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DealB%k WITH FOUNDER ANDREW ROSS SORKIN

At BlackRock, a Wall

By LANDON THOMAS Jr. SEPT. 15, 2016

LOS ANGELES — Laurence D. Fink, the leader and founder of BlackRock, the world's largest asset manager, had come home.

A Bruin to the bone — class of 1974 — he had a story to tell the 5,000 giddy graduates packed into the cavernous basketball arena at the University of California, Los Angeles. Once upon a time he was a rock star on Wall Street. He had big hair and flashed turquoise jewelry, and making money had never seemed so easy.

Until it wasn't.

"I screwed up," Mr. Fink declared, recalling the $100 million he blew thanks to failed mortgage trades in 1986. "And it was bad."

For the graduating millennials, the morality tale resonated not least because it came from a U.C.L.A. grad who had ascended, fallen from and again scaled Wall Street's treacherous peaks. But it was his description of why he stumbled that truly explained his evolution from down-on-his-luck bond trader to master of a firm that has its eye on a sum about equal to the $16 trillion United States economy.

"I had become complacent — too sure of what I thought I knew," Mr. Fink said. "I believed I had figured out the market. But I was wrong because while I wasn't watching, the world had changed."

Over the last decade, no other financial firm has gone further in challenging the classic Wall Street moneymaking model for investment banks and traditional mutual fund companies: Hire — and handsomely pay — hotshots to make big bets with other people's money.

The future of finance, Mr. Fink has argued, lies with rules-based, data-driven investment styles such as exchange-traded funds, which track a variety of stock and bond indexes or adhere to a set of financial rules. The idea is that such an approach eliminates at least some of the potential for human error, while lowering costs.

It is this notion of using technology to root out investment risks that lies at the heart of BlackRock's investing strategy. Putting this into practice is the firm's risk-mitigation platform, Aladdin, which enjoys a ubiquity within the firm — it tracks everything from bond trades to head count — that evokes HAL 9000, the sentient computer in the movie "2001: A Space Odyssey." Some employees even use Aladdin as a verb, as in, "Has the new portfolio manager been Aladdinized yet?"

Directing the Flow

On Wall Street, prestige and influence have always been functions of a firm's ability to capture a large amount of what investors call flow — the trillions of dollars in securities that are bought and sold on a given day worldwide. Before the financial crisis, Goldman Sachs's reputation was made because the choice transactions ran through its bankers and traders. The same could be said of the hedge fund SAC Capital Advisors under Steven A. Cohen, who rose to fame (and also became the target of regulators) on his ability to trade off this cascade.

But in today's world of violent price swings and cash-starved markets, those with near infinite buying power — central banks, sovereign wealth funds and the largest money manager in the land — have become the new arbiters of flow. "We have never seen a paradigm shift like this," said Anthony J. Perrotta Jr., an analyst with the Tabb Group, which analyzes the structure of financial markets. "It is not about the flow of securities anymore, it is about the flow of information and indications of interest."

BlackRock's strategy was forged, and ultimately empowered, by two market calamities over the last three decades. The first, of course, was Mr. Fink's experience at First Boston in 1986, when he bet big on mortgages without assessing how the securities would trade in a period of extreme stress.

But BlackRock became the behemoth it is today only after the events of 2008. That is when a souped-up, toxic variety of the securitized mortgages that Mr. Fink helped design years earlier at First Boston imploded — setting off a chain of bank failures and the deepest global economic downturn since the Great Depression. Chastened investment banks were forced to exit these businesses under pressure from regulators.

And in stepped BlackRock. Its assets under management swelled as investors — starved for higher returns — piled into the company's E.T.F.s, which tracked the highflying markets.

"The balance of power is now with firms like BlackRock because they have the 'bid,'" said Mr. Perrotta of Tabb, using Wall Street argot to describe the buying power of large asset managers.

The power shift was on display this spring, when Mr. Fink took the stage at an investor conference alongside John Cryan, recently charged with reviving the sagging fortunes of Deutsche Bank, one of the global investment firms that was minting money before the markets collapsed in 2008. While the event was billed as a cozy exchange of ideas between two Wall Street heavy-hitters, it played out instead as a series of slightly peevish questions posed by Mr. Cryan to Mr. Fink.

"You are effectively becoming the supplier of liquidity of last resort — beyond the central banks," Mr. Cryan said to Mr. Fink.

The assertion bordered on the impudent — suggesting that BlackRock and its $5 trillion stash of assets had become the new guarantor of stability because of its ability to buy and sell stocks and bonds in times of duress. Investment banks, which previously aspired to this duty, have been complaining for years that the financial system has become riskier because BlackRock and similar firms cannot perform such a market-making function.

But to say as much to Mr. Fink directly — and in a room full of investors, no less — was highly unusual. Mr. Fink was clearly irritated by the query. "Well that is not our role — we won't play that role," he replied stiffly.

It was not the most convincing of replies.

'I Am Aladdin'

Over the last 10 years, Mr. Fink has transformed BlackRock from a bond shop catering to pension funds and insurance companies into an asset-gathering machine that uses advanced technology to reimagine how investors buy, sell and assess the risks of a wide variety of securities. Via its $1 trillion-plus in exchange-traded funds, BlackRock has been instrumental in creating newly liquid markets in high-yield and corporate bonds — a direct attack on the business model of banks like Deutsche Bank.

And through its big data-mining risk platform, Aladdin, or Asset Liability and Debt and Derivatives Investment Network, BlackRock says it has developed the market's most highly evolved framework for stress-testing how securities will respond to certain situations — such as a sudden rise in interest rates or what happens in the event of a political surprise, like Donald J. Trump being elected president.

Staffed by 2,300 of BlackRock's 13,000 employees, Aladdin promises to help firms trade, analyze and keep a compliant eye on the assets they manage. In an era of severe regulatory scrutiny, the service has become quite popular. Seventy-five firms — including Deutsche Bank's asset management unit and Freddie Mac — managing a total of $10 trillion, now use it.

For a man who, in his speeches, consistently spends more time talking about technology and risk analytics than the vagaries of the capital markets, Mr. Fink is no techie. Like many Wall Street titans of his vintage, the 63-year-old Mr. Fink rarely sends emails. An infrequent texter, he does most of his communicating by phone, in meetings or over a plate of spicy pasta at his go-to Italian restaurant in Midtown Manhattan.

Mr. Fink maintains a grueling schedule, mixing regular bicoastal trips in the United States with frequent client jaunts to China and the Middle East. "This job requires an enormous commitment," he said. "The pace is relentless. There will be a day when I wake up one day and say I just can't do it anymore."

That day remains well in the future, he says. Still, with BlackRock's growth in size and sway, the issue of who, if anyone, from within the firm is qualified to succeed Mr. Fink has become an existential question for the company's board of directors.

The problem is typical when replacing a founder: Mr. Fink has increased assets to $5 trillion from zero, and the imprint of his domineering personality has become so profound that virtually anyone will suffer to some degree in comparison, considering his track record.

After all, in 1983, he structured one of the first collateral mortgage obligations, and along with Lewis Ranieri at Salomon Brothers made it possible for large investors to enter the market for mortgages. A quarter of a century later, Mr. Fink recognized that the time was right for E.T.F.s and — in the depths of the financial crisis — bought Barclays's iShares business, a deal analysts consider one of the shrewdest in recent Wall Street memory.

And beyond a soaring stock price, there are few better ways for a financial chief to command the respect of his peers than to slip through the grasp of regulators. So when Mr. Fink and his high-powered lobbyists in Washington were able to make the case, after the 2008 financial crisis, that major fund companies like BlackRock posed no risks to the markets because of their size, it only added to his aura.

There is a moment in Don DeLillo's "Cosmopolis," his meditation on the alienating effects of money and machines, when the protagonist financier offers a bit of advice to a colleague. There's only one thing worth pursuing professionally and intellectually, he says: the interaction between technology and capital — its inseparability.

That, more or less, is what Mr. Fink told Dexter Senft, his computer expert at First Boston in 1982. "We are bringing the computer onto the trading floor, Dexter," Mr. Fink recalls saying at the time. "If we can do this, it will change our business forever."

Not only would Mr. Fink and his bond wizards be able to sell billions of dollars of new securities, giving birth to today's market for asset backed mortgages, they could also analyze how these securities would trade in certain situations.

The immense losses at First Boston in 1986 taught a lesson that eventually shaped BlackRock. Mr. Fink realized that his clients on the "buy side" (the fund managers, insurance companies and pension funds shopping for investments) had become dependent on the ability of the "sell side" (the Wall Street investment banks) to analyze mortgages. That was because few buy-side clients had invested in computers and technology to the level First Boston had.

Most money management firms highlight their investment returns first, and risk controls second. BlackRock has taken a reverse approach: It believes that risk analysis, such as gauging how a security will trade if interest rates go up or down, improves investment results.

That is where Aladdin comes in. Aladdin is a network of code, trades, chat, algorithms and predictive models that on any given day can highlight vulnerabilities and opportunities connected to the $15 trillion the firm tracks — $10 trillion of which belongs to outside firms that pay BlackRock a fee to have access to the platform.

Aladdin fills the monitors of most BlackRock employees. One portfolio manager even went so far as to hang a nearly cinema-size screen on his office wall in order to get the full Aladdin experience. And at the company's investor day in June, Mr. Fink and other top executives mentioned Aladdin 82 times — more than any other business line — even though the platform represents just 5 percent of the $11.3 billion in revenues BlackRock took in last year.

Or consider a recent marketing video that shows Mr. Fink and other top executives gazing at the camera and intoning one after the other, "I am Aladdin."

Moment in the Sun

From Mr. Fink's early days on Wall Street, his ambition has been stoked by a sense that he has not been receiving the proper credit for his achievements. At First Boston, even though he was among the earliest to popularize trading in mortgage securities, his peers including Mr. Ranieri and others drew more public attention as innovators and moneymakers.

As a successful, albeit mostly anonymous, bond manager at BlackRock in the 1990s and 2000s, he saw acclaim, pay and influence go to the chief executives of Goldman Sachs, Merrill Lynch and Morgan Stanley. That began changing only in 2009, when he bought Barclays's E.T.F. business. Last year he was among a small circle of Wall Street executives to attend the state dinner at the White House for the Chinese president, Xi Jinping.

A part of Mr. Fink — a fervent Democrat today — believes he would make a pretty good Treasury secretary, say people who have discussed politics with him. Although he recently persuaded Cheryl Mills, one of Hillary Clinton's closest advisers, to join the board of BlackRock, the view is fairly strongly held that if Mrs. Clinton becomes president, there is little chance that she will tap a Wall Street insider for the Treasury job.

With BlackRock's stock having more than doubled since 2011, far outpacing the likes of Goldman and JPMorgan and trading close to its record high, it seems that the market has come around to Mr. Fink's financial worldview: that a low cost, systematic style of investing will, over time, grow faster than the costlier "active investing" model in which individuals, not algorithms, make stock, bond and asset allocation decisions.

And the numbers in that regard are arresting. Through July, E.T.F.s and traditional index funds made up 30 percent of total mutual fund assets, according to the Investment Company Institute, a ratio that has doubled in just under 10 years.

Of course, with close to $1.5 trillion in actively managed funds, Mr. Fink is not ready to write off a segment of the industry that even after years of outflows clocks in at $11 trillion. And he underlines the importance of being able to offer the best of both active and passive investing styles to BlackRock clients.

But inside the firm and out, there is little doubt that he is betting the ranch on E.T.F.s and similarly themed investments choices. These include so-called factor strategies, in which a bet is made on a certain investment outcome — like value stocks outpacing growth stocks, or a basket of low-volatility equities beating the broader indexes.

In San Francisco, a team of equity investors deploys data analysis to study the language that a chief executive uses during an earnings call. Does he seem unusually bearish this quarter, compared with last? If so, maybe the stock is a sell.

"We have more information than anyone," Mr. Fink said.

A Not-So-Short List

Some analysts, in fact, argue that BlackRock should be valued as a technology company, as opposed to an asset manager.

Mark Wiedman, 45, a BlackRock executive who is on the short list to succeed Mr. Fink, believes that bond E.T.F.s, in particular, are creating a liquid market where a new generation of bond investors can freely buy and sell.

For years, he and Mr. Fink have been pitching insurance companies and pension funds to stop buying individual bonds (from the likes of Deutsche Bank) and instead choose a BlackRock bond E.T.F. Now it's happening.

"I think of E.T.F.s as technology," Mr. Wiedman said, as he leaned back in a swivel chair in his office. "It is a product that bundles up a bunch of securities, puts them on a screen and makes them easier to trade."

Like many top executives here, Mr. Wiedman can get a bit manic when discussing the subject: Midway through an interview, he felt the need to somewhat violently undo his tie and cast it aside.

Regulators are less enthusiastic. Global watchdogs like the Bank for International Settlements and the International Monetary Fund have described these bountiful flows into and out of BlackRock bond E.T.F.s as a liquidity illusion. Which means, according to Ken Monaghan, an investor in high-yielding corporate bonds, that easy-to-trade E.T.F.s have lured "tourist" investors — people seduced by the rich yields, but who may not be able to stomach a sustained market reversal.

And if they all leave at once, watch out.

"E.T.F.s do not create liquidity," said Mr. Monaghan, of the global fund manager Amundi Smith Breeden. "These new investors are not permanent."

Aside from Mr. Wiedman of BlackRock, the short list to succeed Mr. Fink includes Robert S. Kapito, 59, a founding partner and current president of the firm who is seen as the top choice if a handover occurs sooner rather than later. Other candidates are Rob Goldstein, the 42-year-old chief operating officer and driving force behind Aladdin's growth; Mark McCombe, 50, a former HSBC executive who looks after the firm's big clients; Rich Kushel, 50, who oversees multi-asset investment strategies for clients; and Gary Shedlin, 52, the chief financial officer. There is also Mark Wiseman, a new hire who joined the firm this month to oversee its equity business.

It is a long list, and purposely so. For Mr. Fink, recommending a successor to his board is probably the weightiest decision he will make as BlackRock chief. He has taken pains to not tip his hand. “I want to make sure that the day after I leave, the firm is better off without me,” he said.

This spring, Mr. Fink called together more than 100 of the firm's most senior executives for two days of meetings in Barcelona, Spain. BlackRock was approaching its 30th anniversary and Mr. Fink was in a nostalgic mood. Yet there was an edge to his remarks.

Yes, BlackRock was thriving because of its focus on low-risk, low-cost funds and the all-seeing wonders of Aladdin. But now was not the time to coast.

“We cannot let someone brand us as a vampire squid,” warned Mr. Fink, referring to a defining article in Rolling Stone magazine that so described Goldman Sachs.

Nor was this a time to sit fat and happy on a big pile of assets and let the fees roll in, an indirect slap at actively managed giants such as Franklin Templeton and Pimco, where assets under management have recently been declining.

Never before, he said, had the fund management industry been so competitive and changing. “If you think you know everything about our business, you are kidding yourself,” he said. “The biggest question we have to answer is: ‘Are we developing the right leaders?’”

And then, looking out over the striving BlackRock executives gathered before him, he put it to them directly. “Are you,” he asked, “prepared to be one of those leaders?”

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