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Post-crisis environment drives restructurings

For investors as well as asset managers, the financial crisis has driven significant and ongoing change. On the investor side, there's been a rapid shift toward passive products, which in the U.S. last year drew net inflows of more than $400 billion while active funds saw net outflows of over $200 billion, according to **Morningstar**. Within the bond market, persistently low interest rates have driven institutions and individuals into high-yield bonds, with $1.47 trillion in such bonds issued in the U.S. in the five years through 2015, according to the Securities Industry and Financial Markets Association. By comparison, in the five years prior to the financial crisis, the total was $640 billion.

Private markets have been another winner, as investors search both for income and steady long-term returns less correlated to the public markets. For institutions, this includes private equity, which is enjoying an embarrassment of riches, as well as real assets such as real estate and infrastructure. A recent **BlackRock** survey of institutions representing $6.6 trillion in assets showed that more than half are looking to increase allocations to illiquid assets while just 4% plan to reduce exposure, "with real assets attracting the greatest interest." Infrastructure funds alone raised nearly $320 billion in capital between 2000 and 2014, according to BlackRock, but most of that fundraising has occurred since 2007, when the total stood at only $80 billion.

"The watershed event," BlackRock writes in its 2015 "Infrastructure Rising" report, "has turned out to be the global financial crisis, which greatly accelerated the development of the sector. The crisis reduced the supply of infrastructure capital from traditional sources, as governments practiced fiscal restraint and banks were forced to deleverage. It also spurred institutional investors to seek less correlated alternatives to stocks and bonds and new sources of return in a climate of near-zero interest rates."

In response to investors' changing demands and the broader post-crisis transformation of the industry, asset managers have been consolidating already large and diverse operations. This year, that roster includes three giants whose reorgs in varying degrees focused on alternatives, including the hot area of real assets: BlackRock, **Massachusetts Mutual Life Insurance** and **TIAA Global Asset Management**. The restructurings serve one core purpose: to provide institutions with a big-picture review of their portfolios and one-stop shopping multi-asset solutions spanning a range of market environments.

In a recent report on the industry, McKinsey cites "five specific themes" that asset managers must pursue "decisively and urgently in this quest for agility," including the need to "build more integrated organizations to better address the needs of clients who demand more holistic solutions across asset classes and geographies." There is also an economic factor at work in the restructurings, as suggested by McKinsey data: the cost base of asset managers rose 44% between 2007 and 2014. As the consultant notes, "This persistent increase in costs, which affects every functional area, has meant that the industry has failed to benefit from the potential operating leverage that is in the asset management business model."

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The benefits notwithstanding, the reorgs pose some challenges. One is the natural rifts that can arise as units are merged and a new executive pecking order created. Portfolio managers who previously operated inside a smaller unit may be similarly uneasy about a shift that threatens to add internal administrative layers or a change in their operating culture. The effort by marketers to juggle new and additional responsibilities can also impact the quality of the commentary prepared for investors.

Among the three major asset managers to kick off restructurings in the first quarter, BlackRock was first out of the gate with the January announcement of a broad-based reorg that spans asset classes, including combining the real estate and infrastructure units into a unified real assets division. That group is being led by Dublin-based Jim Barry, who as managing director has helped build out the firm's infrastructure group since 2011. Prior to that, Barry had been CEO of an established Irish infrastructure investment firm, **NTR**. Marcus Sperber, a BlackRock real estate veteran, remains head of global real estate, based in London. The selection of Barry may be an indicator in part of BlackRock's view of the higher growth potential of infrastructure.

In a memo to employees that was widely circulated in the media, BlackRock Chairman and CEO Larry Fink said he is "deeply committed" to "reshaping our organization to maximize the full power of BlackRock." Three months later, during the company's first-quarter conference call, Fink elaborated on that theme, saying, "Our goal is not to just sell [clients] individual products, but rather to understand the client's objectives, their needs and to fashion a cohesive solution that helps achieve those goals. While many firms claim to do the same, no other asset manager draws on the same breadth of active, index and alternative strategies."

BlackRock has $30 billion in AUM in its newly combined real assets unit and employs more than 320 professionals in 22 offices around the world. The infrastructure piece is $8.7 billion, including renewable power, a debt platform, and a solutions business. Last year, BlackRock added one of Mexico's leading infrastructure investment firms to the mix when it acquired **Infraestructura Institucional**, which has $1 billion of invested and committed capital. "As our clients' demand for high-quality infrastructure assets continues to grow, we believe that Mexico presents a rapidly evolving investment opportunity for institutional investors globally," Jim Barry said at the time.

The newly rebranded TIAA Global Asset Management, which has made several acquisitions of real asset firms in recent years, also announced plans in the first quarter to form a standalone real assets business. TIAA said the new business "will further leverage the firm's capabilities by aligning affiliates, business teams and strategy in support of the division's continued growth." The unit will include real estate, agriculture, timber, infrastructure and energy businesses, as well as five related subsidiaries; it will have 900 employees in 31 offices globally. TIAA has $100 billion in real assets, with nearly $17 billion in its general account: 55% in commercial real estate; 19% in energy and infrastructure; 16% in farmland; and 10% in timberland.

The group is being led by President Jose Manaya, a TIAA veteran who had been running the private markets business and prior to that served for many years as head of natural resources and infrastructure investments. As with BlackRock, the ascension of a non-real-estate pro to the top spot — and the departure of two real estate veterans — may hint at TIAA's view of future demand and opportunity. Manaya said the new structure will enable TIAA to effectively "leverage our distinct expertise in this space and better serve our investors, which have grown beyond our retirement base to include sovereign wealth fund, pension fund and insurance company clients." Manaya added that his group would become "nimble" and "accelerate our speed to market with transactions and products."

TIAA is making the changes following efforts in recent years to build out its real assets business, including via acquisition. In 2015 alone, it bought out the interest of **Henderson Global Investors** in a real estate joint venture the two firms created in 2013, and also formed a new real estate joint venture with **Swedish National Pension Funds AP1** and **AP2**. Together with its majority-owned timber company, **GreenWood Resources**, TIAA created a $667 million global timber company, **Global Timber Resources**. Additionally, TIAA announced the close of its second agriculture investment partnership, **TIAA-CREF Global Agriculture II**, with $3 billion in commitments.

Massachusetts Mutual Life Insurance was the third major asset manager to announce a restructuring this year, with plans to combine its four affiliates into one multi-asset firm with a solid position in alternatives. The reorg wraps in Charlotte, N.C.-based **Babson Capital Management** and its subsidiaries, **Cornerstone Real Estate Advisers** and **Wood Creek Capital Management**, along with London's **Baring Asset Management**. The combined firm creates a "leading global, multi-asset investment management firm" with $260 billion in AUM, offices in 20 countries, and more than 1,700 professionals. The firm is being led by Tom Finke, chairman and CEO of Babson, and is headquartered in Charlotte. Although Babson accounts for $223 billion of the AUM, the new entity will be branded under the Barings name, which has more cachet outside the U.S., underlining the global ambitions behind the reorg.

The new Baring will span all the major asset classes, from equities to alternatives, as well as global geographies. "As a unified firm we will be better able to deliver our diverse and global investment offerings to clients," Finke said in a statement. In a separate interview with P*ensions & Investments*, Finke added, "As we see the trends among larger pools of capital around the world, big institutional investors are looking to do more than just one special asset class. They're looking for managers that can specialize in more than one asset and provide scale." ▲