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FORUM

Limits to asset manager adaptation

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Abstract

In *Our Lives in Their Portfolios*, Brett Christophers provides an account of the rise of 'asset manager society' – a world in which the infrastructures of public life are converted from public to private ownership. Here I use Christophers' analysis to comment on growing calls for asset manager investment in climate adaptation. The asset manager business model requires ever-escalating returns, a poor fit with the now unavoidable losses that climate change promises to bring.

Keywords: asset management; corporate governance; corporate finance; nature and climate

In August 2023, President Biden's National Infrastructure Advisory Council (NIAC) released its report on 'Preparing United States Critical Infrastructure for Today's Evolving Water Crises' (NIAC, 2023). The report noted that '[d]ecades of chronic underfunding and underinvestment' have detrimentally impacted the nation's water infrastructure: 'The US government's share of capital costs on water infrastructure fell from around 60% in 1977 to below 10% in 2020'.[1] As the trade magazine *The Bond Buyer* happily reported, the NIAC hailed privatization of municipal water schemes as a promising solution (Devitt, 2023). In the face of an enormous capital deficit, the President's Council recommended that the government should enable 'privatizations, concessions, and other nontraditional models of funding community water systems' (NIAC, 2023). Not only should critical infrastructure traditionally held by municipalities be turned over to the private sector, the NIAC argued, but federal grant programs should be opened up to private water operators.

An outraged Food and Water Watch, a US nonprofit that has long argued against the privatization of drinking water systems, quickly pointed out that the advisory council behind the report was chaired by the CEO of Global Infrastructure Partners (GIP) (Hart, 2023). GIP makes repeat appearances in Brett Christophers' *Our Lives in Their Portfolios*. He describes GIP as a 'major player in infrastructure asset management', water infrastructure being one of its primary investment targets. Christophers explains that 'asset manager society is a child of broader political-economic shifts, relating in particular to the changing role of the state: indeed . . . . [asset managers are an] 'unelected elite . . . increasingly standing in for the state', making 'big money' from owning assets that 'the public used to own [and] on which citizens vitally depend' (Christophers, 2023: 68). In early 2024, asset management giant BlackRock announced it was acquiring GIP for $12.5 billion (Reuters, 2024).

Christophers argues that asset managers prefer to invest in already existing assets – often assets with characteristics like market power, in the case of utilities and infrastructure, or scarcity, in the case of housing and land. These assets cost little to maintain, and thus the profits they generate are extractive *rentier* profits – they are not

based on innovation or increasing productivity. The rush by institutional investors to capitalize on California's dwindling groundwater resources bears this out. Investors buy up farmland and fund the digging of the deepest wells, sucking their neighbors dry. A recent Bloomberg exposé explained, water is an 'asset class virtually assured of appreciating in a warming, more populous world' (Waldman, Rangarajan, and Chediak, 2023).

Christophers attacks many aspects of this trend, particularly the removal of important infrastructures of public life from democratic accountability and into private hands. One does not need to be a member of Food and Water Watch to be skeptical of drinking water privatization schemes. I once helped to make a short film about a rural community in Texas facing the threat of water privatization after their system failed (Rosenberg and Condon, 2016). A Texas water authority official explains to the camera in a slight drawl: 'If you have a city government, they are interested in paying the bills. If you have a private company, they are interested in paying the bills and putting a little in their pocket'. It really is that simple. In industry parlance, 'hurdle rates', or required returns on investment, shape just how little or large the amount siphoned off to private pockets may be. As Advait Arun has pointed out, these hurdle rates determine investment priorities and can make or break proposed infrastructure projects (Arun, 2023a). Even a profitable project may not be profitable 'enough' to justify funding. The private sector's own conception of the future determines this profitability bar, and new research shows that hurdle rates are often set arbitrarily, regardless of economic conditions (Gormsen and Huber, 2023).

Lately, not just NIAC, but everyone seems to agree that because large institutional investors have all the money, they will need to be the ones that fund our response to the climate crisis. Both our transition away from fossil fuels and our adaptation measures must be paid for by private investors – because no one else, governments included, has the money to pay for it (Gordon, 2024). Hedge funder Ray Dalio recently joined the likes of John Kerry and the International Monetary Fund in reaching this conclusion.[2] Of course, Dalio argues, in order for investors to part with their money, we must 'make it profitable to invest in' climate solutions. As Christophers explains, making assets profitable, or 'bankable', has become part of the broader climate-related political project. Initiatives seek to 'de-risk' and 'blend' projects to make them appealing to private capital (Amarnath et al., 2023).

But I argue here, following Christophers, that letting private investors lead our response to adaptation would be a mistake. Adaptation requires planning and coordination on a scale the private sector is not equipped to deliver. When key infrastructure is turned over to private control, municipalities lose the ability to plan their infrastructure holistically. Christophers points to the example of a parking-meter concession in Chicago, whose contractual commitments restricted the city's ability to expand its new rapid bus system (Christophers, 2023: 177–79). This anecdote shows us that adaptation will be severely impacted if parts of public infrastructure are siphoned off to the private sector. Private actors can become holdouts from broader adaptation plans. As Christophers makes amply clear, our adaptation response cannot be driven by financial managers whose bonus pay is tied to reaping portfolio returns within short horizons, sometimes a matter of months. Our response to climate change must not be driven by these short-term profit-seeking values – it must necessarily have long-term horizons.

Christophers focuses on asset managers – and the 'asset-manager society' they create. Importantly here, asset managers are different from asset owners. Asset owners are what we think of as traditional institutional investors: pension funds, insurance companies, endowments, and sovereign wealth funds. They have big piles of money that must be kept in some assets so that they can pay out in the future – to retirees, to the insured, and to the institutions and governments they serve. Often, asset owners hand over some amount of their money to *asset managers* – the subject of Christophers' book. Just how much asset

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owners retain control over their money and invest their own assets varies considerably between institutions. But as Christophers (2023) thoroughly documents, a substantial amount of the money managed by the nefarious Macquarie, Blackstone, and GIP belongs to these underlying asset owners. This is important because asset managers, as opposed to these other kinds of institutional investors, have particular incentives of their own (Braun, 2022; Bebchuk et al. 2017). They are typically paid to maximize short-term gains rather than long-term portfolio 'stewardship'. This is also important because their middlemen status has arguably served to limit asset owners from accountability for the impacts of their investments.

Asset owners themselves may be realizing that the asset managers under their employ may not have perfect incentives (Kane, 2023). For a host of reasons, including political pressure on public pension funds, asset owners have begun to make substantial climate commitments. Complaints mount, especially in the United Kingdom, that pension funds cannot get asset managers to fully honor these commitments, even with the asset owners' own money (Williams, 2023). The Net-Zero Asset Owner Alliance released a set of guidance documents for members to use in setting climate-related expectations for asset managers (NZAOA, 2023). Asset owners have also banded together in lobbying proxy advisory services, whose climate-related voting advice is sometimes followed in lockstep by asset managers (Wilkes and Jessup, 2023). But so far, these have been baby steps. As Lenore Palladino points out in this forum, few asset owners are reconsidering their relationship to asset managers altogether. The most substantial investments in climate action has come from institutions subject to clear democratic political pressures. California's largest public pension fund recently made a headline-grabbing climate commitment – as part of its strategy to fend off legislative pressure to divest from fossil fuels (Kerber, 2023). How California Public Employees' Retirement System (CalPERS) plans to execute its decarbonization commitments is unclear. Will it bring asset-allocation in-house, potentially accepting smaller project-specific short-term hurdle rates in exchange for achieving long-term climate targets? Or will it farm out its decarbonization investments to a third-party asset manager seeking the typical sky-high private equity returns?

The fact remains that seeking profit is simply what asset managers are set up to do. Asset owners themselves face professional and legal obligations to make sure there is enough money in the pot to pay out for future claims – or retirees. But what if, in aggregate, saving the world just isn't that profitable? In his newer book, *The Price is Wrong*, Christophers explores this very question with respect to renewables – they may be cheap, but are they profitable now? (Christophers, 2024). I'd like to push us to zoom out even further to consider how this relationship between financial returns and climate adaptation will play out in the long run.

While Ray Dalio holds the hilariously low-balled belief that climate change will eventually shave 5% off world GDP, the tide is beginning to turn on financial leaders ignoring our dire straits. As I have explained elsewhere (Condon, 2023), neoclassical models largely fail to capture expected climate damages and some asset managers are finally adopting alternative methodologies for considering our climate-impacted future.

One recent climate scenario exercise came at the request of the Universities Superannuation Scheme, the UK's largest private pension fund consortium (UEUSS, 2023). The 'baseline' scenario outlines expected physical risks and climate impacts from now through the year 2030. It paints a bleak picture. Typhoons pummel Southeast Asia, the US Gulf Coast is severely disrupted by a hurricane, and crops suffer around the world – at the end of the decade, an ecological catastrophe is declared as the Amazon burns. A different scenario with longer horizons was produced by the professional association of insurance actuaries in the United Kingdom (as a refutation of mainstream financial services climate models that grossly understate risk) (Trust et al., 2023). Under their approach, 50% of global GDP destruction is expected 'somewhere between 2070 and 2090' (Trust et al., 2023: 26).

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To prepare for these outlined tragedies, we have the current system of infrastructure investment, driven by closed-end funds seeking to make quick profits. Arguments that the scale of climate change may require a drastic overhaul of traditional investing approaches have begun to appear in surprising places. The UK insurance actuaries argued that the crisis-laden future forecast by their models compelled achieving net zero as a matter of fiduciary duty: 'as if we do not mitigate climate change, it will be exceptionally challenging to provide financial returns' (Trust et al., 2023: 26). This conclusion mirrors an argument I have made before; that it makes sense for institutional investors to exercise their shareholder power to reduce intra-portfolio harms (Condon, 2020).

In the climate world, the future is spoken of with grim resignation, even optimism must be a little sarcastic. As author Andrew Boyd has quipped, there's something funny about the goal of the climate activist being not to save the world, 'but rather . . . to help it get less worse, more slowly' (Gen Dread, 2023). In Boyd's terms, 'we need to do all we can to achieve a better catastrophe: the best catastrophe that's still available to us' (Gen Dread, 2023). Managed retreat scholars speak of planned pullback away from coastlines as 'expanding the range of possible futures' (Mach and Siders, 2021). Such a planned retreat would be a choice representing a certain set of societal values. How does atomized, short-term, liquid, finance 'manage' a retreat? Is there money in retreat? Can we expect endlessly higher profits in an increasingly riskier world? (Arun, 2023b). My own retirement fund held by an asset manager has a target date of 2050; what would it mean for asset managers to genuinely fulfill their duties to me as a potential retiree? What does an 'efficient' allocation of resources look like in this context? In a time of crisis, perhaps they'll just need to get out of the way.

I assume that everyone who uses the internet has seen the 2012 *New Yorker* cartoon in which a man in a tattered business suit explains to children gathered around a fire: 'Yes, the planet got destroyed, but for a beautiful moment in time we created a lot of value for shareholders' (Toro, 2012). As someone who works on climate and uses the internet, I've seen this cartoon approximately 1,000 times. But I hadn't seen a different *New Yorker* cartoon, until recently, and I think it's even better. In it, a suit-wearing man is at a podium, giving a business presentation: 'And so, while the end-of-the-world-scenario will be rife with unimaginable horrors, we believe that the pre-end period will be filled with unprecedented opportunities for profit'. I discovered this cartoon not long after finishing *Our Lives in Their Portfolios*. I suspect we may be nearing the end of the 'pre-end period'.

Christophers argues that fans of the US Inflation Reduction Act and Infrastructure Bill prematurely hail 'the return of the state'. The bulk of the infrastructure funds are going to repair old and falling down infrastructure, not build new structures (English, 2022). To Christophers, and in truth, this funding is 'pinched' in comparison with the scale of the state response required. My own guess is that as the size and pace of climate-related disasters grow, and things fall apart, the state will be compelled to rush in, in one way or another.[3] We can see the beginnings of this happening both in the insurance industry and in the bailouts of electric utilities. It's just twisted, isn't it, that asset managers are able to hinder adaptive investment in the present, due to their claims on the over-valued profits of the future (Condon, 2022).

Notes

1. The Federal Reserve confirms that US infrastructure investment fell from 7% of US GDP in 1961 to less than 3.5% in 2021 (FRED Blog, 2021).
2. Dalio (2023) argues that 'the big money is in the hands of big institutional investors such as pension funds and sovereign wealth funds that need adequate returns to meet their financial obligations to their constituents'. See also Worland (2023) and Black, Jaumotte, and Ananthakrishnan, (2024).
3. Cédric Durand (2022: 55) describes the left vision of 'channeling investment according to social need and ecological boundaries' as 'the revenge of use value'.

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