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Best Practices for CIO Succession Planning Require Long-Term Preparation

Carrying out executive transitions smoothly requires thoughtful processes established well in advance.

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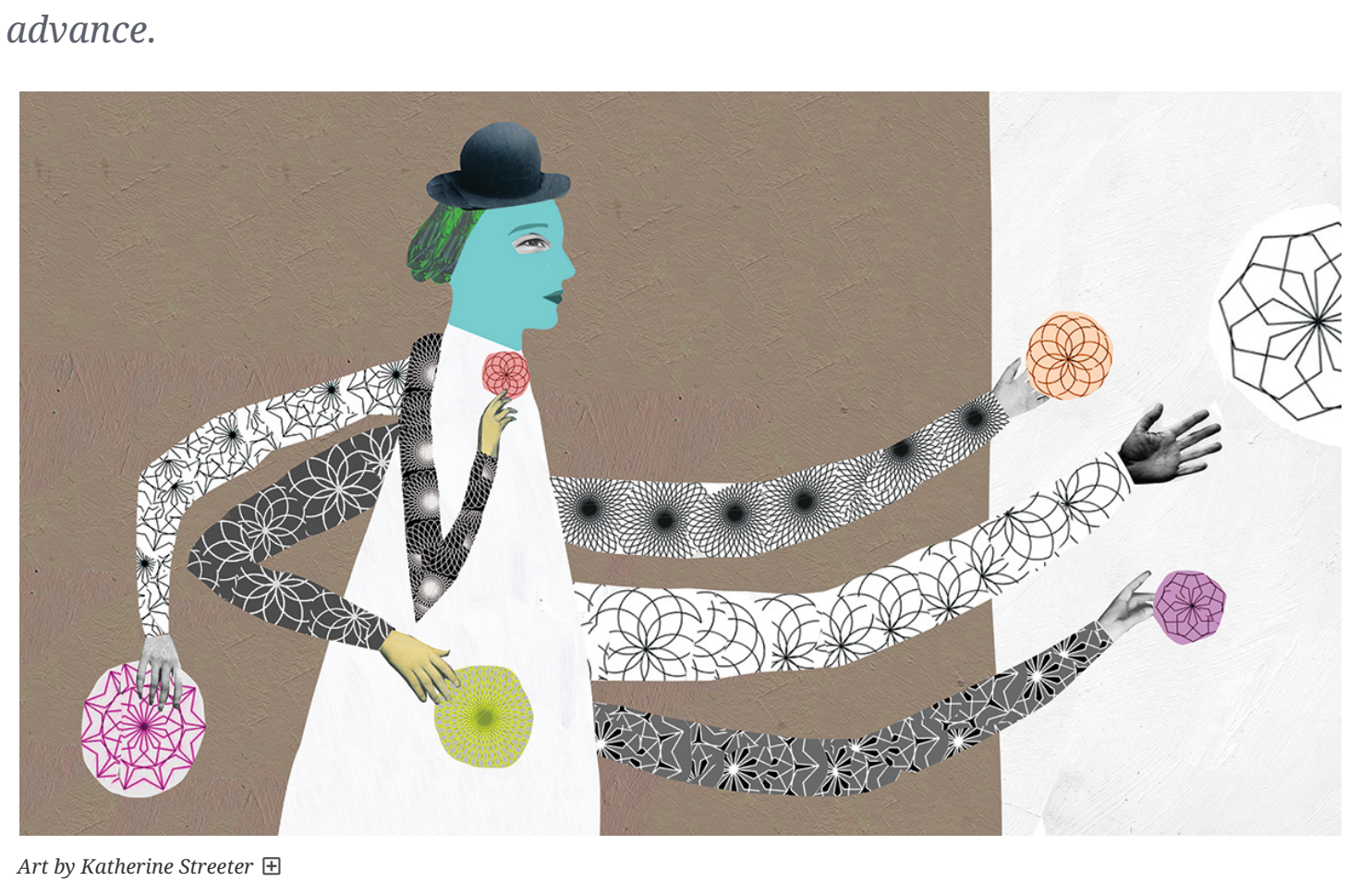

Art by Katherine Streeter

Mansco Perry III, the former head of the Minnesota State Board of Investment, told the fund's board in December 2021 that he planned to retire in 2022, but he did not provide an exact date.

"I ended up being a little more accommodating than I probably should have been," Perry says, noting that he did not officially leave his job until October 2022, about 11 months later.

In the meantime, the board set up a committee to find his replacement and worked with a recruiting firm to design a job description and interview both internal and external candidates. Perry did not serve on the committee, but he did provide the names of some candidates for potential interviews. In August 2022, the organization announced the appointment of Jill Schurtz, then the CIO of the St. Paul Teachers' Retirement Fund Association, who started at the SBI in October 2022.

While the transition was a smooth one, Perry concedes that the organization could have prepared better for the succession. But CIO succession planning is something for which many institutional investors fail to properly plan.

There are several strategies an organizations can put in place to prepare for its CIO's eventual departure—whether that occurs tomorrow or 10 years from now.

Make It an Ongoing Process

CIO succession planning should begin as soon as a new CIO starts, rather than waiting years or decades for when the CIO announces plans for departure, says Vanessa Akhtar, a managing director at Kotter International, a firm in Cambridge, Massachusetts, that helps companies deal with change management.

"Succession planning ought to be a discussion that the organization has periodically, regardless of the tenure of the CIO or CEO," Perry says. "I could have said, 'I'm leaving,' and been gone in two weeks."

Regular discussion of succession planning can also help the CIO from taking offense or worrying that about being pushed out when the board considers succession. It also provides protection against the risk of an unexpected event creating a rushed, less thoughtful process.

"You never know what's going to happen," Akhtar says. "Someone could win the lottery, or someone could get sick and can't do their job anymore. The CIO should always be thinking about building a team where if they moved out of their role, the whole house wouldn't come crumbling down."

While she just started her role as CIO of Fordham University in August 2022, Geeta Kapadia says she is already working to build processes aimed at prioritizing future succession.

"Part of my mandate is building out an investment team that will alleviate some key-person risk, as well as aim to develop staff who should be able to mitigate the impact of any one person leaving the team," Kapadia says.

Think About the Future Needs of the Organization

The first step in succession planning is for the board or committee to consider the criteria that would make the next CIO successful. It is important for organizations to avoid the trap of looking for a replacement identical to the incumbent—no matter how successful they've been—and think instead about how the next person will move the company forward in the future.

"We don't want a bad copy; we want a new original," says Stephen Miles, an executive coach and founder of The Miles Group, which helps companies develop talent strategies and succession plans. "That's an important framing, because the role and the needs of the organization change over time."

A top priority, of course, is the ability to deliver necessary returns on the portfolio, but organizations also want to think about opportunities that might arise in the next three to five years and the CIO skillset that could best capitalize on them, Akhtar says.

"The organization needs to ask what types of leaders they need, what types of change they anticipate and who is best to step into that position, rather than starting with, 'Here is what has always worked,'" Akhtar says.

In today's world, it is also critical to consider an executive with the ability to pivot quickly or respond to quickly changing markets, regulations or other conditions.

"Our world is more uncertain and turbulent and volatile than it's ever been, so when you're thinking about putting someone in that succession pipeline, it's important to identify people [who] embrace the notion of agility," Akhtar says.

Such an approach often means broadening the field of potential candidates beyond obvious or internal ones.

"You should always be trying to hire someone who can be in the seat for 10 or more years," says Jase Auby, CIO of the Teacher Retirement System of Texas. "You shouldn't just simply elevate the current No. 2. Oftentimes, the current No. 2's experience doesn't translate to 10 or more years."

Develop Plans for Internal Contenders

Once an organization has defined criteria for the next CIO, it should assess existing employees to identify future candidates for the position, Miles says. That includes people the board may consider 'not ready' for the role.

"By definition, nobody is going to be ready now, unless they've done the job before," Miles says. "What we're really assessing for is their viability for the role: Do they have the requisite ingredients and the capacity for growth to be ready for the role, rather than being ready right now?"

If the answer to that question is, 'Yes,' the organization and current CIO can focus on giving those employees more responsibilities, experiences and coaching to further their development.

At Texas Teachers, that process began three years before former CIO Jerry Albright left his post. After he and the board identified Auby, then chief risk officer, as successor, they moved Auby into a deputy CIO role and worked to give him more in-depth exposure to specific asset classes and opportunities to build external relationships.

"I started to be invited to attend meetings I normally hadn't been in, with the state legislature, our state government and with senior investment managers outside of the organization," Auby says.

Tweak the Plan Over Time

Regularly revisiting the succession plan, rather than thinking of it as a moment-in-time transaction, typically leads to better outcomes, Miles says. It also prevents incumbent CIOs from getting defensive that a board wants to move on to the next person immediately.

"Thinking of it as an ongoing process makes our hygiene around the process better and allows us to retain some of our highest-performing candidates, because we are doing things with them," he adds. "They're being assessed, they're getting coaching—that creates a connectivity to the organization."

It can also help ensure that the organization has at least one 'name in the envelope' of someone who can take over as acting CIO immediately in an emergency while the board works to find a full-time replacement.

"What we want is to have someone in place who is stabilizing the situation while we run the process to take one last look at the role and assess internal candidates," Miles says. "Hopefully they've been developed, but sometimes the timing isn't perfect."

Also Consider Outside Candidates

While most of the time, advanced succession planning leads to the hiring of an internal candidate, Miles says it can be helpful to interview external candidates as well.

"You want to know who's out there that's recruitable, available and affordable," he explains. "That can give you a comparison that allows you to choose the very best candidate for the role."

There are risks involved in both types of hire. With internal candidates, they often have not performed the role or had as many responsibilities before—no matter how well the organization has prepared them. Meanwhile, external hires typically need more time to get up to speed, and while the organization should interview and consider culture fit, sometimes once the candidate starts, it's clear that is not a match, Miles says.

Set the Incoming CIO up for Success

In the best-case scenario, the former CIO gives a few months' notice and can spend time putting processes and procedures in place to reduce friction for the successor. This can also include making introductions and bringing the successor to important meetings.

However, it is not necessary for the former CIO to assist directly in facilitating the transition. Having written processes and records and a welcoming staff can make a big difference.

"I'm very grateful that Fordham had a lot of good systems in place and people who have been able to point me in the right directions and try to shorten that uphill climb to learn as much as you can about an organization," Kapadia says. "I really appreciated all the face time with people in leadership positions right away, so I could build first impressions."

The process is inherently smoother for internal candidates in a planned succession, who have the advantage of time with their predecessor. Auby says he appreciated receiving a clear enumeration of the CIO's duties and the opportunity to gain experience in those areas in which he had less.

"For me, that was the opportunity to be more external-facing," he says. "I was the chief risk officer previously, and I was much more of an internal presence than an external presence. Just learning how the prior CIO engaged externally was really helpful for me."

Tags: corporate CIO, Geeta Kapadia, Jase Auby, Jerry Albright, Jill Schurtz, Mansco Perry III, public pension fund CIO, Special Coverage: Succession Planning, Stephen Miles, Succesion planning, Vanessa Akhtar

By Beth Braverman

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Pitcairn Family Office Names Sonnenberg as New CIO

Art by Jia Liu

China is a fast-growing giant, destined to be the world's economic leader, and investing in it is a must. China is a despotic rogue state with no regard for the rule of law and big underlying problems that threaten its growth, so investing there is iffy. Those competing narratives are tugging at North American asset allocators nowadays.

The allocators' response? Thus far, most are standing pat (example: Florida's State Board of Administration) or only marginally increasing their exposure (the Canada Pension Plan Investment Board) to Chinese assets. Plans to cut China investments, such as those of the Teacher Retirement System of Texas, are not widespread as of now.
Such less-than-glowing views of the world's second largest economy and its investments stand in stark contrast to China's golden allure not that long ago.

The issue today is how many of the new qualms about the place are temporary, due to recent turbulence, as opposed to permanent, born of the hard-headed realism that China might not be an investment nirvana after all. As China has struggled under its COVID-19 lockdown , which Beijing recently lifted, foreign direct investment has fallen off rapidly, Rhodium Group statistics show, with inflows in last year's third quarter down 30%, compared with the first period's $60 billion.

Beyond that looms the matter of whether China will continue to grow in economic strength and surpass the U.S.'s gross domestic product. Is that outcome inevitable? After all, another expanding Asian power, once seen as destined to eclipse the U.S., has faded. That, of course, would be Japan.

Change in Tempo

China's astounding GDP expansion was possible because it started from a low base, and now those enormous gains have become more muted, a familiar template as economies mature. Looked at another way, says Rob Almeida, global investment strategist at MFS Investment Management, China "has exhausted its growth model," although its pace still outdoes other major nations.

Markets have reflected the change in tempo. Chinese investments have encountered a bumpy road of late, with the Shanghai Composite Index sliding 15% in 2022. At least the Chinese index didn't lose as much as the S&P 500, down 19% last year. And it has blipped up in recent weeks with the ending of the pandemic restrictions.

Time out here for a sobering reality check to put things in context: In historical terms, the China investing fad does not look that clever. For a long time, U.S. stocks have far overshadowed Chinese shares' performances. Right before the global financial crisis, Chinese stocks soared. They since have shed almost 40% of their value, while its American counterparts have quadrupled in worth. Since the crisis, Chinese stock rallies fizzled before they could overtake American equities other than briefly. "They tried to get there in 2015 and 2021, and fell short," observes Huntington Private Bank's CIO, John Augustine.

How Allocators Differ

As a result, the case for investing in China these days boils down to one of diversification, rendering its stocks and bonds worthy additions to a portfolio, but not must-haves. Nobody now is seeking to make a big score with the hottest growth story on the planet.

Opinions differ as to just what Chinese assets to invest in. A large body of thought favors China's tech businesses, especially those oriented toward consumers, such as online commerce giant Alibaba, social media and video-gaming company Tencent and search-engine provider Baidu. Those are better bets than government-owned outfits, which are subject to political interference, suggests Kevin Carter, CIO and founder of investment manager EMQQ Global, which focuses on emerging markets.

The overall watchword for investors nowadays is to approach China with caution, advises Steffen Reichold, chief EM economist at Stone Harbor Investment Partners. He points to a number of significant impediments: foreigners' limited access to China's markets; the nation's weak property rights; U.S. sanctions (several dozen Chinese companies are on Washington's blacklist, hindering them from buying American technology); and the lack of transparency of many domestic Chinese companies. To be sure, China has agreed to divulge more financial details of its companies listed in the U.S.

Yes, China could well be starting to recover now that COVID-19 restrictions are lifted, says Reichold. In the meantime, this possibility has failed to excite institutional investors, who doubt there will be much of an explosive gain from China. They mostly are content to bide their time and see what happens.

Allocators don't usually display political or other subjective opinions in explaining their investment policy moves. Any policy shifts are often explained in the briefest terms. A prime example is the State Board of Administration of Florida, whose board of trustees voted in April 2022 to stop making new investments in China while it continues to assess the risks.

The board chose not to increase the positions due to "increasing risks and uncertainty," Lamar Taylor, the interim executive director and CIO, said at the time. Previously, the board had discussed China's rickety real estate market and its government crackdown on Chinese tech companies.

The organization's last annual report, as of June 2022, did not state all its holdings, Chinese or otherwise, but did list several China-oriented mutual funds: BlackRock China A shares ($226 million), William Blair China A shares ($236 million) and Warburg Pincus China ($102 million).

Florida Governor Ron DeSantis, who chairs the SBA board, has been an outspoken critic of China and insisted that the agency conduct a survey of its investments in the country. The survey indicated that Chinese assets were about 3% of the Florida program's total, and the board's vote to stop further investment came within weeks.

Meanwhile, the CPPIB added to its new China assets by a small amount recently, but it remained unclear if that was offset by any sale of other holdings. As of March 2022, the end of the CPPIB's fiscal year, its China investments totaled C$56 billion (US$42 billion). It has substantial public equity holdings in Alibaba, China Gas Holdings, Postal Savings Bank of China and Tencent.

In late 2022, despite all the controversy over China, the CPPIB invested US$184 million in the Hong Kong initial public offering of China Tourism Group Duty Free, a leading travel merchandiser with 193 stores in airports, cruise ships and downtown areas. It would not discuss the rationale for this particular move.

In its 2022 annual report, the CPPIB did acknowledge that Chinese investments had been a drag on performance, albeit to a minor extent, citing "losses in emerging markets … predominantly driven by investments in China." The fund returned 1.3% in fiscal 2022, down from the previous year's 20%, which came amid a much stronger market.

In September 2022, the Texas Teachers board of trustees voted to halve its China exposure, but it styled the shrinkage as diversification. At its meeting, one official said the fund "needed more balance." Not a word was spoken about Chinese policies, or China assets' strengths or weaknesses.

The Texas Teachers allocations were guided by China's place in a well-followed index. The fund's emerging market benchmark, the MSCI EM index, has long kept China's portion at a little more than one-third (oddly, China is still classified as an EM), and thus the Texas program did, as well. At this level, China was 3% of the fund's entire portfolio. By reducing the China stake, the plan brought that down to 1.5%. For all of 2022, the MSCI index without China lost 19.2%; the China index was worse, yet not overwhelmingly so, down 21.9%.

China's Trajectory

The U.S. economy is projected to have grown just 1.8% in 2022 and, amid economic woes, will increase just 0.5% this year and 1.0% in 2024, says the Organization for Economic Co-operation and Development. China should do better, but nothing like the double-digit rate it enjoyed in years past: 3% in 2022, then inching up to 4.6% and 4.1% over the following two years. China's GDP, according to the World Bank, is $17.7 trillion, with the United States economy slightly more than $2.1 trillion.

China has enjoyed a spectacular ascent since it joined the World Trade Organization in 2001, even counting the recent deceleration, and it is expected to continue out-running others. No wonder Goldman Sachs predicts that China's gross domestic product will overtake the U.S. economy by 2035.

The remarkable growth of the Chinese economy, despite its 2022 stumble due to the strict pandemic lockdown, continues to show potential—and investors are wise to invest in it, argues Matt Lloyd, chief investment strategist at Advisors Asset Management. "They will be a world power, and in 20 years a bigger economy" than America's, he says, adding that considerable headwinds could slow the Asian colossus. China suffers from problems that won't go away, like its aging population and debt-crippled housing system.

Aside from U.S. resolve to stand by Taiwan, which Beijing threatens to invade, flashpoints between the two nations are few. At this point, America and China "have an indirect geopolitical competition," says Seamus Smyth, chief economist at Virtus Investment Partners. China aspires to tech leadership, for instance, yet has a long way to go to draw anywhere close to the U.S., home to Microsoft, Apple, Cisco Systems and on and on.

Military clashes between the two nations, however, cannot be ruled out. Hot-headed human emotions can prevail over calm economic analysis. One pessimistic school of thought: If the world has two rival superpowers, they are bound to go to war. While such a gargantuan conflict, reminiscent of the early 1940s, could set back China's quest to be a prosperous nation, dictatorships operate under different norms than democracies do.

Harvard scholar Graham Allison calls this "the Thucydides Trap," named after the ancient Greek historian, who averred that up-and-comer Sparta, in the 5th century B.C., was bound to militarily challenge Greece's dominant city-state, Athens. In his book about U.S.-China relations, *Destined for War*, Allison warns of "a deadly pattern of structural stress that results when a rising power challenges a ruling one," which stretches from classical times to the recent past, when Germany went to war twice in the 20th century.

To China bears, the regime's indifference to the rule of law is a major red flag for investors. "Does anyone say: 'So what if I can't get my money out of China'?" remarks Fiduciary Trust's CIO, Hans Olsen, reasoning that the returns from Chinese investment are not sufficient to offset the chance that Beijing will confiscate their assets. "No one is paid enough to take that risk."

Nonetheless, if China does overtake the U.S. economically, what difference would it make? "At least, the Chinese would have bragging rights," says Frank Rybinski, chief macros strategist at Aegon Asset Management. Just the same, becoming No. 1 in GDP still leaves China way behind in terms of per capita wealth, he adds. The extent of its poverty and the now-slowing expansion of its middle class are hurdles to any improvement.

Using that gauge shows that China has a long way to go. While it dwarfs the U.S in terms of population (1.4 billion versus 333 million), Chinese GDP per capita is just one-fifth of the U.S.'s, observes economist Gary Shilling, head of his eponymous research and investing firm. Comparing growth rates for each nation's GDP per capita measure, he calculates, means China would possibly overtake America in 109 years, rather than 12, as in the Goldman model.

The Last Word

All right, is China a worthwhile destination for investments?

True, it remains an economic powerhouse. "The world still needs China's goods," says Alison Adams, executive vice president at Meketa Investment Group.

Yet those other worrisome factors intrude. Investors in its securities, she goes on, can be "optimistic over the short term, but there are questions over the long term."

The upshot is that many institutional investors are well aware of these realities as they plan for the future. They may not be bailing out, but the thrill is gone.

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