top 10 plans mentioned above. Individual state and local plans may run their portfolios quite differently from the average/weighted asset allocation.

Figure 2: Allocations by asset class. Source: Public Plans Database



The Public Plans Database does not split out infrastructure –which historically has included consideration of environmental factors -, but these investments are included in the private equity, real estate, other and miscellaneous alternatives categories. There are 18 public plans included in IPE Real Assets' list of the top 100 infrastructure investors 2019, and the 10 retirement plans with the biggest defined benefit assets in infrastructure are all in the public sector (Table 3). Allocations to infrastructure are relatively small, with the exception of Maine Public Employees, and may include energy investments.

Table 3: Allocations to infrastructure investment. Source: Pensions and Investments, the Largest Retirement Funds, February 4 2019

$ BILLIONS	TOTAL DB ASSETS IN INFRASTRUCTURE	% OF TOTAL DB ASSETS
CalPERS	4,379 (plus 1,360 in forest land)	1.2 (1.5)
CalSTRS	2,769	1.2
Oregon Public Employees	1,772	2.2
New York State Common	1,720	0.8
New York City Retirement	1,614	0.8
Virginia Retirement	1,604	2.0
Maine Public Employees	1,540	10.5
Pennsylvania School Employees	1,254	2.3
South Carolina Public Employees	937	3.0
Michigan Retirement	839	1.2

A number of public pension plans manage a high proportion of their assets internally (Table 4).

Table 4: Funds with the most DB assets managed internally. Source: Pensions and Investments, the Largest Retirement Funds, February 4 2019

$ BILLIONS	TOTAL DB ASSETS IN INFRASTRUCTURE	% OF TOTAL DB ASSETS	OF WHICH DOMESTIC EQUITY $ MILLIONS
CalPERS	244,574	64.9	74,859
New York State Common	112,096	52.6	69,576
CalSTRS	103,832	45.1	51,533
Georgia Teachers	77,523	100	40,071
New York State Teachers	73,462	61.2	42,627
Florida State Board	69,918	40.0	37,396
Wisconsin Investment Board	62,528	54.5	
New Jersey	58,874	70.2	24,064
Ohio State Teachers	53,894	68.1	18,824
Texas Teachers	48,807	31.9	13,227
North Carolina	47,617	42.8	15,498
Ohio Public Employees	42,276	42.0	18,542
Alabama Retirement	38,533	94.6	21,853
Tennessee Consolidated	34,351	58.9	16,643
Colorado Employees	30,910	57.2	12,355

The asset allocation and investment capabilities of the larger state and local plans should not represent a barrier to responsible investment. However, there are a number of factors that affect decision-making, including governance structures, limitations imposed by schemes' funding positions, and misperceptions around the risk/return implications of responsible investment.

GOVERNANCE STRUCTURES

State and local funds operate according to statutory and regulatory frameworks that vary by geography, although the key elements are fairly uniform. State retirement systems are generally established by the state constitution, which also confers authority for pension investment and administrative oversight on fiduciary boards.[8] The California State Teachers Retirement System was established by the California Education Code. For cities and counties, local plans may be subject to additional legislation. For example, the County Employees Retirement Law of 1937 (known as the '37 Act) provides for retirement systems for California counties, while the San Francisco Municipal Code defines benefits and eligibility for the San Francisco City and County Retirement System.[9]

These frameworks are not prescriptive in terms of investment strategy, leaving investment decisions to the board. It is therefore possible for boards of retirement systems established under the same legal framework to adopt different investment principles and strategies. The PRI have state and local plan signatories in eight states – California, Connecticut, Hawaii, Maryland, Minnesota, New York, Vermont and Washington – but even in these states, not all plans become signatories (for example, Connecticut SERS is a signatory but Connecticut Municipal is not).

One recent piece of research finds that public plan boards tend to be relatively large and that they often prioritize stakeholder representation over technical skills in composition.[10] Most boards include elected member representatives (active and retired), ex-officio members (e.g. members of relevant state administrations) and appointed trustees (appointed by Governors, legislatures or participant groups such as public school teachers). Boards may therefore lack the confidence to integrate new approaches into their investment policy statements (Figure 3).

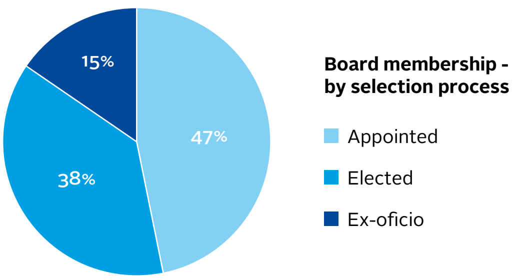
It is possible that governance structures reduce some boards' ability to optimise their investment policies. State legislators may impose limits on headcount or on salaries that make it harder to recruit investment professionals, so that less investment activity is managed internally. This is compounded by the relatively small scale of many plans. Research from 2014 suggests that larger US public plans insourced investment management at around half the rate of Canadian public plans and that insourcing started when plans reach around $30 billion in assets – currently, over 150 plans on the Public Plans Database are below this level and only 40 are above it.[11]

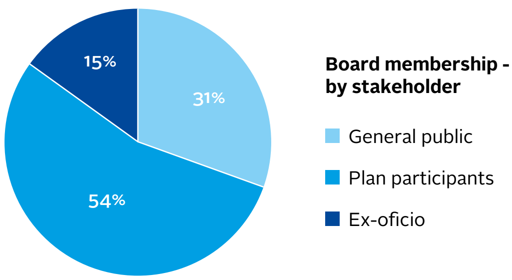
In addition, there is no consistent guidance for public plan boards that lack internal resources or expertise on how to approach responsible investment. The National Conference of State Legislatures' legisbrief cites five state legislatures that considered fossil fuel divestment proposals in 2019, but asks whether these and other screening proposals would unduly shrink the investment universe.[12] Individual plans may be very active in their sustainable activities, but the National Association of State Retirement Associations "does not have a position specifically on ESG".[13]

FUNDING POSITION

Funded status does not appear to correlate strongly with attitudes to responsible investment, although it might be offered as a reason not to adopt these practices. There is a wide distribution of funding ratios among state and local plans, with the top third of funds measured by funded status having an average funding level of 91% and the bottom third of only 55%.[14] The funded status of the relevant PRI signatories ranges from under 40% to over 90%. However, underfunded plans may need to keep some liquidity to pay benefits, giving them less flexibility to tie up assets in long-term investments.

Figure 3: Board composition. Source: NASRA, Aubry & Crawford





8 Note a minority of plans may have separate boards for investment and administration, or a single fiduciary

9 Nasra website

10 Does Public Pension Board Composition Impact Returns? JP Aubry & C Crawford, State & Local Pension Plans No.67 August 2019, Center for Retirement Research at Boston College

11 Public Pension Governance That Works, R Miller and R Funston, Funston Advisory Services LLC March 2014

12 Vol. 27, No. 27 | July 2019, "Policies Drive Public Pension Divestments"

13 NASRA, Topics, ESG 2019

14 Update on the Funded Status of State and Local Pension Plans-FY 2018, JP Aubry and C Crawford, Center for Retirement Research at Boston College, October 2019

15 Public Plans database

PRIVATE SECTOR WORKPLACE RETIREMENT PLANS

Private sector retirement savings plans accounted for 70% of retirement system assets at the end of Q4 2019, up from 65% in 1998. Employer-sponsored DB and DC plans comprise more than a third of system assets, but the rapid growth in IRAs over the past decade – partly driven by rollovers from workplace plans when people have left employment – means that these personal accounts are now the biggest single component of the retirement market.

In contrast to the public sector, private sector employer-sponsored retirement provision has moved decisively from DB to DC. Rules allowing employees to fund 401(k) plans through payroll deductions were introduced in the early 1980s, and led to a rapid growth in 401(k) plans, participants, and assets (Table 5). The percentage of private sector workers that are only members of DB plans declined from 28% in 1979 to just 1% in 2018, while those participating only in DC plans have risen from 7% to 40% over the same period.[16]

Table 5: Growth of 401(k) plans. Source: EBSA Private Pension Plan Bulletin December 2018, Public Plans Database

		TOTAL	DB		DC		INCLUDES, 401 (K)
			SINGLE EMPLOYER	MULTI EMPLOYER	SINGLE EMPLOYER	MULTI EMPLOYER	
Number of plans	1984	604,434	165,732	2,283	435,681	738	17,303
	2016	702,540	44,888	1,412	555,017	1,224	560,373
Number of active participants ('000)	1984	60,618	24,216	5,857	29,670	875	7,526
	2016	93,851	9,689	4,177	76,562	3,423	67,121
Assets ($m)	1984	1,044,592	608,703	91,966	338,670	5,246	91,754
	2016	8,614,940	2,401,195	522,038	5,484,618	207,089	4,738,481

DEFINED BENEFIT PLANS

Table 6 indicates that there has been considerable consolidation in the occupational DB sector, with the number of plans falling by roughly three-quarters between 1984 and 2016. Assets quadrupled over the same period. Indeed, the 100 largest corporate DB plans hold more than $1.5 trillion of assets, almost half the sector total.[17] The 10 largest plans are shown in Table 6. None are PRI signatories (although DowDuPont's asset manager DuPont Capital is a signatory).

Table 6: Largest private sector occupational DB plans. Source: Pensions & Investments, The Largest Retirement Funds, February 2019

SPONSOR	ASSETS $ MILLIONS	SPONSOR	ASSETS $ MILLIONS
AT&T	58,651	IBM	49,207
GM	64,199	UPS	41,253
Boeing	59,700	Lockheed Martin	33,159
Ford Motor	57,710	Kaiser	31,376
GE	54,259	DowDuPont	30,510

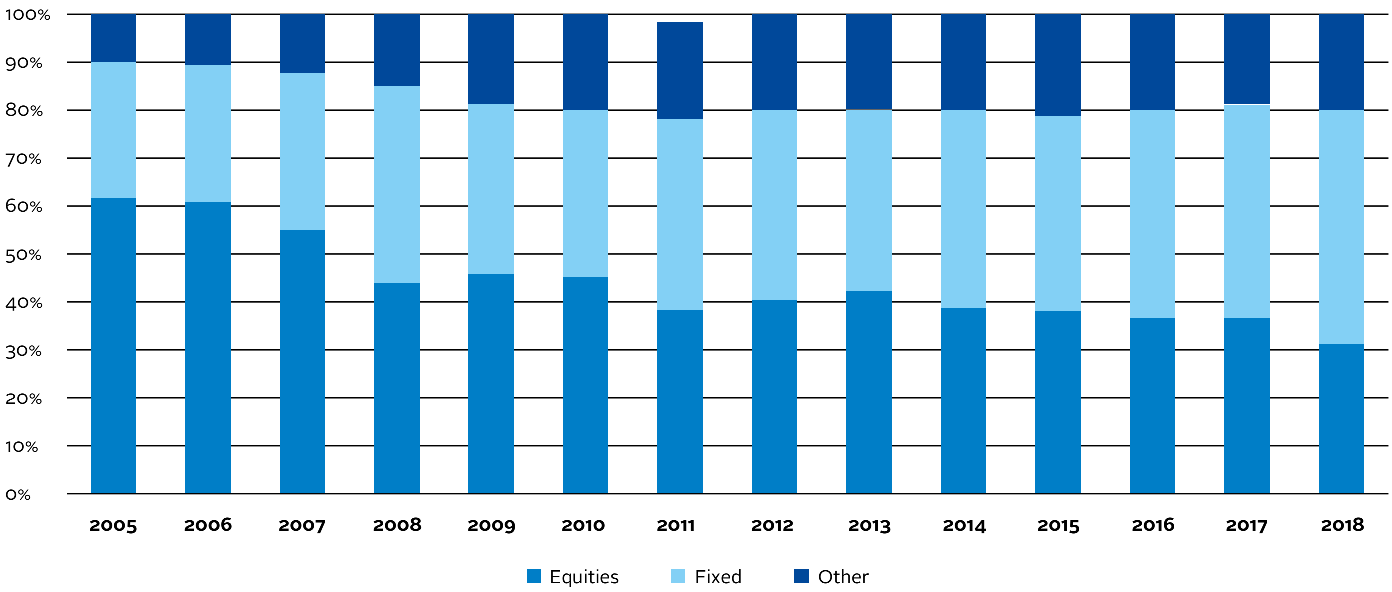
16 Putting Numbers to the Shifting Retirement Landscape, EBRI Fast Facts, January 23rd 2020

17 Milliman 2019 Corporate Pension Funding Study

DB plan participation has been in decline throughout this period. As of 2017, some 25% of members were in plans that were closed to new hires and 12% were in plans that were frozen to new benefit accrual. Despite this, assets remained significant and continued to grow thanks to market returns and employer contributions.[18]

In common with UK DB plans, US private sector DB plans have reduced equity allocations in favour of fixed income and other asset classes (Figure 4); they have also derisked through initiatives including liability-driven investing (LDI), buyouts and "lump sum window" programmes.

Figure 4: Change in asset allocation over time. Source: Milliman 2019 Corporate Pension Funding Study



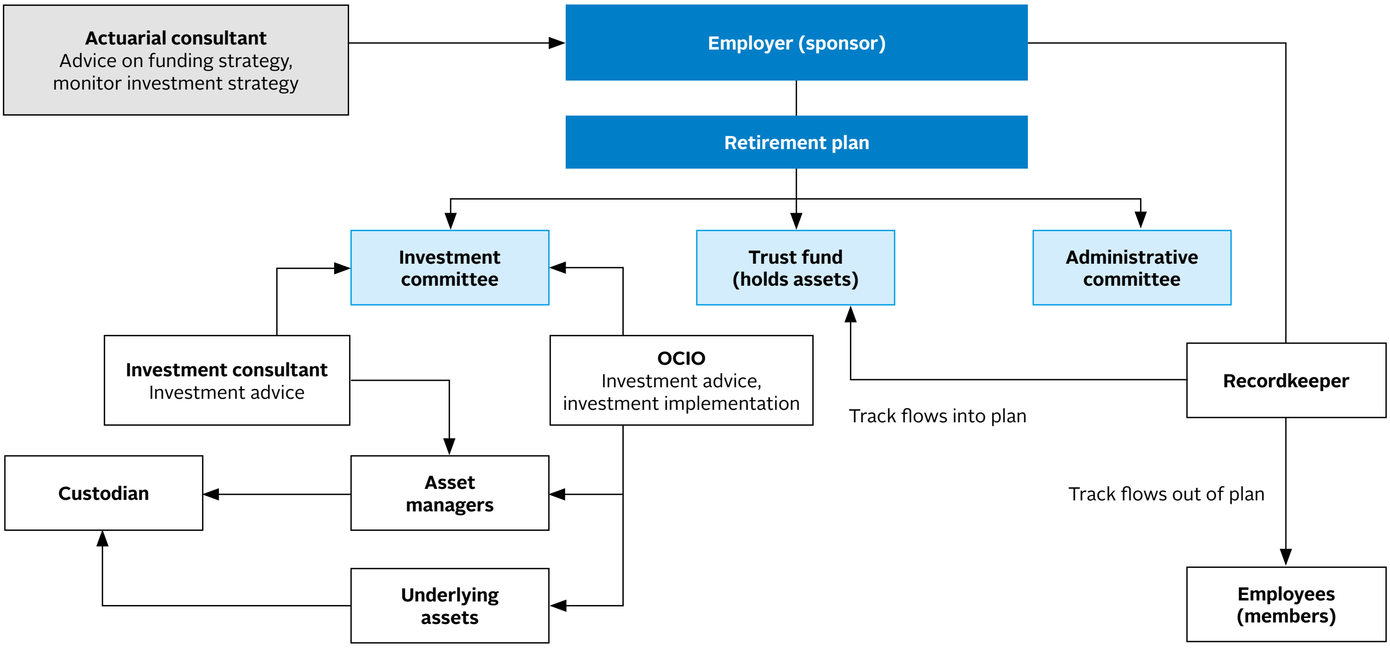
The increasing allocation to fixed income appears to reflect adoption of LDI strategies. "Other" asset classes include private equity, real estate, commodities, hedge funds, and cash or equivalents.

18 Bureau of Labour Statistics TED September 29 2017

DB VALUE CHAIN

Control of private sector occupational defined benefit funds rests with the sponsor (employer). Although the assets are held in a trust fund, independent of the sponsor, plan fiduciaries are almost always corporate officers (Figure 5). Sponsors use a range of actuarial, investment, and employee benefits advisors to ensure that the needs of the plan and the needs of the company are as aligned as possible.

Figure 5: DB governance and value chain



Increasingly, DB plans are using Outsourced Chief Investment Officer (OCIO) services to manage their investment function – OCIO managers are responsible for implementing investment policy and contributing to its development. Corporate DB assets under OCIO management are estimated at $600 billion, with a forecast growth rate of 5% per annum.[19] Confirming the trend away from DB provision, corporate DB plans look to OCIO to help them simplify and exit their pension obligations, but not to advise them on ESG investing. By contrast, ESG capabilities are the primary interest of endowments and foundations ("Non-profits" in Table 7 below).

Table 7: Investment capabilities that institutions foresee needing greater support with, in the next 3-5 years. Source: Cerulli Associates, as of 02/28/2019

INVESTMENT CAPABILITIES	TOTAL	NONPROFITS	CORPORATE DB PLANS
ESG capabilities	43%	69%	0%
Advice on pension end-game	26%	0%	75%
Access to alternatives	22%	31%	0%
Asset allocation	9%	8%	13%
Pension-specific capabilites (LDI, custom glidepath)	4%	0%	13%
Passive management	4%	0%	13%

19 Cerulli Associates | OCIO at an Inflection Point, 2019

DEFINED CONTRIBUTION PLANS

Private sector occupational defined contribution has been dominated by 401(k) plans with $6.2 trillion in assets, alongside other types of DC plan (Keoghs, profit-sharing, stock bonus, money purchase) totalling $560 billion as of 2016.

Employers are not required to offer a 401(k) plan to their employees, but plans are used as part of the overall recruitment and retention package. Since the Pension Protection Act of 2006 facilitated automatic enrolment, the number and coverage of 401(k) plans has grown rapidly to more than 560,000, with 67 million active participants at the end of 2016. However, the market is relatively concentrated, with the 801 largest plans (by number of participants) representing 40% of total participants and 42% of total assets (Table 8).

Table 8: Distribution of 401(k) plans, participants and assets. Source: The Brightscope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2016

	DEPARTMENT OF LABOR 401(K) UNIVERSE		
NUMBER OF PLAN PARTICIPANTS	PLANS NUMBER	PARTICIPANTS '000	ASSETS $ BILLIONS
< 100	503,416	9,529	707
100 – 499	43,493	8,928	489
500 – 999	6,156	4,276	250
1,000 – 4,999	5,601	11,692	808
5,000 – 9,999	821	5,680	458
10,000+	801	26,986	2,025
All plans	560,288	67,091	4,737

The largest 401(k) plans by assets are shown below, none are PRI signatories (Table 9).

Table 9: Largest 401(k) plans. Source: Pensions & Investments, The Largest Retirement Funds, February 2019

SPONSOR	ASSETS $ MILLIONS	SPONSOR	ASSETS $ MILLIONS
Boeing	64,000	GE	26,695
IBM	54,047	UPS	24,991
Wells Fargo	42,900	Northrop Grumman	21,584
Lockheed Martin	33,033	United Technologies	20,658
JP Morgan Chase	28,744	United Continental Holdings	20,575

Plan sponsors are responsible for plan design and for the investment options offered. Key variables in plan design include whether or not employees are automatically enrolled, whether or not the employer makes contributions, and whether or not the plan makes loans.

Employees who are automatically enrolled are likely to use the plan's default option. In 2007 the Department of Labor provided guidance on the Qualified Default Investment Alternative ("QDIA") strategies that could be used as defaults. QDIA must include a mix of asset classes that provide capital preservation and/or long-term capital appreciation, and they must take into account the characteristics of either the member (via a target date fund ("TDF") or a managed account) or the relevant group of members (via a balanced fund).

This has helped to support the rapid development of automatic enrolment and of TDFs: by 2016, over half of plans with more than $250 million in assets automatically enrolled members and more than half of 401(k) participants held a TDF, up from less than 20% in 2006. Some 21% of 401(k) assets were in TDFs, rising to 49% of assets of recently-hired 401(k) participants in their 20s, indicating the predominance of TDFs among default investment options.

It is important in any efforts to make the US retirement system more sustainable that TDFs are considered. However, initiatives to develop "ESG-themed" TDFs have been held back by concerns that these might breach fiduciary requirements, following the publication of EBSA's Field Assistance Bulletin No.2018-01. The Bulletin advises that the Employee Retirement Income Security Act of 1974 (ERISA) does not necessarily require plans to adopt investment policy statements with express guidelines on ESG factors, and suggests that offering a ESG-themed option as a QDIA could breach the duty of loyalty as it would reflect the investment policy preferences of the fiduciary rather than those of the participants.

The bulletin suggests that it would not be prudent to offer an ESG-themed TDF as a QDIA unless it could be established that its risk-return characteristics were equivalent to a non-ESG alternative option. This has made plan sponsors and their advisers reluctant to introduce such funds, especially in a highly litigious environment.

Still, the 2015 Interpretive Bulletin (IB) stated that when ESG factors have economic value, they are "more than just tie-breakers, but rather are proper components of the fiduciary's analysis of the economic and financial merits of competing investment choices". Similarly, in 2016, the Department issued IB 2016-1, which confirmed that ESG issues were consistent with shareholder engagement under ERISA.[20] The underlying law remains the same; however, the interpretation/guidance changes, with favourable or unfavourable language depending on the administration.

For plan participants who do not want to be automatically enrolled into a default fund, sponsors make available a range of other investment options. On average, 401(k) plans offered a menu of 20 funds, plus one or more TDFs. The most common offerings are domestic equity and bond funds, offered by 99.6% and 97.4% of plans respectively (Table 10). Over one third of 401(k) assets are held in US equity funds. Here again Field Assistance Bulletin No. 2018-01 potentially discourages, but does not preclude, sponsors from adding an ESG-themed option to their self-select menus. However, that requires an additional level of due diligence and confidence that it does not "require the plan to remove or forego adding other non-ESG themed investment options to the platform".

Table 10: 401(k) asset class breakdown. Source: The Brightscope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2016

	EQUITY FUNDS		BALANCED FUNDS		BOND FUNDS		MONEY FUND	GICs	OTHER	MEMO INDEX
	DOMESTIC	INTERNATIONAL	TDF	NON-TDF	DOMESTIC	INTERNATIONAL				
% of plans offering	99.6	96.3	80.1	65.4	97.4	30.3	44.2	68.6	64.2	91.3
Average number of options	10.1	2.6	7.4	1.5	2.9	0.3	0.5	0.7	1	
% of total assets	36.3	6.6	21.3	3.2	6.7	0.3	1.9	8.9	14.8	33.2

Data applies to Brightscope universe. GIC = Guaranteed Investment Contract. Other = commodities, Real Estate, individual stocks and bonds

20 https://www.unpri.org/news-and-press/ebsa-issues-new-guidance-on-esg-shareholder-engagement-by-plan-fiduciaries/3033.article

Employers also choose the investment vehicles for each option. Some 45% of 401(k) assets were held through mutual funds in 2016, although the largest funds were more likely to use Collective Investment Trusts than mutual funds. CITs are pooled vehicles similar to mutual funds but are only available to qualified retirement plans. They are cheaper than mutual funds and may offer opportunities for customisation. The largest plans tend to have a relatively high allocation to sponsor stock; on average 21% of assets for plans with more than $1 billion in assets.

Vanguard reported that of the 1,900 plans for which it was the recordkeeper in July 2019, 9% offered a socially responsible domestic equity option, rising to 19% among the largest plans (more than 5,000 participants). This meant that 23% of the 5 million participants served by Vanguard were offered this option. Of these, only 4% selected the option, so just 50,000 participants on Vanguard's recordkeeping platform were invested in socially responsible equity funds.[21] Similarly, a 2019 survey of advisers for 401(k) plans by the Financial Times (FT) found that only 15% of sponsors offered ESG or impact investing options, and that only 3.4% of these plans' assets were held in such strategies.[22] According to the Callan DC index, only 5% of corporate DC plans offered a standalone ESG option in 2018, compared with 43% of public and non-profit plans, while take-up of corporate DC plans was just 1.2%.[23]

The FT survey finds that attitudes to ESG options are evolving, as asset managers provide more resources to help support decisions and as the demographics of the workforce change. However, concern over the DOL guidance, potential controversy and litigation, and the lengthy decision-making processes of 401(k) committees means that adoption will be slow.

A number of states, including Oregon, California and Illinois, have established state-facilitated payroll deduction IRA programs for private sector employees without retirement plan options.[24] These Secure Choice programmes could create significant pools of assets and relieve employers of the fiduciary responsibilities of 401(k) plans. It is likely that the programmes, like 401(k) investments, will be geared towards low-cost, passive investment options. The SECURE Act, effective January 2020, will make it easier for small businesses to join private-sector multi-employer funds and could eventually lead to large asset pools as providers consolidate funds and encourage new employers to participate, as we have seen with contract-based occupational DC providers in the UK.

21 Vanguard, How America Saves 2019

22 FT Special Report, 401 Retirement Advisers October 10 2019

23 Callan blog, 05/29/18

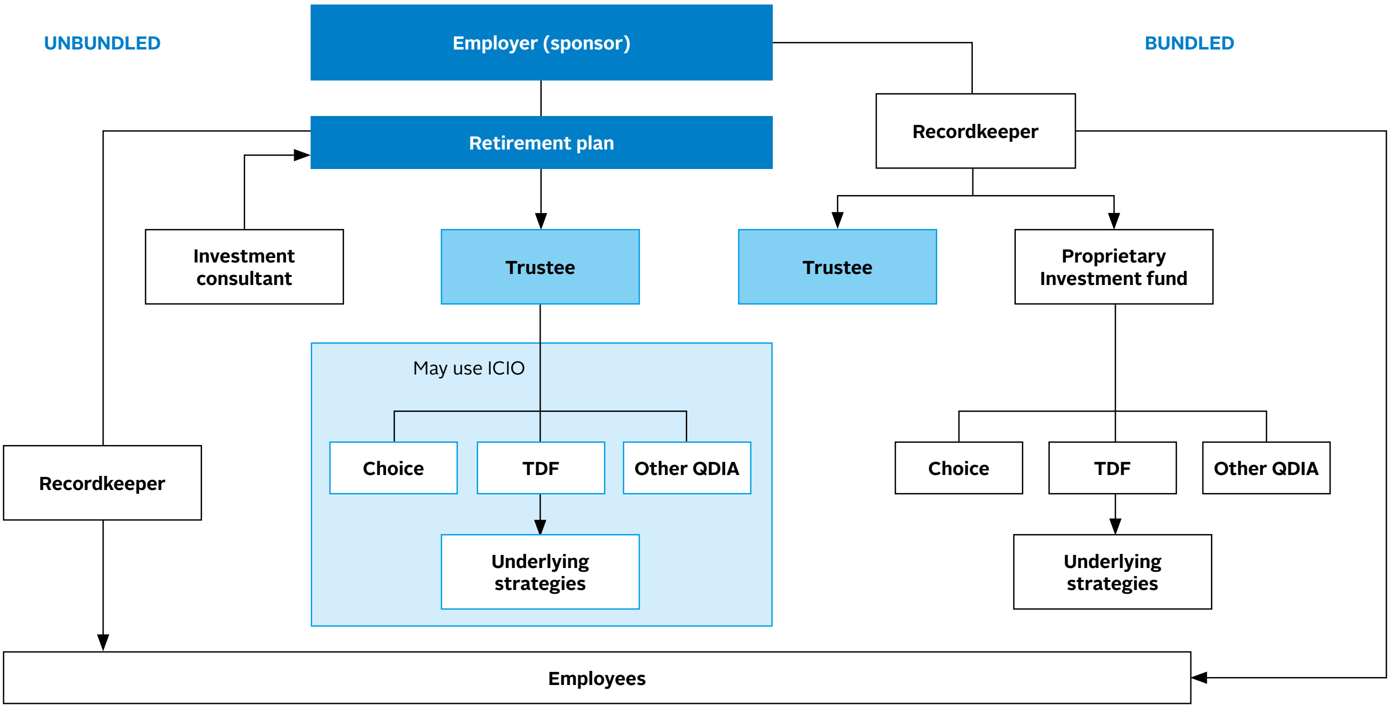
24 Note, the Secure Choice program is subject to challenge in the courts

DC VALUE CHAIN

The value chain for a 401(k) plan revolves around the sponsor. As the named fiduciary, the sponsor is ultimately responsible for the investment line-up. As the proportion of participants automatically enrolled into the QDIA rises, the selection of the default manager – and, where the QDIA is a TDF or a balanced fund, that manager's selection of underlying instruments – will be the primary determinants of how much attention is given to ESG factors in the investment of DC assets.

Large DC plan sponsors often operate the plan themselves, creating committee structures to manage business functions and appointing trustees to manage the plan's assets. Still, almost all plans engage third-party investment managers, administrators, and trustees to carry out day-to-day management (Figure 6). Depending on their role, third parties may have some fiduciary responsibilities, without relieving the sponsor of their obligations. Legal counsels often play an important role in DC plan management, reflecting the risk of litigation if sponsors fail to meet their fiduciary duties.

Figure 6: DC governance and value chain



In practice, sponsors follow the recommendations of investment consultants, use OCIO, or employ other advisers in determining investments. Advisers also play an important role in plan design and in helping employees make decisions about their investments, including when they leave a plan. According to the Retirement Adviser University (a professional education provider in collaboration with UCLA Andersen School of Management) specialist plan advisers work with employers covering roughly two-thirds of DC plan assets. These advisers consult with sponsors on their fiduciary responsibilities and provide advice on plan design, investment design, employee communication and education, and financial wellness.

Advisers may be sole practitioners or part of a larger financial services firm. There is a trend towards consolidation and M&A activity, although in a large part the market remains fragmented and localised.[25]

DC plan assets generate almost $30 billion in revenues for recordkeepers and asset managers. Both services are dominated by a small group of large players, with a long tail of smaller providers. These may specialise in a particular sponsor type (for example smaller employers) or asset class.[26]

25 FT survey op cit.
26 McKinsey 2019

SERVICE PROVIDERS

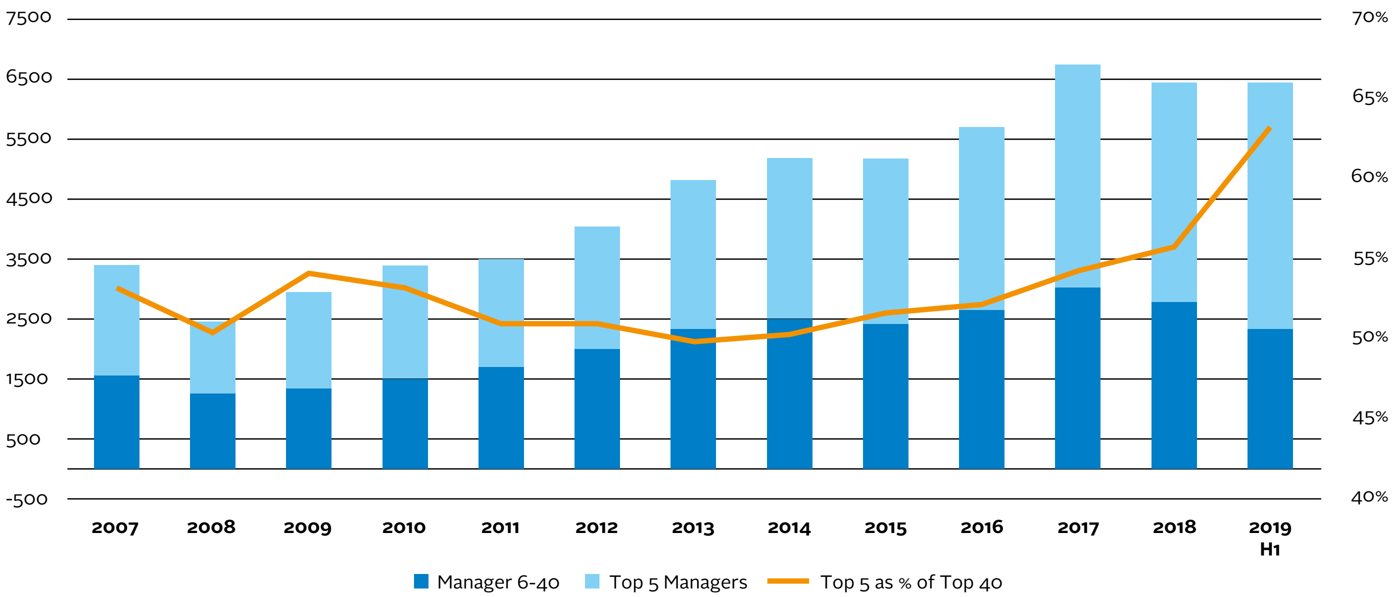
Service providers play an important role in the US private retirement system. Most public and private sector retirement plans use external asset managers, investment consultants and record keepers for a variety of functions.

ASSET MANAGERS

Retirement plan assets are often managed by a relatively small group of investment managers. The top 10 asset managers for DB plans are responsible for more than 20% of DB assets and the top 10 asset managers for DC plans for more than 50% of DC assets (Table 11).

There is a trend towards concentration in DC asset management (not just private sector). At the end of June 2019, the 40 largest asset managers had $6.4 trillion of DC assets, with the five largest responsible for over $4 trillion (Figure 7). The top five DC managers by assets were Vanguard ($1.4 trillion), Blackrock ($954 billion), Fidelity ($773 billion), T Rowe Price, and Nuveen ($500 billion each).[27] The five next biggest were Capital Group, State Street Global Advisers, Prudential Financial, JPMorgan Asset Management, and Northern Trust Asset Management. All are PRI signatories.

Figure 7: DC manager AUM (billions). Source: P&I online, October 31 2019



27 Source: P&I online, company websites

The top ten asset managers could play a major role in making the US retirement system more sustainable. However, recent research found that the biggest three passive fund managers globally have stewardship budgets that are only 0.2% of the estimated fees that they earn from managing equity assets, and that there was no real incentive for them to do more.[28] Indeed, a report by InfluenceMap highlighted the relatively weak performance of many large US asset managers in terms of alignment with the Paris Agreement.[29] Similarly, Majority Action found that BlackRock and Vanguard had a particularly poor voting record on climate-related US shareholder proposals in 2019, and both firms failed to support the three proposals at Exxon, Ford and GM that were backed by the Climate Action 100+ investor coalition (neither did JPMorgan AM, Goldman Sachs and Northern Trust).[30] The Securities and Exchange Commission has suggested changes to shareholder proposal rules and the role of proxy advisory firms. These would further reduce the number of proposals submitted to issuers and increase the voting power of asset managers relative to asset owners.[31]

A study by Cerulli found that "an estimated 88% of total US public market assets, including publicly traded equity, fixed-income and liquid alternative funds, are affiliated with a PRI signatory, yet only 4.5% of firms managing those assets say in their official documents that ESG considerations inform their investment decisions".[32] This does not necessarily reflect bad will on the part of signatories; rather the threat of lawsuits if they cannot precisely match their investment outcomes to the language in their documentation.

Seven of the top 10 DB and DC managers in the US are PRI signatories; Prudential and Legg Mason have subsidiaries that are signatories; NISA is not a signatory.

Table 11: Top asset managers of US retirement assets. Source: P&I The Largest Money Managers, May 27 2019

	MANAGERS OF DB ASSETS*	ASSETS $ MILLION		MANAGERS OF DC ASSETS*	ASSETS $ MILLION
1	BlackRock	540,875	1	Vanguard Group	1,176,384
2	State Street Global	356,831	2	BlackRock	829,826
3	Prudential Financial	194,996	3	Fidelity Investments	666,396
4	PIMCO	170,700	4	Nuveen	507,797
5	NISA Investment	158,295	5	T Rowe Price	413,122
6	JP Morgan AM	149,219	6	Capital Group	366,471
7	BNY Mellon	148,400	7	State Street Global	297,272
8	Goldman Sachs Group	110,983	8	Prudential Financial	221,916
9	Legg Mason	110,107	9	JP Morgan AM	194,729
10	Northern Trust AM	100,171	10	Northern Trust AM	166,334

Data as at year end 2018. *US institutional, tax-exempt assets managed internally

28 Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, Lucian Bebchuk and Scott Hirst, 2019
29 Asset Managers and Climate Change, InfluenceMap, November 2019
30 Climate in the Boardroom, Climate Action, 2019. Note that BlackRock has since joined Climate Action 100+
31 Financial Times, October 25, 2019
32 P&I magazine, November 25, 2019

RECORDKEEPERS

Recordkeepers provide administration services for both DB and DC plans, including maintaining plan records, processing employee contributions and distributions, and running plan analytics; they may also offer corporate trustee and other fiduciary services. For plan participants, recordkeepers provide member services such as statements and call centres and may offer additional financial products such as annuities that are outside the sponsor's design.

Recordkeepers can play a larger role in DC plans, providing trustee and/or investment services in addition to administration. Larger plans in particular are likely to use an asset manager as their recordkeeper while smaller plans are more likely to use insurance companies and mid-sized plans tend to use banks.

Pure-play recordkeepers are more likely to win business with either very small or very large plans. Overall, asset managers provided recordkeeping services for 30% of 401(k) assets in 2016, and 58% of assets in plans worth more than $1 billion. For insurance companies, the figures were 48% and 15%; for pure recordkeepers, 11% and 17%; for banks 7% and 7%; brokerage firms made up the rest of the market.[33]

Fidelity Investments is the largest recordkeeper in terms of DC assets, 401(k) assets, and DC participants. It is the tenth largest in terms of DC plans serviced, implying that it is recordkeeper to larger 401(k) plans (Table 12).

Table 12: 2019 Top Recordkeepers. Source: Plans Sponsor 2019 Recordkeeping survey

	TOTAL DC ASSETS ($BN)*		401 (K) ASSETS (BN)		TOTAL DC PLANS*		TOTAL DC PARTICIPANTS*	
1	Fidelity investments	1,917	Fidelity investments	1636	Paychex Inc	84,477	Fidelity Investments	22,284,450
2	TIAA	606	Empower Retirement	400	American Funds	57,809	Empower Retirement	8,657,754
3	Empower Retirement	540	Alight Solutions	376	Voya Financial	49,585	TIAA	6,328,347
4	The Vanguard Group Inc	454	The Vanguard Group Inc	375	ADP Retirement Services	48,788	Principle Financial Group	5,595,743
5	Alight Solutions	444	Voya Financial	196	J Hancock Rtmt Plan Services	47,807	Voya Financial	5,091,559
6	Voya Financial	309	Wells Farge	191	Ascensus	42,384	The Vanguard Group Inc	4,932,156
7	Principle Financial Group	216	T Rowe Price	159	Principle Financial Group	41,992	Alight Solutions	4,822,800
8	Wells Farge	213	Prudential Retirement	147	Empower Retirement	38,434	Bank of America	4,500,867
9	Bank of America	204	Bank of America	147	Nationwide	35,578	Transamerica	4,072,603
10	Prudential Retirement	203	Principle Financial Group	143	Fidelity Investments	33,544	Wells Fargo	3,461,255

* Includes public sector

Research indicates that integrated providers have a competitive advantage, in that mutual funds provided by the recordkeeper are more likely to be added to, and less likely to be deleted from, the plan's investment menu than similarly-performing funds from rival asset managers.[34] Still, recordkeeper fee structures and fund costs relative to competitor offerings are coming under increased scrutiny. Recent data indicates that the number of fully-bundled plans (in which the recordkeeper also provides trustee services and manages all the investment funds) is declining.[35] Many plans remain partially bundled (not all investment funds are managed by the recordkeeper).

DC assets in proprietary mutual funds totalled $3.19 trillion at the end of H1 2019, of which proprietary TDF mutual funds were about a quarter. The value of proprietary TDF strategies combined (mutual funds, commingled accounts, separate accounts) totalled $1.7 trillion. DC plans with over $1 billion in assets are more likely to be fully unbundled, i.e. the recordkeeper, trustee, and investment funds are independent of each other.

33 All data Brightscope/ICI op cit

34 It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plan, TIAA Institute 2015; Menu Choices in DC Pension Plans, NBER Reporter 2015 No. 4

35 Callan DC Trends Survey 2019

INVESTMENT CONSULTANTS

US investment consultants are regulated by the SEC but take on some fiduciary responsibilities under ERISA when sponsors take their advice on investment strategy.[36] Investment consultants advised on nearly $23 trillion of US institutional, tax-exempt advisory assets as of June 2019.[37] The market for investment consultants is concentrated; the top 10 firms advise on more than 80% of assets and the top 20 on more than 90% (Table 13). Much like sponsors, consultants are cautious in recommending responsible investment strategies in the current regulatory and litigation environment.

In addition, consultants usually do not include investment strategies in their watch lists until they have a three-year track record. However, international consulting firms are beginning to transfer knowledge from the EU – where there is more demand for responsible investment advice. Of the top 10 consulting firms by assets, five are US-focused and five are international.

OCIO assets managed by consultants have almost doubled over the past five years to $1.4 billion.

Table 13: Top 10 consulting firms by US institutional, tax-exempt advisory assets. Source: P&I Special Report Investment Consultants, November 2019

RANK	CONSULTANT	INTERNATIONAL/ AMERICAS	TOTAL ASSETS $ BILLIONS	DB $ BILLIONS	DC $ BILLIONS	PRI IGNATORY
1	Mercer	International	4,246	1,062	1,079	yes
2	Aon	International	2,947			yes
3	Callan	US	2,507	1,807	324	yes
4	RVK	US	2,197	1,420	714	
5	Meketa Investment Group	US	1,976			yes
6	NEPC	US	1,068	695	178	yes
7	Wilshire Associates	International	983	884	38	yes
8	Cambridge Associates	International	953			yes
9	Russell Investments	International	729			yes
10	Rocaton Investment Advisers	US	583	147	228	

36 Jenner & Block, Practice Series, ERISA Litigation Handbook, 2012

37 Source: P&I Special Report, note includes non-pension assets

REGULATORY FRAMEWORK

All private sector employer-sponsored plans come under the ERISA framework. ERISA requires that plan fiduciaries ensure that the plan is run solely in the interests of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. They must act prudently, diversify the plan's investments to reduce the risk of large losses, and avoid conflicts of interest.[38]

Plan sponsors retain ultimate fiduciary responsibility, even when they delegate both administration and investment decisions to third parties. Sponsors are therefore the key to the value chain in both DB and DC private sector workplace retirement plans. This is in contrast to jurisdictions such as the UK, where plan fiduciaries are independent of the sponsor. However, under the existing regulatory framework in the US, there may be a tension between the sponsor's responsibilities towards shareholders and its responsibilities towards plan participants This may discourage investment innovation in general and responsible investment in particular.

The tension should be less problematic in DB plans, where the sponsor promises employees a pre-determined retirement income and is responsible for delivering it. In DC plans, by contrast, the sponsor is responsible for the plan design and investment menu, but does not offer any guarantee in respect of the outcome. When participants are disappointed with the performance of the fiduciary they may take legal action against the sponsor. For corporate officers who serve as plan fiduciaries, there is a strong incentive to avoid any action that may lead to the sponsor being sued and a strong disincentive to offer a plan that deviates from the "average".

Fiduciaries have come under increasing scrutiny for how they select and monitor their service providers and investment strategies. Fiduciaries of 401(k) plans in particular have faced legal challenges for failing to control costs and fees. The Supreme Court ruled in 2015 that trustees had a "continuing duty to monitor" the investment options offered to plan participants[39] and class action lawsuits have resulted in significant settlements, including Lockheed Martin ($62 million, 2015), American Airlines ($22 million, 2017), and Allianz Asset Management of America ($12 million, 2018). This has contributed to a focus on cost in plan design and increased use of passive investments: 33% of 401(k) assets are now held through index funds. A 2019 PIMCO study of plan advisors servicing more than $4.9 trillion of DC assets found that the priority demands from clients were to review the TDF and check investment and administration fees.[40]

In conclusion, while ERISA in principle leaves scope for a broad range of investment strategies (as long as investment decisions are well-researched and documented to demonstrate their compliance with fiduciary responsibilities), in practice it offers few incentives to develop new growth investment strategies. For example, a fund that screens out "bad" companies could fail the fiduciary requirement of prudence, because it restricts the investment universe and so is less diversified than funds that do not screen. An impact investment strategy could fail the "sole purpose" test by being categorised as an "economically targeted investment" (investments selected for the economic benefits they create apart from their investment return to the employee benefit plan). Sponsors are potentially opening themselves up to challenge from employees if they offer responsible investment options that subsequently underperform, even if employees have other, non-ESG options available.

The DOL is also considering rules, similar to those proposed by the SEC, that would limit the ability of trustees to use proxy voting services and shareholder activism where the retirement plan is just one among many investors.[41]

38 See Fiduciary Duty in the 21st Century for detailed analysis

39 Supreme Court of the United States, Tibble et al. v. Edison International et al, October 2014

40 PIMCO DC Consulting Study, April 2019

41 Plan Sponsor, December 12 2019

INDIVIDUAL RETIREMENT ACCOUNTS

IRA assets totalled an estimated $11 trillion at the end of 2018. Over a third of US retirement system assets and a third of US households had at least one IRA account.

Traditional IRAs were established under ERISA to; (1) give workers not covered by an occupational plan a means to save for retirement, and; (2) give participants in employer-sponsored plans the possibility of preserving their assets and their tax advantages if they retire or change jobs, by allowing them to roll over their plan balances into an IRA.

Savings into traditional IRAs are tax-free, while withdrawals are taxed. Roth IRAs were introduced in 1998; contributions are taxed, and withdrawals are tax-free. Employer-sponsored IRAs (SEP, SAR-SEP and SIMPLE IRAs) are designed to encourage small businesses to provide retirement plans.

The bulk of IRA assets are held in traditional IRAs, and most assets have come from rollovers from employer-sponsored retirement plans (Figure 8).

Figure 8: Households holding IRAs and assets. Sources: ICI Research Perspective "The Role of IRAs in US Households' Saving for Retirement. 2018" and "The US Retirement Market, Fourth Quarter 2018"

	YEAR CREATED	NUMBER OF US HOUSEHOLDS WITH TYPE OF IRA (2018)	PERCENTAGE OF US HOUSEHOLDS WITH TYPE OF IRA (2018)	ASSETS IN IRAs (BILLIONS OF DOLLARS, YEAR-END 2018)
Traditional IRA	1974 (Employee Retirement Income Security Act)	33.2 million	26.0%	$7,496*
SEP IRA	1978 (Revenue Act)	7.5 million	5.9%	$510*
SAR-SEP IRA	1986 (Tax Reform Act)			
SIMPLE IRA	1996 (Small Business Job Protection Act)			
ROTH IRA	1997 (Taxpayer Relief Act)	22.5 million	17.6%	$800*
ANY IRA		42.6 million	33.4%	$8,806*

* data are estimated

Households may own more than one type of IRA. SEP IRAs, SAR-SEP IRAs, and SIMPLE IRAs are employer sponsored IRAs.

According to the 2016 EBRI database, 34% of traditional IRA accounts originated from contributions and the average account balance was $97,515; some 30.7% of accounts originated from rollovers and the average account balance was $133,353. Each type of account could have received rollovers or contributions or both since inception.[42] Inflows from rollovers were $148 billion in 2016, compared to $9 billion from contributions (which are subject to an annual limit).

IRAs can be administered by a variety of financial institutions, including brokerage houses, mutual fund companies, and banks. The importance of rollovers in IRA savings may give an advantage to recordkeepers and other service providers associated with employer-sponsored retirement plans.

The GAO found in 2013 that, "Plan participants are often subject to biased information and aggressive marketing of IRAs when seeking assistance and information regarding what to do with their 401(k) plan savings...in many cases, such information and marketing come from plan service providers."[43] Research by Cerulli in 2014 indicated that two-thirds of rollovers went to firms with which the individual had an existing relationship. The EBRI found that asset allocation changes significantly when the funds are rolled over from a 401(k) to an IRA, implying that the financial institution receiving the funds has an influence over how they are invested.[44] All of these examples underline the dominance of financial institutions relative to individuals in investment decisions.

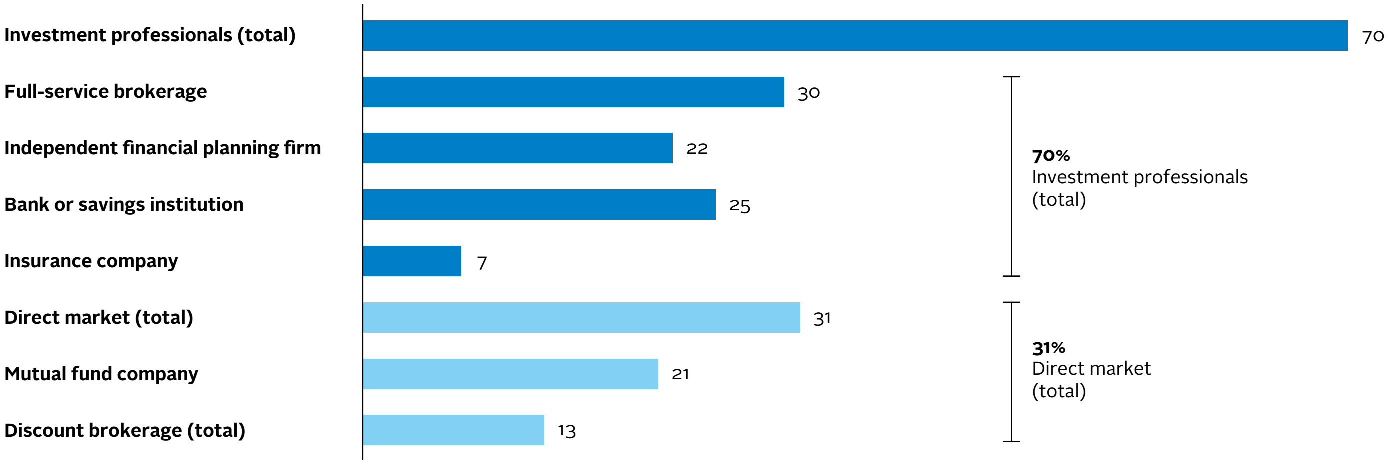
42 EBRI Issue Brief no. 456, August 13 2018: IRA Balances, Contributions, Rollovers, Withdrawals, and Asset Allocation, 2016 Update

43 401(k) Plans: Labour and IRS could Improve the Rollover Process for Participants, GAO March 2013

44 EBRI Issue Brief, November 7 2019

In 2018, 70% of households that owned traditional IRA accounts held them through an investment professional and 30% held them directly through accounts opened with a mutual fund company or a discount brokerage (Figure 9).[45]

Figure 9: Traditional IRAs are held through a variety of FIs. Source: Investment Company Institute IRA Owners Survey



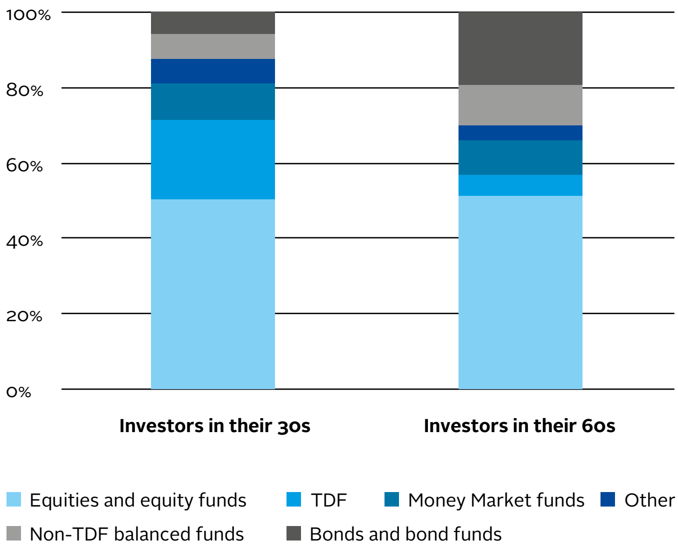
Multiple responses are included

In addition to choosing where to hold their IRA, individuals must choose how to invest it. Usually, they will have many more investment options than in a 401(k), where the menu has been pre-selected by the sponsor. Mutual fund companies will typically offer a large range of proprietary funds; banks and credit unions can only offer a limited range of investment instruments; but all three types of institution can offer an almost unlimited choice of funds from any asset manager if they have a brokerage division. Discount brokers are not tied to any investment manager. Most individuals use a financial adviser to help them navigate the vast range of options.

Registered Investment Advisers (RIAs) are people or firms that are regulated by the SEC and have a fiduciary duty towards their clients to provide suitable advice and act in their best interests (the standards are generally considerably lower for the relationship between broker-dealers and their retail clients).[46] The adviser market is fragmented and advisers may offer services other than IRAs (such as advice on 401(k) or other wealth management activities). There are an estimated 10,000+ RIAs, with 52 firms having client assets of more than $5 billion and another 338 having client assets of more than $1 billion.[47] There is considerable M&A activity in the sector and Cerulli estimates that a further $2.4 billion of assets could be consolidated through mergers and rollups.

Over 50% of IRA assets are held in equities and equity funds. Older IRA account holders hold more bond funds and bonds than younger investors (Figure 10).

Figure 10: Traditional IRA asset allocations. Source: Investment Company Institute, The US Retirement Market, 2nd quarter 2019



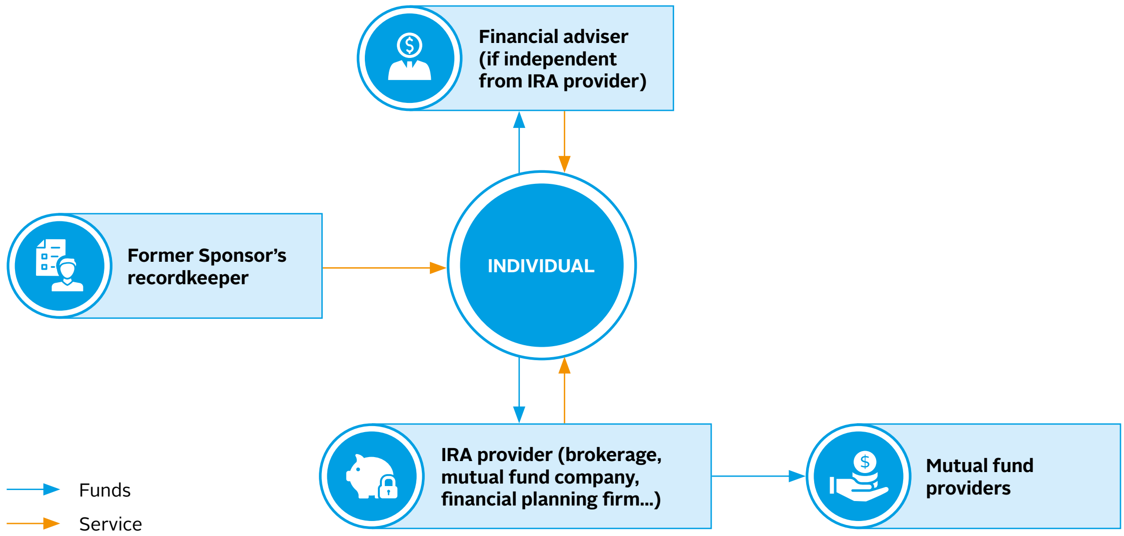
45 Note: full service broker gives research and advice.

46 Securities and Exchange Commission, Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 2019

47 All data from article "RIAs acquiring firms at record pace", Investment News, September 28 2019

To the extent that many IRA accounts are held at brokerages and mutual fund companies, and that 45% of IRA assets are held in mutual funds, it is likely that the same asset managers that dominate the DC market also dominate the IRA market (Figure 11).

Figure 11: IRA Value chain.



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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

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The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact