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Bloomberg Businessweek

January 24, 2022

# China's Games

How the balance of power has changed since Beijing last hosted the Olympics 6

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Some things you don't.
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Bloomberg Businessweek

January 24, 2022

◀ Champion-Cain projected success, but her businesses weren't what they seemed



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## ■ COVER TRAIL

How the cover gets made

❶

"So this week's cover is about the Winter Olympics in Beijing. China last hosted in 2008, and a lot has changed."

"Ah, 2008. Skinny jeans, *Twilight*…oh, and wasn't that just before the whole financial system blew up?"

"Yeah, that whole thing. And China was still out to prove itself."

"Relatable—that's why I wore the skinny jeans."

"Uh…"

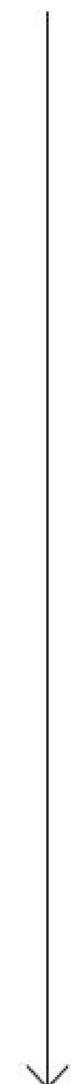
"But after a while you loosen up that market, make big gains in manufacturing, and before you know it you're the world's second-largest economy, and the *real* winner, before the 2022 Winter Games have even begun."

"I'm totally lost."

"It's OK, you just need to write the headline."

"China's Games?"

"Nailed it!"



Cover:
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BUSINESS: COURTESY RENT THE RUNWAY

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Sarah Kemp
LPGA Player

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● Global coronavirus cases are approaching 335 million, almost

**5.6m**

people have died, and more than 9.8 billion vaccine doses have been given. With cases rising, China halted ticket sales to the public for the Beijing Olympics, though select groups of spectators will be invited to attend the games, scheduled to begin on Feb. 4. ▷6

● The House Select Committee investigating the Jan. 6 insurrection at the U.S. Capitol has subpoenaed Rudy Giuliani. Donald Trump's personal attorney was summoned to testify alongside two other members of the former president's legal team for allegedly advancing efforts to overturn the election results. Giuliani's lawyer says he's reviewing the subpoena.

● Surveyors said the massive volcanic eruption in Tonga on Jan. 15, which sent deadly tsunami waves as far away as Peru, has disabled undersea communications cables, complicating relief efforts in the tiny island nation.

● António Horta-Osório, the chairman of Credit Suisse, quit after less than a year in the job.

Hired to stabilize the scandal-plagued Swiss bank and hold employees accountable, Horta-Osório was reprimanded for flouting a coronavirus quarantine last year. ▷19

● The University of Michigan will pay

**$490m**

to settle allegations of sexual abuse by a doctor in its athletic department. The payment, among the largest of its kind by a U.S. university, will be distributed among more than 1,000 students who claim that Robert Anderson, who died in 2008, molested them during physical examinations.

● Microsoft agreed to buy Activision Blizzard for $68.7 billion.

Activision, which has been responsible for gaming franchises such as *Call of Duty* and *World of Warcraft*, has been roiled by claims of sexual misconduct and discrimination. ▷12

● The price of oil hit its highest level in seven years on Jan. 19, with a barrel of West Texas Intermediate closing at

**$86.96**

● "Russian soldiers have gathered near the Ukrainian border without any apparent reason. It's difficult not to comprehend this as a threat."

On her first visit to Moscow, on Jan. 18, German Foreign Minister Annalena Baerbock confronted her Russian counterpart, Sergei Lavrov. Russia has amassed 100,000 troops near Ukraine's border, raising concerns that an attack is imminent.

● Verizon and AT&T agreed on Jan. 18 not to switch on hundreds of 5G towers near American airports.

Airlines say the faster service could interfere with crucial aircraft systems. On Jan. 19 the Federal Aviation Administration said it could confirm that 5G would not affect the altimeters on at least 62% of the U.S. aviation fleet.

● The wealth of the 10 richest people on Earth—all men—doubled during the pandemic, hitting

**$1.5t**

according to a study from Oxfam, a U.K. charity. Incomes for 99% of the population, it found, declined over the same period.

TONGA: MAXAR/GETTY IMAGES. HORTA-OSORIO: CHRIS J. RATCLIFFE/BLOOMBERG. OIL: GETTY IMAGES. BAERBOCK: RUSSIAN FOREIGN PRESS SERVICE/GETTY IMAGES

# As Inflation Soars, The Fed Needs To Keep Its Head

So much for transitory. U.S. prices rose by 7% in 2021, the steepest increase in almost 40 years. Remember: The Federal Reserve's target for inflation is 2%, something that gets less attention than it used to, back when "hawks" and "doves" were measuring deviations in tenths of a percentage point. It's an enormous overshoot, and some of it is likely to prove persistent without corrective action.

The good news is that the Fed can no longer be accused of playing down the risks. In the past two months, its policy stance has moved briskly from patience to concern, with a hint of alarm. Chair Jerome Powell told lawmakers on Jan. 11 that he regarded inflation as a "severe threat." So far, to its credit, the central bank has accomplished this abrupt shift in messaging without roiling financial markets. Investors expect the Fed's bond-buying program to be promptly wound down and have calmly penciled in four interest rate increases this year, starting in March.

Will this accelerated timetable be enough? It looks about right—but with the Covid-19 pandemic far from contained and new uncertainties surrounding the omicron variant, it's impossible to be sure. The Fed needs to keep an open mind, and stay ready to tighten or loosen policy as conditions evolve.

The reasons for the surge in prices are plain enough. Unprecedented supply chain disturbances have throttled output while equally unprecedented fiscal and monetary stimulus have turned up demand to the max. Looking ahead, fiscal policy is likely to be much less aggressive. (Supposing President Joe Biden's stalled Build Back Better plan eventually passes, it would likely involve only a modest further stimulus.) And monetary accommodation is slowly being withdrawn. Even bearing in mind that an inflation spike has the effect of loosening monetary policy (by lowering the real rate of interest), the Fed is no longer deliberately spurring demand.

Yet even as the demand side is coming under better control, the supply side is still a black box. The omicron variant is so transmissible that it's already causing severe disruptions and wrecking plans for a return to business as usual. On the other hand, after two years of Covid-19's spread, policymakers seem to be rethinking the trade-off between caution in controlling the disease and the economic disruption that strict lockdowns cause.

Adding to these uncertainties are looming questions about the medium term and beyond. What kind of permanent changes, if any, will the pandemic make to the way work is organized? And how many pandemic-related exits from the labor force will be reversed once savings, currently buoyed by high asset prices, start to look depleted?

At the moment, the labor market is unambiguously tight. The unemployment rate stands at 3.9%—and, more pertinently, there are clear signs that wages are rising both in response to worker shortages and to offset higher prices. This incipient wage-price spiral, if it continues, threatens to entrench some part of the inflation surge and make it persistent. Over the coming months, this will be the key indicator for judging whether the Fed's corrective action is enough.

Amid all the uncertainty, what's crucial is that the central bank is no longer seen as boxing itself in to a fixed policy. Again, Powell hit the right note on this earlier this month. He said the central bank would need to be "humble and a bit nimble." Exactly. Ⓑ *For more commentary, go to bloomberg.com/opinion*

## ■ AGENDA

ILLUSTRATION BY DAPHNE GEISLER

### ▶ The Italian Job

The Italian Parliament begins voting for a new president on Jan. 24. Prime Minister Mario Draghi is seen as the front-runner for the job, though media tycoon Silvio Berlusconi is also attempting a long-shot comeback.

▶ The U.S. Federal Reserve sets interest rates on Jan. 26. With inflation continuing to climb, pressure is growing on the Fed to raise borrowing costs faster than expected.

▶ Analysts believe the year's first reading of U.S. economic growth, on Jan. 27, will show a 6% expansion. But wrangling in D.C. over stimulus packages has dimmed the outlook.

▶ Turkey's central bank releases its quarterly inflation report on Jan. 27. The bank has said its looser monetary stance will return inflation to a downward trend.

▶ The International Monetary Fund publishes its *World Economic Outlook Update*, an analysis covering projections for global growth, on Jan. 25.

▶ Germany's Bundestag will hold a three-hour debate on Jan. 26 on instituting a vaccine mandate, a controversial topic in Europe's largest economy even as Covid cases surge.

▶ Tesla reports earnings on Jan. 26. The battery-car pioneer smashed delivery records last year, lifting its market value into the rarefied club of $1 trillion companies.

# Same City Different Games

2008



2021

● What's changed since Beijing last held the Olympics? Almost everything

● By John Liu and Janet Paskin

For China, hosting the 2008 Summer Olympics was a chance to prove it could hold its own among the great global powers. When the world tunes in for the opening ceremonies of the 2022 Winter Olympics on Feb. 4, a very different China will be in the spotlight.

In 2008 the country had just surpassed Germany to become the world's third-biggest economy. Its gross domestic product still trailed Japan's and was only one-third the size of the U.S. economy. Today, China's GDP is three times larger than Japan's and steadily closing on the No. 1 spot. If Chinese President Xi Jinping is able to deliver on growth-boosting reforms, and U.S. President Joe Biden's legislative agenda stumbles, China could overtake the U.S. as soon as 2031, according to forecasts by Bloomberg Economics.

"In 2008, China was desperate to make its case to the world that it belonged on the global stage as an equal," says Xu Guoqi, a professor of history at the University of Hong Kong and author of *Olympic Dreams: China and Sports, 1895-2008*. "The message now is China is a strong power. Deal with it."

Western nations have also done their part to boost China's confidence. Three weeks after the 2008 closing ceremony in Beijing, Lehman Brothers filed for bankruptcy, setting off a global financial crisis that pummeled economies around the world, China's included. An estimated 20 million migrant Chinese workers lost their jobs, prompting the government to introduce a 4 trillion-yuan ($630 billion) stimulus package in November 2008. That, along with a surge in lending by the country's state-owned banks, made China, and not the U.S., the world's primary engine for growth for the past 15 years. Although the global economy would recover, China's view of the West never did. The financial crisis "dashed" any illusions that the Western system was "near perfect," says Henry Wang, who founded the Center for China and Globalization in 2008 and has also served as an adviser to the Chinese cabinet.

For many countries, hosting the Olympics no longer seems worth the cost or the headaches—and that was before the global pandemic rewrote the rules for sprawling gatherings. But enthusiasm for big, expensive international contests hasn't dimmed for countries such as Russia, Qatar, and China. Critics have said these governments are engaging in "sportswashing"—using the goodwill and excitement of the games to improve their reputation.

To get to host the 2008 Olympics, the Chinese capital beat out Istanbul, Osaka, Paris, and Toronto. And the Communist Party worked overtime to demonstrate that China took its global responsibilities seriously. It brokered a cease-fire in Sudan, invited envoys of the Dalai Lama to Beijing for negotiations, and unblocked access to previously censored websites, including those of Human Rights Watch and Amnesty International.

For the 2022 edition, China's only competition was Almaty, Kazakhstan's largest city, which has recently been engulfed in violent antigovernment protests. Oslo dropped out because the Norwegian parliament refused to fund the games. Stockholm and Krakow, Poland, also pulled out, while referendums passed in Munich and Switzerland's St. Moritz that barred the cities from bidding.

"If cities in Europe with strong winter sports traditions did not drop out, Beijing would definitely have been a long shot," says Xu of Hong Kong University. "China hosting these games is, in that sense, a gift from Western countries."

In the runup to the 2008 games, the International Olympic Committee argued that having China host would push the country toward convergence with the West on issues such as human rights. Instead, today the divergence is as vast as ever, with Beijing wiping away political opposition in Hong Kong and denying accusations of abuses in the Xinjiang region that the U.S. says are tantamount to genocide.

Beijing has steadfastly denied accusations of genocide in Xinjiang and says its efforts in the country's westernmost province are aimed at fighting extremism. China's state-run media have described the allegations as part of an effort by the U.S. to suppress China's rise. Speaking to a group of journalists in Washington in December, Qin Gang, the Chinese ambassador to the U.S., described American actions over the past few years as "a violent attack." He said "the United States is trying to mobilize allies to kick China out of the international system."

Susan Brownell, a professor at the University of Missouri at St. Louis and author of *Training the Body for China: Sports in the Moral Order of the People's Republic*, says such concerns shouldn't disqualify China or others as hosts. These Olympics, for example, have made the country's human-rights record more prominent for a much larger audience than if the games were getting under way in, say, Oslo. "It's probably a good thing for the games to go to what the pundits call dictatorships," she says. "I don't fully subscribe to the idea that the games legitimize dictators—I don't think the global audience is that stupid."

Yet instead of bowing to pressure, China is more than ever going on the offensive. That's been most evident in the increasingly confrontational behavior of the country's "wolf warrior" diplomats, who've become known for their willingness to engage in verbal scuffles with foreign journalists and government officials alike.

The struggle is broader than them, too. When President Biden hosted officials from more than 100 governments for a virtual gathering dubbed the Summit for Democracy, China responded with a media blitz. Beijing published a white paper days ahead of Biden's summit arguing that China was a "democracy that works," then followed up with a forum of its own on democracy featuring speakers from home and abroad.

"Rather than say, 'Oh, you're a democracy, so we're an autocracy,' China now says, 'No, we're a democracy, too,'" says Wang. "You have freedom of press, one man, one vote. We have a consultative democracy. We have a meritocracy. But let's see who did better on performance. That's the right way to compare."

And with the Olympics back in Beijing, China is ready for the competition. Ⓑ



FROM TOP: GABRIEL BOUYS/AFP/GETTY IMAGES. YI HAIFEI/CHINA NEWS SERVICE/GETTY IMAGES

# Keeping Covid Out of The Cabin

● As the pandemic enters Year 3, airlines are stepping up their hygiene routines

In that long-ago time before the pandemic, most travelers chose an airline based on a single, straightforward factor: price. And those who didn't grab the cheapest fare typically steered their business toward a carrier where they had frequent-flyer miles. Cleanliness, by contrast, barely registered.

These days, hygiene is the most important factor in choosing a travel company for almost 60% of Americans, according to a survey by aerospace products manufacturer Honeywell International Inc. That tracks with International Air Transport Association data showing that passengers worry about boarding planes, with 42% of them uncomfortable using lavatories and more than a third concerned about breathing recirculated cabin air. "We know that our customers are more conscious than ever about hygiene," says Anil Jain, engineering chief at Air India Express, which has introduced robots to clean its planes. "We need to be proactive."

Gone are the days when airlines could get away with quickly picking up the trash and wiping down the galley between flights, doing a deep cleaning only once a month or so. As the pandemic sent revenue into a tailspin in the spring of 2020, most carriers stepped up their hygiene game in hopes of convincing travelers that it's safe to fly. They began touting their hospital-grade HEPA filtration systems that bring in fresh air every few minutes. And many

Edited by David Rocks

UV-VECTOR: COURTESY AIR INDIA. UV WAND: COURTESY BOEING

planes now get a serious cleanse every day with virus-killing chemicals, antibacterial foggers, electrostatic sprayers, or ultraviolet lights that zap germs. But with the omicron variant of the coronavirus wreaking havoc worldwide as the pandemic enters its third year, consumer fears about cleanliness are spiking again.

Although some changes made early in the pandemic were seen as temporary measures to win back travelers, carriers today are taking the long view, embracing innovations such as robots that sanitize surfaces in minutes, devices that spray electrically charged cleaning mists, and seat cushions that kill viruses. "I don't think we as the traveling public will allow airlines to operate flying pigsties again," says travel industry analyst Henry Harteveldt. "We are all hyperaware of biosafety now."

With no global rules governing aircraft hygiene, carriers have adopted a patchwork of solutions. Korean Air Lines Co. sprays all surfaces with a cleaning fluid that it says neutralizes more than 100 bacteria and viruses. United Airlines Holdings Inc. says it wipes down high-touch areas with a disinfectant and uses electrostatic sprayers and UV light disinfection systems. The robots at Air India Express have cleaning arms that plop down into the rows to reach every nook and cranny.

In July 2020, Honeywell introduced a system that can be pushed through the cabin, bathing the plane in high-intensity UV light. The technology has been used for decades to kill germs in water treatment plants and hospitals, and advocates say it destroys almost all viruses on surfaces and in airborne droplets. Honeywell says its device is being used by nine airlines such as Qatar Airways QCSC and Brazil's Azul SA. Last year both Honeywell and Boeing Co. started selling handheld UV wands to disinfect hard-to-clean places such as the flight deck. "It's evident that airlines, airports, and lodging providers must address safety and cleanliness as part of their core brand offering," says Bill Kircos, a marketing vice president at Honeywell.

A Canadian company called Aero Hygenx has taken the concept a step further, with a sanitizing robot it calls Ray that can clean narrowbody planes from front to back in as little as five minutes and a jumbo jet in under 20—about twice as fast as human-operated machines. The unit, which looks something like a beverage cart, steers itself with cameras and a laser sensor and can kill 99% of viruses and bacteria within 5 feet, the company says. The robot also collects information about each cleaning job—creating a data trail airlines can use to reassure passengers. "We wanted a solution that's sustainable, doesn't use harmful chemicals, and can meet airlines' quick turnaround needs," says Arash Mahin, chief executive officer of Aero Hygenx, which has distribution deals with the maintenance units of Deutsche Lufthansa AG and Mitsubishi Heavy Industries Ltd.

At the onset of the pandemic, many carriers adopted electrostatic sprayers that turn cleaning liquids into an electrically charged mist that adheres to surfaces. MasVida Health LLC, a Texas company that has sold such devices to carriers including Alaska Air Group Inc., says it logged record growth in 2020 before seeing demand taper off last year. As omicron spreads, sales are picking up again, not only to airlines but also to cruise lines, schools, and hospitals. The company has developed a newer version of its primary device, a backpack weighing less than 15 pounds that can spray multiple planes before refilling. Next up are robotic models, says MasVida CEO Joshua Robertson, as well as technologies that can be quickly adapted to new variants or other viral threats. "Covid is relatively easy to kill," Robertson says. "We have to be proactive and ready for the next outbreak."

◀ A UV light wand is used to disinfect the cockpit of a Boeing plane

**"I don't think we as the traveling public will allow airlines to operate flying pigsties again"**

An alternative approach to scouring planes is to neutralize germs as soon as they land or keep them from sticking to surfaces in the first place. French aircraft-parts giant Safran SA is developing spray-on seat coatings that it says will kill viruses for a year or more. Boeing is researching polymer-based sprays that can resist and kill viruses, and it's planning touchless features such as lavatories with toilet lids that lower and flush at the wave of a hand. "Covid has accelerated what we're doing," says Dan Freeman, engineering chief of Covid-related safety at Boeing. "We're looking into how we can create an environment that's hostile to viruses and incorporating that into the design process." *—K. Oanh Ha and Kyunghee Park, with Ragini Saxena and Justin Bachman*

THE BOTTOM LINE Carriers expect to deploy ever-more robots that sanitize surfaces in minutes, devices that spray electrically charged cleaning mists, and virus-killing seat coverings.

# So Tired of Wearing Red

● Rent the Runway is betting new tracking tech can help it bounce back after a stock rout

When Brian Donato became chief supply chain officer at Rent the Runway Inc., the 2019 holidays were winding down and women across the U.S. were packing up the gowns and designer jackets they'd gotten from the company for galas, seasonal soirees, and office parties. Then, about a month after he showed up at Rent the Runway's New Jersey warehouse for his first day on the job, the country went into lockdown and events from high school proms to the Met Gala were called off. "The business paused," says Donato, 50, a veteran of Amazon.com Inc. who oversaw the online shopping giant's grocery fulfillment operations.

Donato took advantage of that pause to revamp the way Rent the Runway tracks its garments, from brands such as Ralph Lauren, Nanushka, Jason Wu, and Lululemon. He had radio frequency identification (RFID) tags sewn into 1.5 million items. He installed scanners that register when garments leave or enter the company's warehouses. And he added machines that automatically sort the clothes for various wash cycles. "I said, 'Hey, let's turn this into something,'" Donato says while showing off the technology at the company's bustling fulfillment center in Secaucus, N.J., just a few miles from Manhattan and Newark Liberty International Airport.

When Rent the Runway was founded in 2009, women typically used it for gowns to wear to one-off events such as black-tie galas or weddings—instead of buying an outfit they might don once and then stash in the back of the closet. Today the company makes most of its money from subscriptions for clothes increasingly oriented toward a day at the office or a casual night out. For the fiscal year ending on Jan. 31, the company says it expects to have as many as 122,000 subscribers and sales of about $200 million. Executives say the company will generate enough cash to cover its expenses in the medium-term, without being more specific.

Rent the Runway's shares are down more than 70% since it went public in October. Some investors say the company overestimates demand for clothing rentals, and others say the high cost of sorting, delivering, returning, and cleaning hundreds of thousands of garments a month will keep it from turning profitable. "The business model is very challenged, with overhead costs that are inescapable," says Milton Pedraza, head of the Luxury Institute, a consulting firm.

Still, Verified Market Research predicts the fashion rental market will almost double in value by 2028, to $2.3 billion. That's attracting a growing number of rivals, many of which specialize in niches such as athletic and leisure wear, maternity outfits, or men's clothing. Gwynnie Bee, which launched in 2012 with a focus on plus-size garments, has since added styles starting at size zero. Urban Outfitters Inc. in 2019 introduced a service it calls Nuuly, with rentals of clothing from its own labels and hundreds of others. And Ralph Lauren Corp. last year started the Lauren Look, a subscription service that starts at $125 a month.

Wells Fargo & Co., which rates Rent the Runway's shares a "buy," says that to become profitable the company must boost efficiency and quadruple subscribers, generating revenue of $800 million a year, up from the bank's forecast of $300 million for fiscal 2022. KeyBanc Capital Markets Inc. reckons that in the longer term, Rent the Runway can

● Hyman

● Donato

● RFID tags sewn into Rent the Runway garments

**1.5m**



DRESS: KATIE PATTERSON/GETTY IMAGES. HYMAN: COURTESY RENT THE RUNWAY. DONATO: COURTESY RENT THE RUNWAY. DATA: BLUE ALPHA CAPITAL, FREIGHTOS, ALPHALINER. FIGURES DO NOT ADD TO 100% DUE TO ROUNDING

attract 1.5 million subscribers as more women seek to reconcile their craving for "new" with their desire to lead a more sustainable lifestyle. But KeyBanc cautions there's still a chance many consumers may reject the idea of renting clothes.

Jenn Hyman, Rent the Runway's co-founder and chief executive officer, says doubters underestimate changes implemented during the pandemic. In September 2020 she boosted profitability by terminating an option that let users borrow an unlimited number of garments for $159 a month, instead introducing plans ranging from $89 a month for four garments to $199 for as many as 16. And she's added more casual clothes as the pandemic upends dressing habits. "We are no longer reliant on people going back into the office or going to galas," says Hyman, 41.

She also points to Donato's overhaul, with the RFID tags streamlining the crucial tasks of sorting, washing, and maintaining sweaters, ball gowns, tops, or trousers. Before, employees at distribution centers–the one in New Jersey and another near Dallas–would unpack garment bags and manually sort clothes into a half-dozen bins for laundering. Now items pass through a scanner that reads the RFID tags and steers them into one of 26 bins destined for different wash cycles–divided among silks, wools, cottons, and so on–which extends their life. The company says its clothes are rented an average of 20 times before being retired.

As the items pass by, employees with scanners can see a garment's history with notes on, say, whether a shirt's buttons tend to fall off, a sweater has started to pill, or dark jeans are fading. Stained garments are sent to a team of "spotters," and the inspectors can add comments or pull a garment from the rotation and send it for repair. Once the clothing has aged, Rent the Runway offers the items for sale or donates or recycles them.

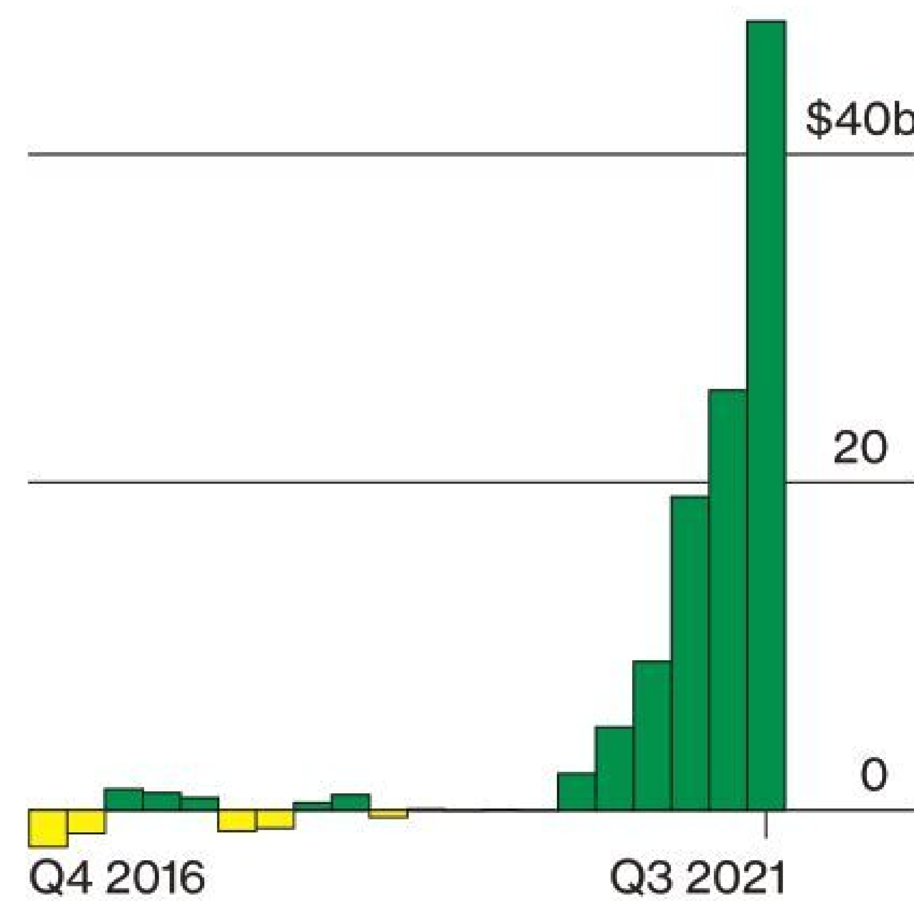
Just as important, customers provide feedback: whether jeans are true to size and offer a flattering fit, a winter coat is warm enough, or the arms on a dress are too tight. Those comments and the detailed information on what's renting provide insights into customer preferences that couture houses lack, Hyman says, helping Rent the Runway produce its own clothing. "That data on quality, on fit, on how she wears it–it's data that no other business in the fashion industry has," she says as garments stream past on rotating racks at the New Jersey warehouse. "Their data ends when something is sold." *—Jeannette Neumann*

THE BOTTOM LINE Skeptics say Rent the Runway's costs are too high for the company to turn a profit, but executives insist changes made during the pandemic will eventually push it into the black.

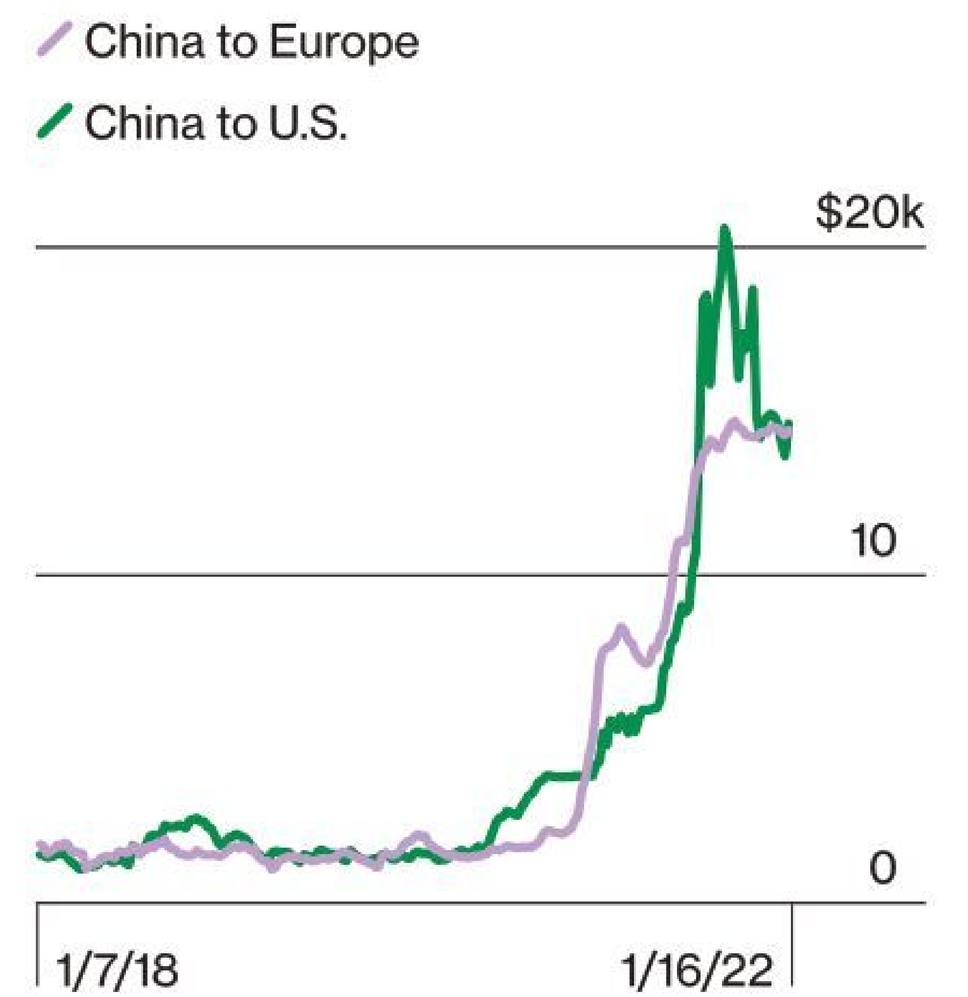
# Shipping High Seas Rates

The cost of moving a 40-foot container from Asia to the U.S. topped $20,000 last year, 10 times what it cost a few years ago. While that's eased to about $14,000, rates will likely stay high for most of this year. That means big profits for cargo carriers, but it'll leave consumers paying more for just about everything. *—Lauren Etter and Brendan Murray*

Net income or loss for the container shipping industry



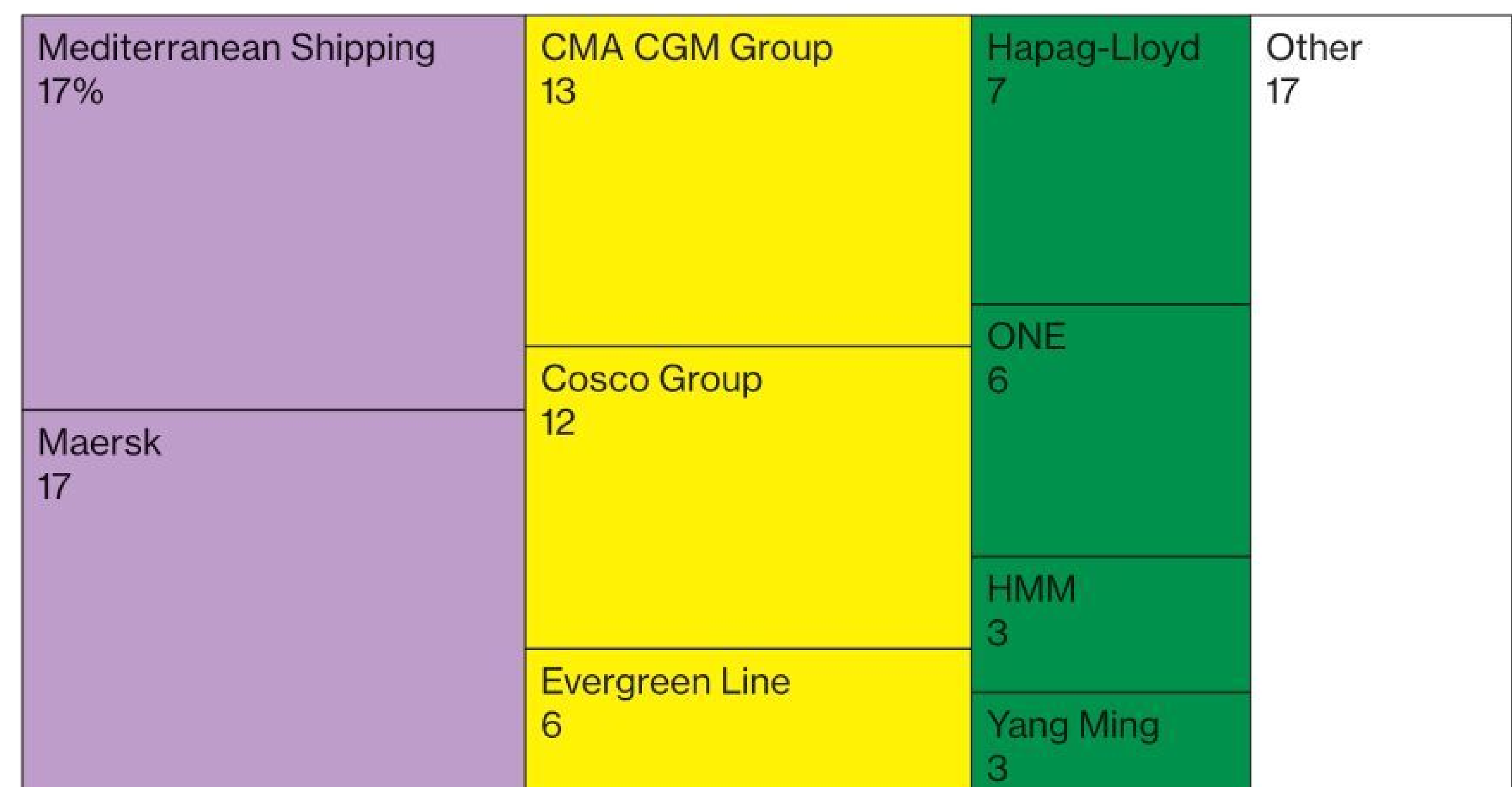

Spot rates on ocean freight, per standard shipping container equivalent

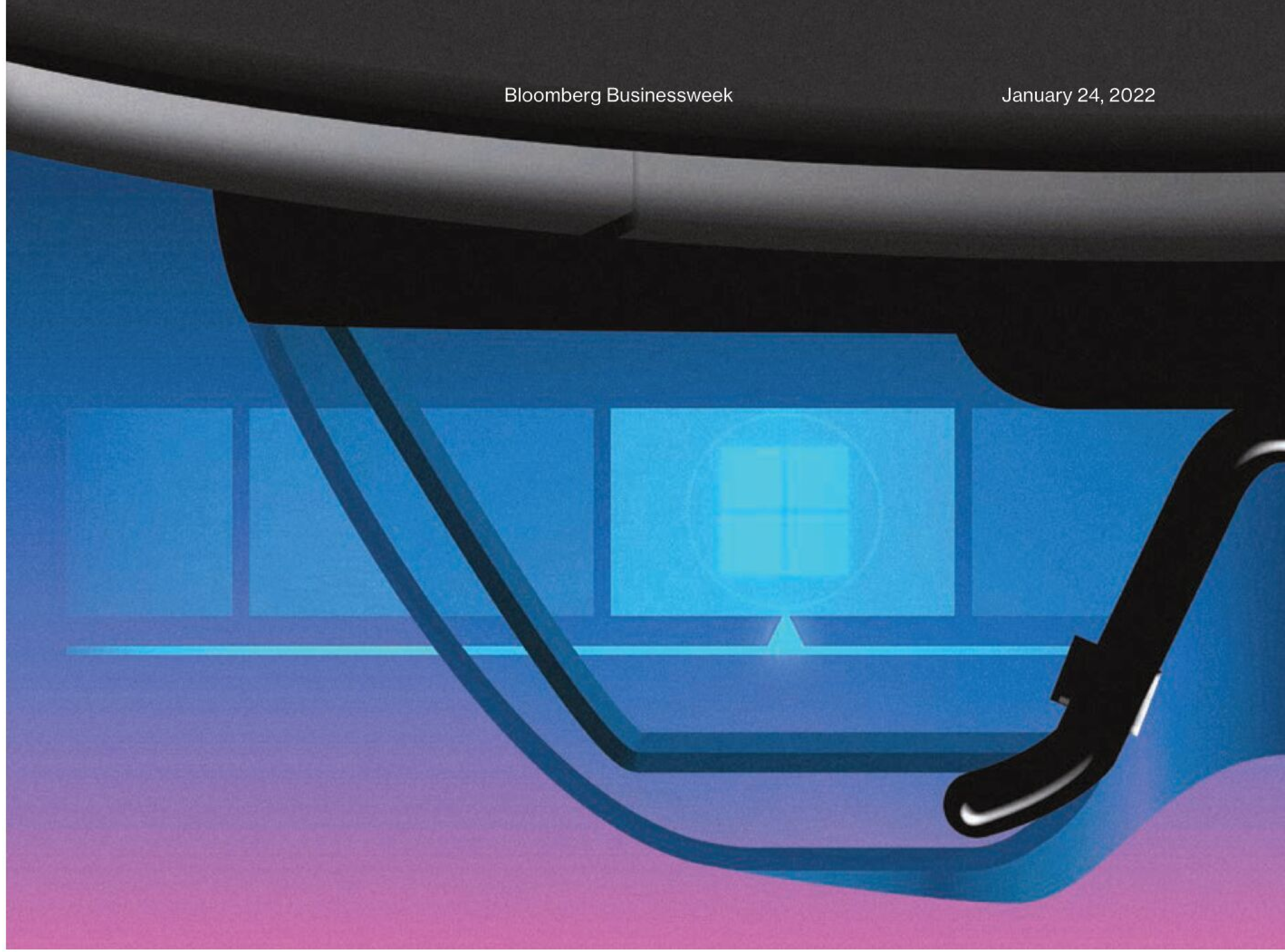



Giants such as Walmart Inc. and Ikea can demand better terms or absorb the added expense, but smaller companies that rely on carriers to haul everything from electronics to grains are in a tougher spot. The situation highlights the market concentration of shipping lines and their immunity from antitrust laws. Although officially competitors, nine of the biggest operate under agreements to share space on their vessels.

Largest shipping companies by share of global shipping capacity

Shipping alliance ■ 2M ■ Ocean ■ THE





# Microsoft's $69 Billion Down Payment On the Metaverse

● The deal for Activision Blizzard shows how fast the digital land rush is heating up

There are many reasons why Microsoft Corp. would have wanted to purchase Activision Blizzard Inc., which publishes a range of famous video game franchises, from *Call of Duty* to *Candy Crush Saga*. The $68.7 billion deal, which was announced on Jan. 18 and requires regulatory approval, would make Microsoft the third-largest gaming company in the world. But in Microsoft's own explanation of the largest acquisition in its 46-year history, the word "metaverse" did a lot of the heavy lifting.

The metaverse refers to a new generation of computing where instead of switching among discrete apps, people enter a collection of immersive digital worlds, which they explore in the form of cartoon avatars. In the most ambitious version of this vision, users will be able to do whatever they do in the physical world with a sense of presence that hasn't been available online, thanks to three-dimensional designs they can experience through augmented- or virtual-reality headsets.

Last year, Facebook Inc., which had already poured billions into virtual reality, changed its name to Meta Platforms Inc. to signal its seriousness about the metaverse. People mocked the move as primarily an attempt by the company to shift the public conversation away from the many scandals associated with its existing social networks. But the tech industry was ready to take the metaverse seriously. Following the announcement, a wide array of companies and developers joined a startlingly rapid rush to explain how their own work was intended to help construct the foundations of the metaverse, too.

Edited by Joshua Brustein

The world everyone is hyping doesn't yet exist. But many of those trying to articulate what it will be like point to gaming, which already introduces users to new digital worlds and therefore, they say, metaverse concepts. "As the digital and physical worlds come together, [gaming] will play a critical role in the development of metaverse platforms," Microsoft Chief Executive Officer Satya Nadella explained on Tuesday.

Even before the acquisition, Nadella had begun to describe Microsoft games as metaverses in their own right. "If you take *Halo* as a game, it is a metaverse," he said in October on Bloomberg Television. "*Minecraft* is a metaverse, and so is *Flight Sim*. In some sense they are 2D today, but the question is: Can you now take that to a full 3D world? And so we absolutely plan to do so."

Activision Blizzard CEO Bobby Kotick uses similar vocabulary to frame the logic of the Microsoft deal. "Every company that has significant resources has aspirations for gaming in the metaverse, and so the competition has never been greater," he says. "And that's one of the real motivations that we had for this partnership."

The deal isn't just about inventing the future, of course. Activision Blizzard has been in crisis following allegations of sexual misconduct and discrimination, making it easier for Microsoft to negotiate a takeover and harder for Activision to find anyone willing to pay more. Kotick says the controversies had nothing to do with the acquisition. A person familiar with the negotiations says Kotick will continue to serve as CEO only until the deal closes.

For Microsoft, buying Activision allows it to advance its ambitions to build subscription gaming services with Game Pass, help Xbox compete against PlayStation, and move deeper into mobile video games. The deal also builds on other significant gaming acquisitions during Nadella's tenure. His first acquisition as CEO was a $2.5 billion purchase in 2014 of Mojang, the maker of the virtual-world-building game *Minecraft*. In 2020, Microsoft spent $7.5 billion on ZeniMax Media Inc., the parent company of Bethesda Softworks, which publishes *The Elder Scrolls*, *Doom*, and other well-known titles.

But "metaverse" has become a catchall for the tech industry's next era, and describing the Activision deal in such terms allows Microsoft to convey the scope of its ambitions. The metaverse may be mostly composed of gaming now, but if it replicates our current reality, the logic goes, the market opportunity could be on the scale of the creation of the internet, or the shift to smartphones. Microsoft's actions today are the precursors to a future in which we'll all be invited to attend football games and weddings in a virtual world, and where we'll be able to send our cartoon avatars to business meetings instead of commuting to an office. (Whether any significant number of people will accept such social invitations or choose to structure their professional lives in that way, of course, is an open question.)

Microsoft may be in a better position than its metaverse-building peers at the top of the tech world, given its deep portfolio in gaming, combined with ▶

▼ Activision Blizzard market value

ILLUSTRATION BY 731. DATA: COMPILED BY BLOOMBERG

◀ its own augmented- and virtual-reality projects. That includes HoloLens, a headset with holographic displays intended to help workers in manufacturing, health care, and construction.

The company may also have more freedom to make land grabs like this, at least for now. Unlike the technology industry's other cash-rich giants, Microsoft has so far avoided the latest wave of antitrust scrutiny. Leaders of Amazon, Apple, Facebook, and Google have all testified in front of Congress on anticompetitive behavior and continue to face the prospect of government lawsuits or new rules. Their ability to get deals of this size through regulatory review is questionable at best.

By attempting to purchase Activision Blizzard, Microsoft is testing how much more leeway it has than its main competitors. "If the government does not challenge the Activision deal, it reveals a competitive disadvantage for Meta relative to Microsoft," analysts at New Street Research said in a note.

The concept of an immersive world, replicating reality, has been around for decades without generating much enthusiasm among consumers. That includes gamers, says Xbox creator Seamus Blackley. "The potential Activision acquisition is the acquisition of something with known revenue and profit," he says. "The metaverse angle is odd because the metaverse has been a failed business historically and has shown no revenue and no profit."

Nor is it clear that Microsoft and Meta even mean the same thing when they talk about the metaverse. Meta CEO Mark Zuckerberg describes a single digital environment where people can meet friends to play board games, take an exercise class, or participate in other activities. Users would likely wear Meta's Oculus headsets, and the company's code would provide a significant amount of the underlying infrastructure, but many of the experiences inside this world would be created not by Meta but by other companies and developers.

Microsoft, by contrast, describes a series of separate worlds where one might move back and forth between its metaverse and, say, Meta's. Besides converting existing game worlds into three dimensions, the company wants to bring along its flagship Office products. Nadella imagines workers using Microsoft Office in VR. In the first half of 2022 the company plans to begin offering a metaverse version of its Teams chat, where people's avatars will be able to give one another PowerPoint presentations in the virtual world.

Getting to Microsoft's future requires building at least one metaverse. While Nadella points to games as proof we've already reached that stage, other metaverse-builders are not sure that counts. Having some expensive new video game properties may not get Microsoft closer to the metaverse, because the concept needs to expand beyond gaming "to really make it real," Vivek Sharma, a vice president at Facebook gaming, wrote on Twitter the day the Activision deal was announced. Still, he said, "What a time to be alive!" —*Sarah Frier and Dina Bass*

THE BOTTOM LINE Microsoft's biggest deal ever is both a logical extension of its gaming business and a way to signal how bullish it is on its vision for the future of tech.



# Open Source Software Scares The White House

● A flaw found in a popular piece of software illustrates one danger of volunteer-run development projects

Vincenzo Chianese thought he was doing a public service in 2017 when he helped publish a piece of software called Express Gateway, which consists of 22,554 lines of JavaScript code that aids in communication between software programs. Anyone could download Express Gateway for free and integrate it into their own products. As people did, a growing number found what they thought were flaws, and they turned to Chianese to complain and request repairs.

Chianese had built the code while working for a startup called LunchBadger Inc., where maintaining Express Gateway was part of his job. The company shut down in 2019, and he was faced with the prospect of keeping up the project by himself. Overwhelmed, Chianese sought help from well-known organizations that were using Express Gateway, including Dell Technologies Inc. and FIFA, the global soccer organization. "I said, 'Hey, this is a situation,'" he says. "Their response was essentially zero." Dell and FIFA didn't respond to emails seeking comment.

Facing a new full-time job with its own responsibilities, Chianese abandoned the project. His decision to step back from the painstaking task of

addressing each user's complaints probably left flaws unresolved.

Open source software projects make up a key part of the code powering the desktop computers, mobile phones, and computer servers of the modern internet. This model of development has flourished for decades as an alternative to software sold by major tech companies, which can be expensive, regularly comes with onerous copyright restrictions, and is often tightly controlled by small enclaves of programmers.

Many developers take it as a point of faith that open source development results in software that's more stable and secure. But a potential vulnerability is the reliance on volunteer coders, whose technical skills, personal whims, and changing schedules can determine whether a program is properly maintained.

Public officials have expressed new security concerns around open source software after a critical security flaw with Log4j—a project that helps monitor activity in untold millions of pieces of software globally—was revealed in November. Log4j is maintained by a group of unpaid programmers as part of the nonprofit Apache Software Foundation. Left unfixed, the flaw could allow hackers to overtake computers remotely, leading to a wide range of consequences.

Anne Neuberger, the U.S. deputy national security adviser for cyber, told Bloomberg Television in December that open source was a "witch's brew" that's "built by volunteers, broadly used, and not managed." On Jan. 13 senior Biden administration officials met with Alphabet, Apple, IBM, Meta, Microsoft, Oracle, and other companies to discuss improving the security of open source projects. The White House said the summit focused on how to better prevent security defects, improve the process for finding them, and shorten the time it takes to get faulty code fixed.

U.S. cyber officials say the Log4j flaw remains a pressing concern, even if they can't point to widespread hacks resulting from the vulnerability. "The scale and potential impact of this makes it incredibly serious," says Jen Easterly, who heads the federal Cybersecurity and Infrastructure Security Agency, which is part of the Department of Homeland Security.

Boaz Gelbord, chief security officer of Akamai Technologies Inc., says the tech industry should offer more financial assistance to open source projects and perform security reviews to search for vulnerabilities, because the incredible complexity and automation of modern software can make it difficult for people to understand fully how any system works. "I think in some way there's almost less visibility today than there was in the past," he says.

This would be a welcome change for open source developers like Chianese, who complain that commercial companies are happy to use free software but have shown little interest in investing resources to shore it up.

Not all software built on open source code is a labor of love. Some of the world's largest tech firms have contributed money and resources to the software, and have themselves built on open source code for their own uses. Google's Android operating system, used in more than 3 billion devices, is based on the open source Linux OS. But volunteer-written code is dispersed widely enough to make the competence and continued commitment of volunteer developers critical to the health of many software products. GitHub Inc., the popular code-repository platform, reported in 2019 that millions of projects rely on open source systems that have 40 or fewer direct contributors.

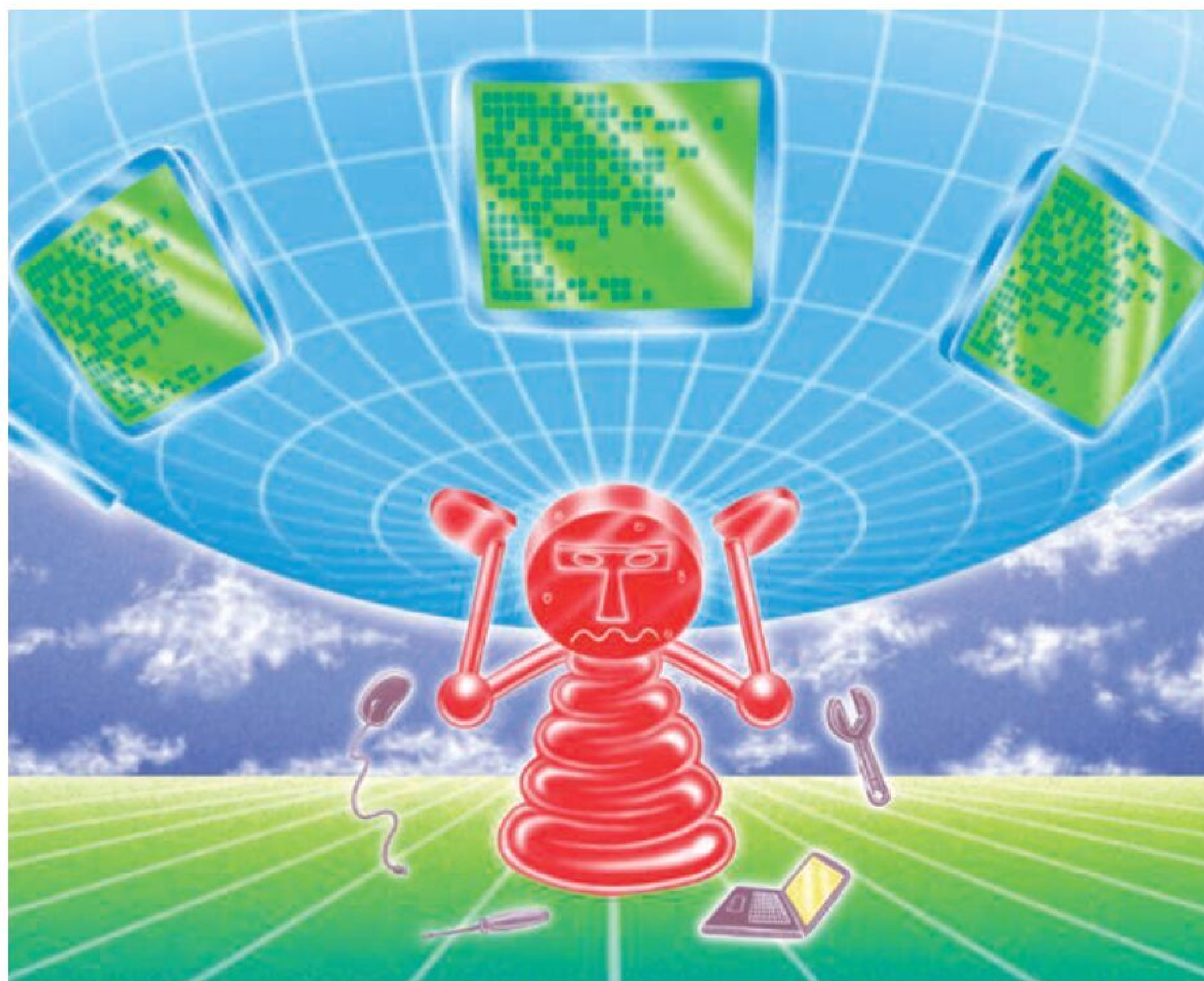


ILLUSTRATION BY MARCELO LAVIN

The whole idea of open source is that people who use the software will identify needed improvements and either suggest them or make them on their own. An employee at Alibaba Group Holding Ltd.'s cloud security team was the one who found the Log4j flaw and alerted the Apache team. But there's no guarantee that the person to discover the next vulnerability would make the same move. Chinese regulators have targeted Alibaba for allegedly violating a law requiring that security issues in software be reported first to the government. Security experts outside China took that as an ominous sign. *—Jack Gillum and William Turton*

THE BOTTOM LINE The Biden administration met with large tech companies to discuss how they could better support widely used open source software projects.

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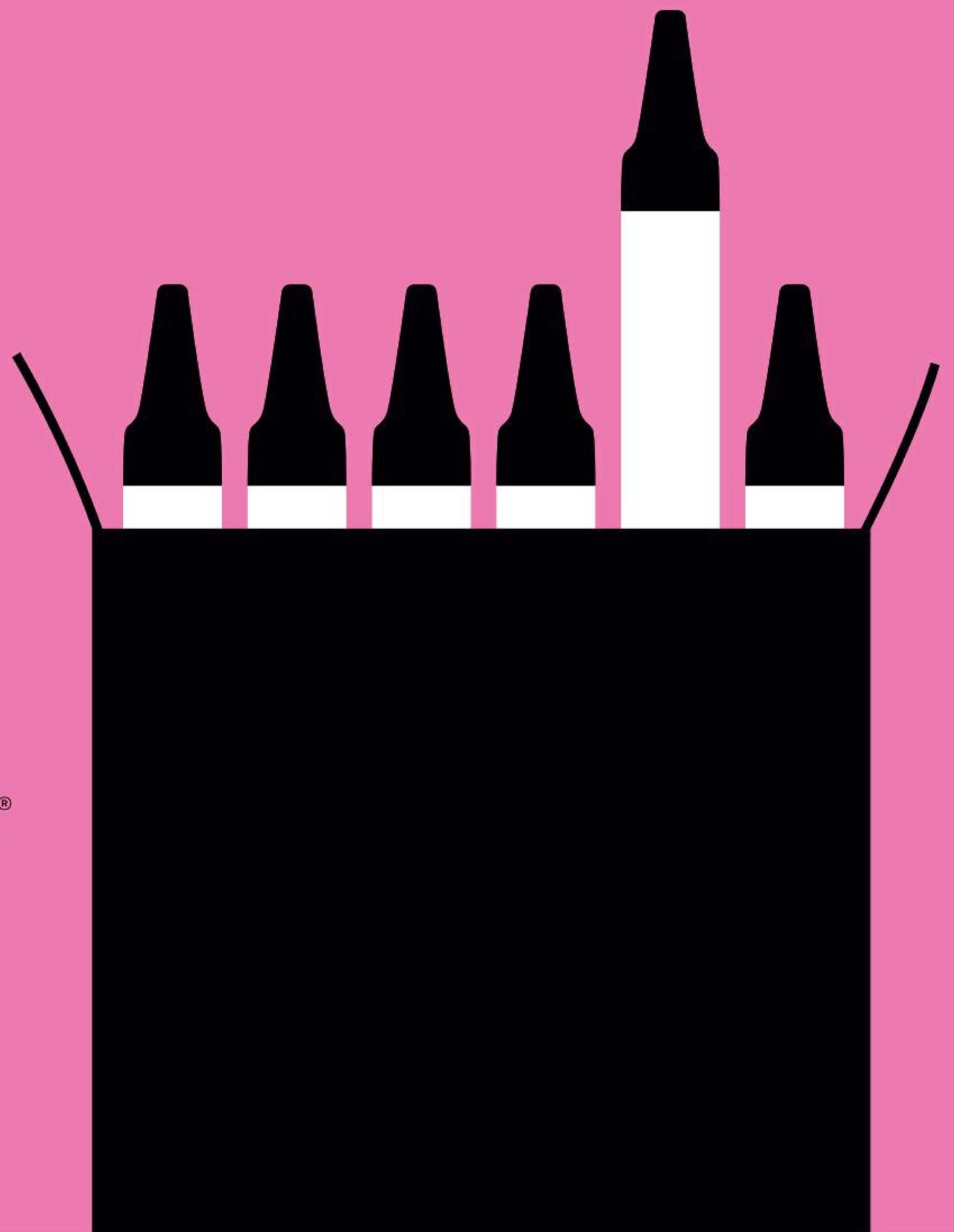

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# Revisit Your Retirement Strategy

High valuations, rising interest rates, and spiking inflation make it time for a checkup

After years of watching strong markets swell portfolios, many recent and would-be retirees are in a nice spot—on paper. But it may be an awkward and anxious moment emotionally. The assets that sent account balances to such heights—particularly a handful of big U.S. technology stocks—now look expensive by many measures and have been showing some weakness this year. At the same time, reducing your exposure to stocks feels dangerous with inflation running at the highest rate in decades, eating away the modest returns of more conservative investments. And with the rise in interest rates seen by many as just getting started, bond funds look vulnerable to losses.

"There is definitely a lot more strain now for retirees," says Wade Pfau, a professor at the American College of Financial Services in King of Prussia, Pa., which trains financial planners and advisers. "We are outside of all the historical situations that we have been talking about for retirement."

After months of predictions that inflation would be transitory, the Federal Reserve's recent sharp pivot to being concerned about it may be the start of an unmooring of interest rates from historically low levels. While annual yields on 10-year U.S. Treasury bonds are hovering near a two-year high at about 1.86%, that's far from the 6% average back in the early 1960s. Bond prices fall as rates rise, so even the safest fixed-income investment may be in for a relatively rocky ride. Higher interest rates will also mean higher ▶

Edited by Pat Regnier

◀ yields from bond funds—and they'll eventually show up as higher rates in certificates of deposit and money-market funds as well. But the hit to bond funds is immediate.

A subpar performance for stocks could have big repercussions for recent retirees. "We have had a tremendous run in the stock market," says David Blanchett, head of retirement research for PGIM, the investment management group of Prudential Financial. These gains may have encouraged people to retire. "The problem is after markets have done well, they tend to do poorly." He sees "a very good possibility" of a market correction in the near future "or just lower-than-average historical returns."

It's not all grim. Investor portfolios have grown bigger and faster than most people would have anticipated, making retirement more feasible. (There's been a larger-than-expected bump in baby boomer retirements, which is likely due to Covid disruptions and health risks as well as asset gains.) Also, the average U.S. homeowner gained $57,000 in equity by 2021's third quarter from the previous year, according to CoreLogic data. So for most people this isn't a time to radically shift gears on a retirement plan.

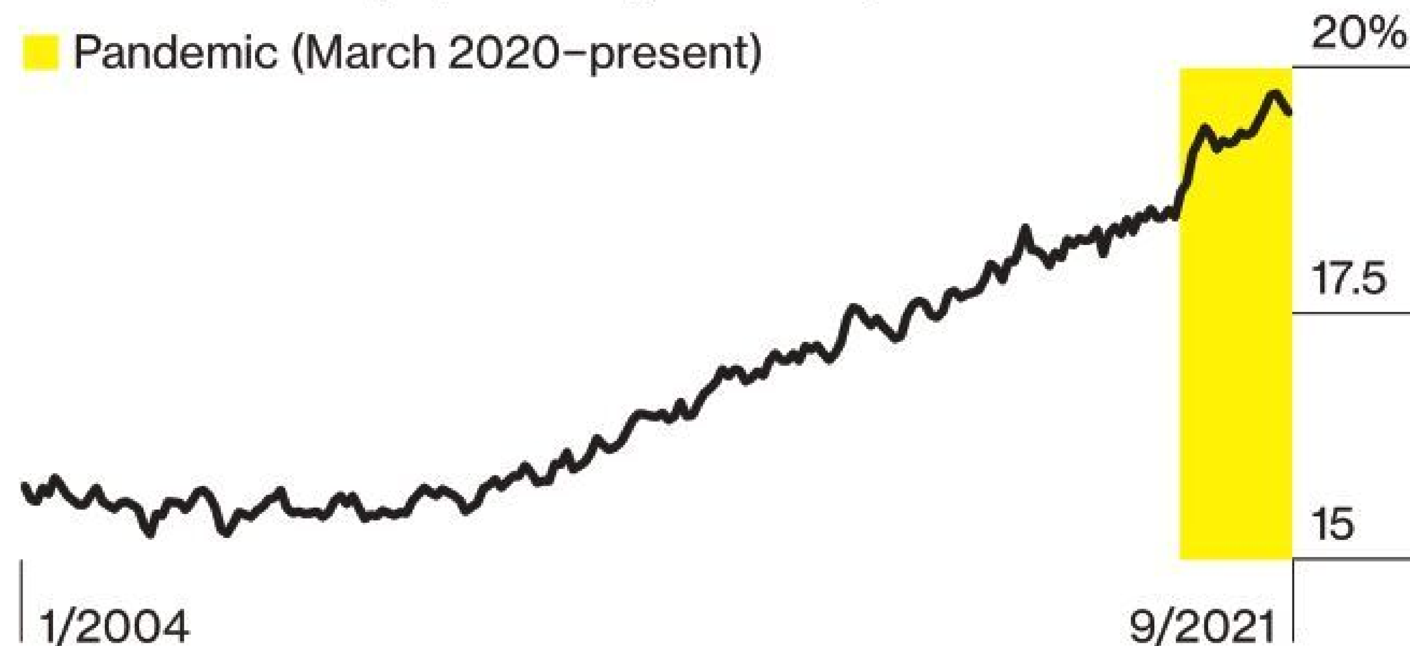
But it's a good time to reassess portfolios and assumptions about spending in retirement. New retirees and near-retirees can sometimes be a little complacent about how much risk they can tolerate. They're old enough to have lived through a few market cycles and tend to be more comfortable with equity risk, says Christine Benz, Morningstar Inc.'s director for personal finance. "They start thinking they don't ever need to de-risk, because you know the market is volatile, but then it comes back," she says.

But the situation in retirement is different. While those still working can ride out volatility as they add money to their savings, those who are hit with a string of stock market losses early in retirement can see their portfolio permanently hobbled, especially if they've been taking withdrawals. Even if markets rebound, the gains come on a diminished pot of savings. "As you start drawing down money in retirement, it becomes less of an intellectual exercise and a real challenge," Benz says. "Because if you don't have enough liquid assets to draw upon then, your only choice is to tap depreciating assets."

One way to address this risk is to scale back spending assumptions, at least initially. The so-called 4% rule, a longtime rough guide for how to draw down cash in retirement, may be too aggressive at the moment. The idea was to take 4% of your assets out in your first year, then take the same dollar amount, plus an increase to match inflation, in subsequent years. Studies had shown that a retirement nest egg would very likely last a lifetime at that rate. "That was based on 30 years of all the different markets going back to the 1920s," says Pfau, the professor at the American College of Financial Services. "But interest rates are now lower than they ever were at the start of retirement historically; market valuations are as high as they ever were in that history." Many retirement experts have whittled down the 4% rule to 3% or 3.5%.

The Pandemic Retirement Bump

Share of the U.S. population age 16 and up who are retired




DATA: FEDERAL RESERVE BANK OF KANSAS CITY

You can add protection by using a "bucket" strategy, where you think of your savings as split into different buckets based on how soon you'll need to access the cash. The far-off buckets can be allocated more aggressively, while money to cover expenses coming up in the next year or two goes into short-term bonds or cash. That way you'll avoid selling stocks when the market is down, Pfau says.

There's a chance that you'll lose money on bonds as well, but Benz thinks investors should keep that in perspective. "Thinking about the magnitude of losses you're likely to experience in high-quality bonds, even in a rising rate environment, it's going to be much less than the loss you would have in the equity portion of your portfolio," she says.

One way to ensure that you won't outlive your money, and to get built-in inflation protection, is to delay claiming Social Security until the age of 70 if you can afford to. This doesn't necessarily mean you have to work that long. People should be willing to spend retirement assets to delay taking Social Security, says William Bernstein, co-founder of investment management firm Efficient Frontier Advisors. For every year past full retirement age, which is 67 for anyone born in 1960 or later, your benefit goes up by 8%. Social Security comes with cost-of-living adjustments, which also apply to the years you delay. "The Social Security trick goes a

● Increase in Social Security benefit for each year of delay after full-retirement age

**8%**

PHOTO: BLOOMBERG

long way toward immunizing you to living to 100," Bernstein says.

Tweaks also can be made to a portfolio to offset inflation. One of the best: buying I bonds, which are U.S. government-issued bonds with a rate–currently 7.12%–that resets twice a year based on inflation. An individual can buy only $10,000 per year, but they can purchase an additional $5,000 using their federal income tax refund. Other classic inflation hedges include Treasury inflation-protected securities (TIPS), which are also available through funds, and real estate.

To diversify, retirees may want to add foreign stocks. "We've had fat years for investing in U.S. vs. foreign stocks, but foreign stocks' expected returns are higher, because they are cheaper," says Bernstein. He figures that 30% of a stock portfolio could be in foreign holdings. PGIM's Blanchett also likes the idea of making sure retirees own stocks beyond the usual large-cap U.S. stocks and suggests a stake in small-cap stocks as well.

The idea isn't to yank all your money out of the S&P 500–that kind of market timing is almost impossible to get right–but to ensure that you aren't overloaded in assets that have done so well for so long. "Retirees need to be careful to not use the past 10 or 15 years as a lens for how to position themselves going forward," Benz says. *—Suzanne Woolley and Liz Capo McCormick*

THE BOTTOM LINE After a long bull market, you may be better set up for retirement than you thought possible. Now you should prepare to withstand some rough weather.

# Credit Suisse's Fix-It Banker Flames Out

● António Horta-Osório resigns after being accused of breaking quarantine rules



From the day he took over as chairman at Credit Suisse Group AG in May of last year, António Horta-Osório made no secret that he planned to take a tough, hands-on approach to the role. In his decades running financial institutions, he'd never experienced a bank in crisis quite like Credit Suisse, he said at the annual shareholders meeting.

The 166-year-old bank had staggered from one humiliation to another. First there was a corporate spying scandal involving senior executives, then the collapse of Chinese client Luckin Coffee. Even more disastrous was Credit Suisse's involvement with doomed finance company Greensill Capital and its billions of dollars of losses from the implosion of one of its trading customers, Archegos Capital Management.

Now Horta-Osório has added to this list of embarrassments. He resigned on Jan. 16 after being accused of flouting coronavirus quarantine rules with several trips abroad, including flying to London last year to watch the Wimbledon tennis tournament.

Even in the hire-and-fire world of banking, the abrupt departure of AHO, as the Portuguese banker is known, is an anomaly. Rarely has an executive who came in with such fanfare flamed out so spectacularly. It took just nine months for Horta-Osório to go from star hire to outcast, and some who witnessed his decline and fall speculate that the quarantine probe may have been an opportunity to sever ties with a leader who'd alienated too many inside Credit Suisse.

In his parting words, Horta-Osório, who was set to make 4.5 million francs ($4.9 million) a year when he came into the job, acknowledged that his actions had compromised his ability to do any kind of cleanup. "If this had been any other banker, it wouldn't be so devastating," says Arturo Bris, a finance professor at IMD Business School in Lausanne, Switzerland. "He was making the case for Credit Suisse bankers to be role models, and executives have to walk the talk."

Horta-Osório had an imposing style that sidelined the chief executive officer, Thomas Gottstein, shadowing him on tours through the bank and making surprise appearances at meetings, say people who asked not to be identified discussing confidential matters. At meetings, he would frequently talk over Gottstein, creating tension between himself and the bank's more reserved Swiss CEO.

By the middle of last year, an exodus had set in at Credit Suisse's investment bank, with many of the departures prompted by the damage to the company's reputation from the constant stream of scandals. But Horta-Osório wasn't seen as ▶

● Horta-Osório

◀ doing enough to stem the flow. He referred to the investment banking unit as an "ancillary" service, even though it delivers more revenue than any other division and ranks in the top 10 globally.

When Credit Suisse announced Horta-Osório's appointment at the end of 2020, the bank's leadership was already in bad shape. Gottstein's predecessor, Tidjane Thiam, left earlier that year after the company was caught spying on a star banker who'd defected to crosstown rival UBS Group AG. And things were about to get even worse.

Weeks before Horta-Osório even took over, the bank suffered two more crushing blows. Credit Suisse lost $5.5 billion over its dealings with Archegos, the investment vehicle of trader Bill Hwang, which defaulted on loans from banks it used to build a $100 billion trading portfolio. Shortly before, the freezing of funds tied to Greensill Capital, an invoice financing specialist, led to a frantic effort to recover $10 billion of trapped clients' money and contributed to the departure of numerous senior managers.

While Horta-Osório was something of a surprise pick—the first non-Swiss person to fill the chairman role at the Zurich-based bank—he promised a fresh perspective as a retail banking veteran with the international experience to complement the Credit Suisse lifer Gottstein. He was credited with reviving Lloyds Banking Group Plc after the 2008 financial crisis, including by cutting head count by about 40%, or more than 41,000 workers. He'd also displayed a human side not often seen in the shark tank of global banking. In 2011, Horta-Osório took a nine-week medical leave after suffering from overwork and sleep deprivation.

The Lloyds triumph cemented his reputation as an astute turnaround specialist and eventually earned him a British knighthood. He took visible pride in his new title by signing off internal memos as Sir António.

With Horta-Osório's tenure cut short, Credit Suisse is left with a leadership duo made up of two Swiss nationals thrust into their roles in the wake of the messy departures of their predecessors. The new chair, Axel Lehmann, is a relative newcomer who joined the board of directors in October after a career at Zurich Insurance Group AG and UBS.

Employees who attended a town-hall meeting following Horta-Osório's surprise weekend ouster described a sense of relief permeating the gathering. Gottstein was chipper as he addressed employees about the post-AHO future. Lehmann reassured them that he'd lead the bank "without distractions," a welcome departure for some from Horta-Osório's leave-no-stone-unturned approach.

Investors, some of whom had counted on AHO being the person to repair the company's culture, were less thrilled. David Herro of Harris Associates, the biggest Credit Suisse shareholder, said he was "very disappointed." Citigroup Inc. analysts wrote that Horta-Osório's departure "leaves Credit Suisse with a lack of strong characters at the top." —*Marion Halftermeyer and Ambereen Choudhury, with Nicholas Comfort*

THE BOTTOM LINE Horta-Osório had serious problems to correct at Credit Suisse, but accusations that he broke Covid rules undercut his ability to demand greater accountability from bankers.

# Market Makers Want In on Crypto

● It may be decentralized finance, but established pros still want their cut

When Christoffel and Jan Raphoen invented market-making in Amsterdam around the 1620s, their job was small in scope: Buy shares of Dutch East India Co., the world's first publicly traded company, from people who wanted to sell, and sell to those who wanted to buy. The brothers were "the missing link," according to historian and economist Lodewijk Petram, connecting buyers and sellers "who happened to be not at the same place at the same time." Four centuries later, the role of market makers hasn't really changed.

ILLUSTRATION BY OLIVIA FIELDS

Whenever there's a financial asset to swap, they find a way to stand in the middle and rake a little money off the top in exchange for providing traders with the liquidity they need.

Today's market makers are "high-frequency traders"—a term they hate—and are embedded in everything from stocks to bonds to derivatives. If you've ever bought a share of Apple Inc. on a free mobile-trading app, chances are you got it from one of the big Wall Street market-making firms. But these vital traders have never seen anything like cryptocurrencies. They're salivating over a once-in-a-lifetime opportunity to trade a whole new set of assets. On the other hand, since cutting out middlemen is one of crypto's guiding principles, the technology could also be a threat to their business.

Market makers are already deep into cryptocurrencies such as Bitcoin and Ether, which trade on multiple exchanges and platforms around the globe. If a big investor wants to buy $1 billion of Ether, a market maker can source the purchase bit by bit from all those trading venues. But the big, well-known coins are only the start. Crypto optimists think blockchain technology and tokens will one day power a wide swath of the global economy—running everything from data storage and game software to financial exchanges and even the internet itself. "We have a similar perspective," says Chris Zuehlke, global head of Cumberland, the crypto division of DRW Holdings LLC. He says that's why DRW, a major market maker that evolved out of the Chicago Mercantile Exchange trading pits three decades ago, was early to move into crypto.

Success for established traders in the newer parts of crypto is far from guaranteed. Some projects are designed to take traditional market makers out of the equation. In the realm of decentralized finance, or DeFi, "automated market makers" are built into popular crypto token exchanges Uniswap and SushiSwap. The Raphoen brothers wouldn't recognize them. AMMs allow anyone to put a pair of coins that other people want to trade into a "liquidity pool," earning a fee in exchange for temporarily tying up their coins. The pool ensures buyers and sellers can find coins to swap. A math equation can then automatically adjust prices and execute trades.

Market-making is especially important for niche, thinly traded assets—and the crypto economy is producing more obscure new coins every day. Imagine you could one day tokenize, say, ownership of apartment buildings in New York City. "You probably do need someone to make a market," says Dean Carlson, head of digital asset investing at Susquehanna International Group. "The question is, does that market maker need to be a firm like SIG?" he says. "Or can it be an AMM?"

Dave Olsen, president of Jump Trading Group, a leading derivatives market maker that also trades crypto, says, "AMMs are the buyer of last resort." He says they can't match the depth of liquidity and tight spreads (trading jargon for a small gap between prices to buy and sell) that Raphoenian market makers can.

Carlson says SIG's market-making arm helps him when he's approaching token-powered startups about making a venture capital investment. "If we can say to that project: 'We'll invest in you and provide liquidity for your token,' that's a valuable service to them," he says. "That's more valuable in some cases than what a traditional VC provides." DRW's Zuehlke agrees that market makers can help get decentralized projects off the ground by preventing "momentary dearths of liquidity."

Some market makers are actively building the plumbing of crypto and the tokenized economy—creating the sort of fast-moving market ecosystem where they want to roam. For example, Jump is helping build a protocol called Wormhole that helps traders get around the notoriously slow speed and expense of transactions using Ethereum, the popular blockchain technology underpinning many crypto projects. Speed-sensitive trades—for example, there could be tokenized versions of stocks—can happen on a faster blockchain called Solana, and Wormhole can then pass the results of the transaction over to Ethereum.

"In a lot of ways we're getting back to first principles of trading," says Jump's Olsen. "What was it? A buttonwood tree that everyone met under on Wall Street, the precursor to the New York Stock Exchange." In those days, exchanges were owned and governed by the traders who used them, and they "figured out the right design." Now, Jump and other market makers want to be part of designing the next market in crypto.

Zuehlke recently addressed a group of old-school finance folks. "You are a room full of intermediaries that is being disintermediated as we speak, at a pace that you've never seen before," he recalls telling them. "If you aren't thinking about how that disintermediation will ripple through the financial markets and the rest of your lives, then you're missing the point." *—Nick Baker*

THE BOTTOM LINE Market-making is a 400-year-old intermediary business at the heart of modern financial markets, and it's already found a foothold in crypto.

**"In a lot of ways we're getting back to first principles of trading"**

# The Fed's Mind Control

● The idea that monetary policy shapes inflation expectations is about to get road-tested

At his Jan. 11 hearing for confirmation to another four years at the helm of the Federal Reserve, Jerome Powell told the Senate Banking Committee that tighter monetary policy "really should not have negative effects on the employment market."

That assertion, echoed by Powell's prospective No. 2, Lael Brainard, in her own appearance before Congress the same week, puts the Fed's policymakers at the center of a debate among economists that stretches back decades about the link between interest rates, employment, and inflation—in other words, how the central bank's toolkit actually works and, for that matter, what determines the course of inflation itself.

Fed officials are walking a tightrope as they lay the groundwork for a series of interest-rate increases that could begin as soon as March. They're heeding calls to quell the fastest consumer price inflation in 40 years while at the same time trying to avoid the appearance of penalizing workers at a moment when they're enjoying historic bargaining power, widely seen as long overdue.

The inflation expectations doctrine that's dominated mainstream economics since the 1980s offers one potential way to square that circle. The idea is that if a central bank can convince businesses and consumers it will maintain low and stable inflation, then it won't have to do much else. That's because expectations about where prices are headed are thought to be a major driver of inflation itself. If

Edited by Cristina Lindblad

workers don't anticipate higher inflation, they won't demand bigger wage increases to make up for their lost purchasing power. Nor will they rush to go out and buy things because they expect them to increase in price, leading to a self-perpetuating upward spiral.

In this telling, that was the Fed's mistake during the 1970s: It lost control over the inflationary psychology of the American public to the point that taming inflation required draconian interest-rate increases that plunged the economy into recession and threw millions out of work. "One thing we certainly learned from history is that once you adjust people's expectations, they can become quite entrenched, and so it's difficult to adjust back in the opposite direction," says Emi Nakamura, an economics professor at the University of California at Berkeley.

Now, with the Fed's preferred measure of inflation well above its 2% target, at almost 6%, policymakers are determined not to find themselves in that situation again. For the moment, they can take comfort that widely followed gauges of inflation expectations—such as those compiled by the University of Michigan and the New York Fed—have risen a bit, but not nearly as much as prices have.

Fed officials view the burst of inflation seen over the past year as driven by temporary factors associated with the pandemic, an opinion widely shared by forecasters on Wall Street. The U.S. government printed trillions of dollars and deposited them directly into Americans' bank accounts in the first year of the pandemic, and supply chains hampered by the global spread of the coronavirus have struggled to keep up with the increased demand. Many economists expect inflation to largely normalize by the end of 2022, as households spend down the extra cash and a receding pandemic allows supply chains to disentangle.

Still, the fear is that high inflation could eventually bleed into expectations, which in turn could prevent inflation from coming down on its own. "I think, so far, the Fed has been very successful in controlling the narrative about what's going on: that there are particular, likely temporary, factors that are driving inflation in the short run, but that in the long run people shouldn't change what they sort of fundamentally believe," Nakamura says.

That's what the coming cycle of interest-rate increases is designed to guard against. The hikes are meant not to bring down today's inflation, but rather to make sure today's inflation doesn't become tomorrow's.

There's just one big problem. Despite a strong belief among economists and central bankers that, beyond short-term movements in prices, inflation expectations are a major cause of inflation, no one really knows for sure how those expectations are formed, let alone how interest-rate decisions influence them. "It's not at all clear that inflation expectations feed into price-setting behavior in any kind of stable or observable way," says Julia Coronado, a founder of the research firm MacroPolicy Perspectives.

Jeremy Rudd, a senior economist at the Fed, caused a stir when he slammed the idea that expectations are a driver of inflation in a discussion paper published in September, saying it's among a number of propositions "that 'everyone knows' to be true, but that are actually arrant nonsense." (The paper included a disclaimer noting the views were Rudd's own and didn't represent those of the Fed's Board of Governors.)

There's another, more clear-cut channel through which monetary policy has long been recognized to affect inflation, and that's the job market. When the unemployment rate falls, the supply of available workers goes down, pushing up the price of labor. Businesses then seek to raise prices to offset their higher payroll costs. To contain inflationary pressures, a central bank can reverse the process by raising borrowing costs throughout the economy, which curbs the demand for workers and tempers wage growth. The reduced spending power in turn limits what businesses can charge for their products.

Powell and Brainard are making the case that the tightening the Fed's policymakers have planned is very incremental, perhaps a couple percentage points of increases, in contrast to the tightening Paul Volcker oversaw in the early 1980s, which quickly sent the federal funds rate north of 20%. Plus the economy is growing so quickly now, it can stand some moderation: With the unemployment rate below 4% in December for the first time since the pandemic began, wages rising fast, and businesses posting record numbers of job openings, the U.S. is already effectively at "maximum employment," they say.

J.W. Mason, an economics professor at John Jay College in New York, is skeptical the Fed can manage to quell price pressures without also hurting the labor market. "There's no sort of direct and painless way that the Fed is going to influence inflation," he says. "You have to somehow or other reduce demand for output—or you have to reduce the cost of producing output—or you're not going to have any effect on prices."

According to Seth Carpenter, the chief global economist at Morgan Stanley, Fed tightening ▶

**"There's no sort of direct and painless way that the Fed is going to influence inflation"**



ILLUSTRATION BY FELIX DECOMBAT

◀ this year will probably slow the decline in the unemployment rate, but it won't have much impact on inflation until next year. And by then, inflation will probably have largely disappeared on its own.

"Most empirical models' estimations of the effect of monetary policy on the economy suggest that it would take longer than this year for Fed policy to directly affect inflation," Carpenter says. "If they do follow through on what's priced into markets," he says—three or four rate increases—"then there's a pretty decent chance that inflation at the end of 2023 could actually be a little bit below the Fed's target." —*Matthew Boesler*

THE BOTTOM LINE Long-standing economic theories about the link between monetary policy, employment, and inflation are getting fresh attention as the Fed prepares to raise rates.

# Boxed In on China

● Biden's inability to extract concessions from Beijing is a liability going into November's midterms

Two years ago, then-President Donald Trump signed the U.S.-China Phase One trade agreement, hailing it as an "historic" deal. Joe Biden's team spent the presidential campaign criticizing it as too limited in scope and lacking teeth. Yet once the Democrat took office, there was a recalibration. In a speech in October, U.S. Trade Representative Katherine Tai described the framework as "useful" and said it's had "value in stabilizing the relationship."

But she also pledged the administration would make sure China lived up to its commitments. "We must defend to the hilt our economic interests," she said. "And that means taking all steps necessary to protect ourselves against the waves of damage inflicted over the years through unfair competition."

With the midterms looming in November, the White House is under increasing pressure to show it's willing to punish China for not holding up its end of the bargain. Trade data through November show its imports from the U.S. amounted to less than 60% of the additional $200 billion the agreement targeted over two years.

Some analysts say the administration is boxed in when it comes to possible countermeasures. Officials have privately admitted Trump's tariffs are inflicting more harm on U.S. businesses and households than on Chinese exporters. They've also recognized that the duties have lost a lot of their leverage. Data point to China having posted a record trade surplus with the U.S. in 2021, thanks in large part to Americans' pandemic-stoked appetite for Chinese-made goods.

Raising the tariffs, which cover 60% of China's exports to the U.S., would be a controversial call at a time when inflation is running higher than it has in decades. Rebalancing the duties to give relief to American businesses would risk accusations from Republicans of being soft on China.

"To make progress on structural issues, the administration needs to be prepared to offer China something it wants—or threaten something it doesn't," says Kelly Ann Shaw, who served as deputy assistant to the president for international economic affairs under Trump and is now a partner at the law firm Hogan Lovells. "If it is unwilling or unable to do either, the most likely outcome is a continuation of the status quo."

Tai and Chinese Vice Premier Liu He held two virtual meetings last year to discuss China's performance under the deal as well as long-standing irritants in the relationship, such as state support ▶

▼ Biden and Xi met virtually in November

SUSAN WALSH/AP PHOTO

◀ for companies Beijing has designated as national champions. Tai's deputy, Sarah Bianchi, also engaged in conversations with Chinese counterparts, which were not publicized by the agency. The talks have yielded no breakthroughs so far, say people familiar with their substance, who spoke on condition of anonymity. USTR spokesman Adam Hodge says the negotiations are ongoing and "it is not in the U.S. interest at this time to get ahead of them."

Hodge says the administration will use the full range of tools—and develop new ones as needed—to deal with the broader economic challenges: "We have also been clear-eyed that Beijing has doubled down on its state-centered economic system in a way that makes it unfair for our businesses and workers, and the PRC is resistant to making meaningful reforms to address concerns shared by the U.S. and many other countries."

Republicans are seizing on the fact that the administration has left most of the elements of Trump's China policy in place as evidence that Biden lacks one of his own. "It is increasingly clear that President Biden and his team simply do not understand the threat posed by the Chinese Communist Party. As a result, they have no plan or strategy to protect America's economic and national security," said Senator Marco Rubio, the Florida Republican and vociferous China hawk, in an email.

Officials in the administration argue that Biden's united-we-stand strategy, which seeks to enlist the European Union, Japan, and other key partners to create a counterweight to China's political and economic influence, will yield more results than Trump's pugnacious unilateralism. The U.S. and its allies have committed to taking joint action against forced labor and to develop a framework that cuts off Beijing's access to sensitive technologies and equipment produced in the U.S. and other nations. The ongoing talks on the export bans haven't yet resulted in tangible action.

Some Democrats say the White House hasn't been forceful enough in staking out its own position on China. "I'm not sure Biden has clearly articulated a China policy yet," says Virginia Senator Mark Warner. "I would argue they're working towards building these alliances of the willing that Trump was so unwilling to do, and I'd give them a grade of trying but incomplete at this point."

Brian Stryker, a partner at polling firm ALG Research, says opinion surveys show the Democratic Party has allowed Republicans to take the China and economic competitiveness issues from them. One potential win for Democrats to take into the midterms, he says, would be to pass the U.S. Innovation and Competition Act, which has been stalled in Congress for months. The legislation seeks to counter China's ambitions to become a global force in advanced technology areas by authorizing $52 billion in funding to bolster U.S. research and development, as well as subsidies for new chip plants. "If Democrats don't pass that competitiveness bill and have nothing to talk about on China, we will have caused our own problem there," Stryker says. "I think it will really hurt Democrats at the ballot without having something to say about China and supply chain issues."

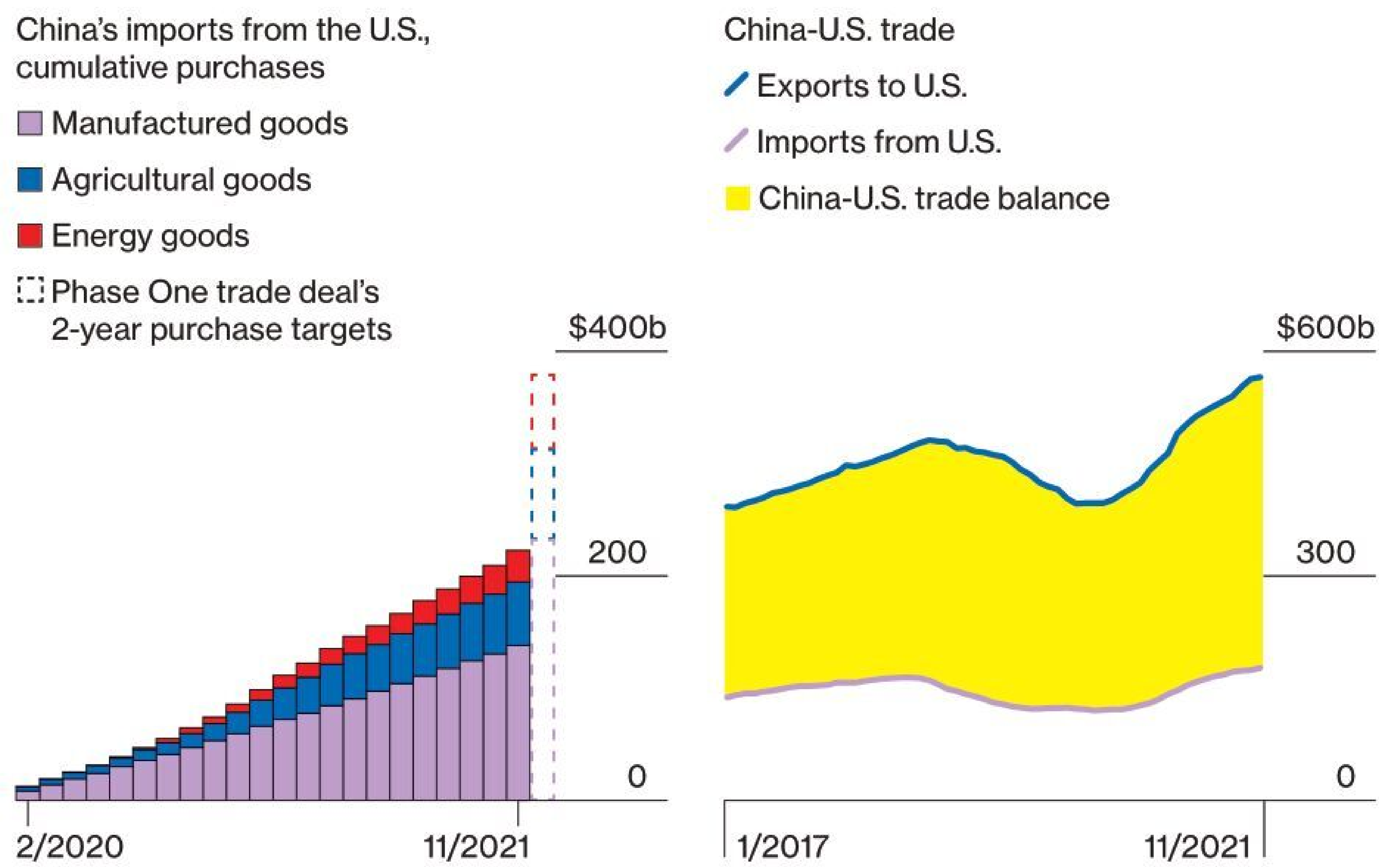
The legislation had bipartisan support in the Senate, making it through on a 68-32 tally in June. But its path to success in the House of Representatives may be narrower, as some Republicans have quietly voiced reservations about handing President Biden and Democrats a perceived win so close to the elections.

The administration's allies say the measure has taken a backseat to many other domestic priorities Biden and congressional Democrats wanted to celebrate in the midterms. Now that some of them have lost momentum or stalled entirely, the focus is shifting back to the competition legislation. A White House official said the team has engaged consistently with Senate and House leadership and relevant committees in both chambers to find common ground on their parts of the measure.

The White House's lack of pressure on the House to pass the bill after it moved through the Senate is a "missed opportunity," says Senator Warner. "I've not understood why that's not been a higher priority. But I think it will be now." —*Jenny Leonard*

THE BOTTOM LINE The Biden administration is facing criticism that trade talks with Beijing have produced no results while efforts to blunt the competitive threat from China have yet to yield fruit.

An "Historic" Deal That Wasn't




DATA: CHINA'S GENERAL ADMINISTRATION OF CUSTOMS; BLOOMBERG CALCULATIONS BASED ON CHINESE CUSTOMS DATA

● Tai

STEPHANIE CHASEZ/WHITE HOUSE PHOTO

# Biden's Year 2 Test

## As the pandemic wears on and prices rise, many Americans are disillusioned with the president. Can he win them back?

For Joe Biden, this wasn't how 2022 was supposed to start.

On the timeline imagined by the White House when he took office a year ago, widely available vaccines would have effectively ended the Covid-19 pandemic in the U.S. by now. The economy would be growing strongly, and a narrowly divided Congress would have already passed the bulk of Biden's agenda. With those mega-missions accomplished, the president could have spent 2022 focusing on voting rights, cutting ribbons on infrastructure projects, and telling Americans what he'd done to make their lives better—with vaccines, stimulus checks, and Great Society-scale investments in child care, education, and the fight against climate change.

It's just not, to put it mildly, how things have played out. Hard on the heels of the delta variant, omicron is now roiling the country. School closures and a shortage of tests are fueling Americans' frustration and despair. Meanwhile, Biden's Build Back Better bill has stalled over the objections of West Virginia Democratic Senator Joe Manchin, leaving the president's agenda in a rut.

Also to contend with: soaring inflation numbers, the highest in 40 years; a simmering standoff with Russia as it masses troops on its border with Ukraine; and progressives' fury at Biden over what they consider to be a late-to-the-game push for voting rights.

Democratic allies say events have forced Biden's White House into reactive mode. "It is hard to control the narrative when you have so many things coming at you, like climate change issues, tornadoes, Ukraine, wildfires destroying parts of the West, and omicron," says former Senate Majority Leader Tom Daschle, a friend to many top White House aides. "I don't know if they feel overwhelmed as much as they feel the gravity of these issues."

The president's approval ratings have slumped as he scrambles to show Americans he's doing all he can. Ipsos polling found that 50% of people disapprove of the way Biden is handling his job, while 45% approve, numbers roughly in line with the fall, when the delta variant was raging. A Gallup poll this month found that 40% of Americans approve of Biden's job performance while 56% disapprove—the 16-percentage-point gap is the largest of his presidency so far. "It's disappointment after disappointment. It hasn't stopped," says Frank Luntz, a longtime Republican political operative who's conducted several focus groups with independent voters in the past six months.

The latest is voting rights. Biden went to Georgia this month to promote voting rights legislation and advocate for changing Senate rules to pass it—only to find himself stymied again by Manchin and his fellow centrist Democrat, Senator Kyrsten Sinema of Arizona. Plus, Stacey Abrams, Democrats' star organizer in Georgia and a staunch advocate of voting law reform, skipped Biden's speech.

Democrats can point to a strong record in some areas. Biden passed the $1.9 trillion American Rescue Plan, which sent child poverty plummeting, and an infrastructure law with $550 billion in new federal funds. The U.S. job market has recovered more quickly than economists predicted—and far faster than it did from the global recession in 2009, when Biden was vice president. America's economy returned to pre-pandemic levels sooner than those of other Group of Seven nations. The Democrat-controlled Senate also confirmed 41 lower-court judges in Biden's first year, the most for any first-year president since John F. Kennedy. "I feel real good about the Biden administration. I wish we were, as a nation, in a better place," says Jim Clyburn, the South Carolina Democratic congressman whose endorsement revived Biden's primary campaign in 2020.

After four years of President Donald Trump in the White House, culminating in false claims ▶

Edited by
Amanda Kolson Hurley

ILLUSTRATION BY KATI SZILÁGYI

◀ of a stolen election and the Jan. 6 insurrection, Americans looked to Biden to restore normalcy. But they're in a terrible mood because of the lingering pandemic and months of rising prices, a fact White House officials privately acknowledge. The question is whether the pandemic, inflation, supply chain glitches, and labor woes can be tamed and if that can happen in time for the 2022 elections. It's all Biden's problem, regardless of whether it's his fault.

The pandemic has largely shaped Biden's fortunes so far. He emerged from the early months of his presidency hoping to put it behind him. Vaccinations had soared; caseloads had plunged. "We're closer than ever to declaring our independence from a deadly virus," he told the country in a speech on July 4. Although he cautioned: "That's not to say the battle against Covid-19 is over. We've got a lot more work to do."

Then the delta variant erupted, ravaging the unvaccinated in particular. A huge number of people refusing vaccines wasn't part of Biden's plan. "I think that surprised him," says Delaware Democratic Senator Chris Coons, a Biden friend.

As vaccinations lagged, the White House imposed mandates, fueling Republican attacks. One mandate has since been blocked by the Supreme Court and another is in legal limbo—but not before millions more American adults got their shots.

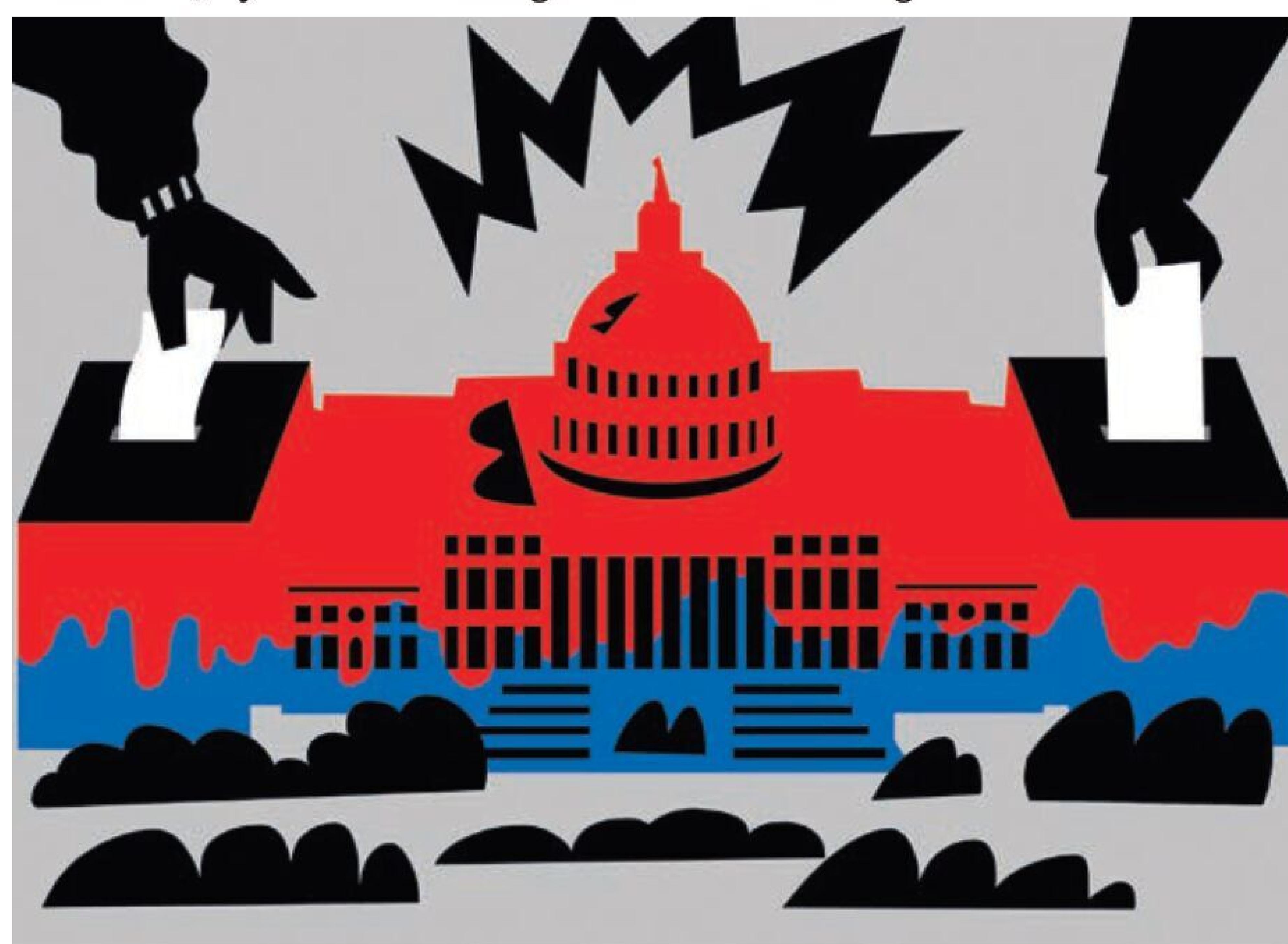
The Centers for Disease Control and Prevention has wavered on its guidance, particularly as officials weighed how to confront the highly transmissible but less deadly omicron. This winter a run on tests and rolling school closures have cast doubt on the administration's preparedness and made it feel like the early months of 2020 all over again. Biden has responded by ordering a billion tests, though it's not clear how quickly it will relieve shortages.

In addition to Covid's human toll was its economic fallout. Jobs, household balance sheets, and gross domestic product data are better than expected, leaving the U.S. with a 3.9% jobless rate. But inflation also has risen much more than Biden's team ever expected and has lasted far longer, a massive political liability.

Biden and his aides were slow to show they understood the toll of inflation on the lives of Americans. "It took too long as a party to recognize the pain," says Brian Stryker, a partner at ALG Research, of the Democrats. His polling firm ran a series of focus groups with Virginia voters after Democrats lost the gubernatorial race there last fall. Just calling inflation "transitory" was no longer cutting it, and the White House quietly stopped using that word over the summer.

In conversations with Biden's aides, a sense of earnestness and righteousness is palpable, and indignation occasionally creeps in. In their view, the administration has a plan that's being executed competently, and the alternative is Republican-led mayhem and dysfunction. They believe the White House should receive more credit for the bright spots in the economy, especially the robust labor market and the falling unemployment rate.

Many Americans don't care about how much credit the White House thinks it deserves, when people's lives still feel upended. In politics, says New Jersey Representative Tom Malinowski, a Democrat, "you don't often get credit for the dog



that didn't bark—the fact that the American economy didn't collapse, the fact that we didn't have poverty and destitution."

Conversely, voters may measure Biden against the ambition of his own unfulfilled goals, a special liability for a president dealing with a 50-50 Senate. Theoretically, Biden has the votes to enact much of his agenda, but only with the slimmest of margins. And Manchin—who represents a state Trump carried in 2020 by a roughly 40-point margin—is happy to act as a check on the president's aims and appears to enjoy the constant attention from White House officials and the press.

On the campaign trail, Biden touted his long experience in the Senate, sending the message that he knew how to move big plans through Congress. Now progressives blame him for decoupling the infrastructure bill from Build Back Better and losing a bargaining tool with moderates to pass the larger package, which hinges on the approval of Manchin, who balked at the price tag.

"Biden ran as a dealmaker, and so far the only thing he's done is deal any leverage he had," says

ILLUSTRATION BY KATI SZILÁGYI

John Paul Mejia, a spokesman for the Sunrise Movement, a progressive climate group. "If Democrats show up to midterms with a message of 'We tried, vote for us,' they're going to lose."

Biden has pressed ahead with new climate targets and executive actions while writing regulations and waiting for passage of BBB. He rejoined the Paris Agreement and almost doubled the U.S. emissions reduction pledge under the pact, killed the Keystone XL pipeline, toughened auto emissions standards, stitched carbon considerations into a U.S. trade pact for the first time, and more. Aides view this as easily the most robust climate record of any administration—and more ambitious than they'd have dreamed of even during the Obama era.

"Two things can be true at the same time: We can have a lot of work to do and have done a lot already," says Ali Zaidi, a veteran of the Obama administration who serves as Biden's deputy national climate adviser.

Although he sought the presidency three times, Biden remains uneasy with some of its trappings. He's restless, aides say, in the fishbowl of the White House residence, with a staff that waits on him and the first lady. He leaves Washington most weekends, heading either back to Delaware or, occasionally, to Camp David. "He would say we never give him any free time or any time to think," Press Secretary Jen Psaki says. "And that is probably true." To settle in, the Bidens recently got a puppy, Commander, and will soon get a cat.

The Biden White House is filled with family photos. On a table in the Oval Office, one of the president's favorite cartoons is also displayed amid the smiling faces of relatives.

In the cartoon, a man shouts to the heavens, asking: "Why me?"

"Why not?" God shouts back.

Biden and Democrats are staring down a midterm election cycle that looks bruising. They're generally expected to lose the House, with New Jersey's Malinowski among those facing tough fights for the waning number of competitive seats as state legislatures aggressively redraw maps. The Senate is also at risk, though Republicans are not having as much success as they would like in drafting strong candidates to run in key states.

Biden is optimistic he can turn things around and believes that good policy ultimately becomes good politics, aides say.

"People don't dislike him," says Luntz, the Republican pollster. "His favorability is higher than his job approval rating, and that would allow him to come back."

Biden's core philosophy is that the way to win elections is to make a difference in people's lives and deliver on promises. To that end, he'll try to revive Build Back Better by striking a deal with Manchin. At a press conference on Jan. 19, he said the package would have to be broken up for any of it to pass. "I'm confident we can get pieces, big chunks" signed into law, he said.

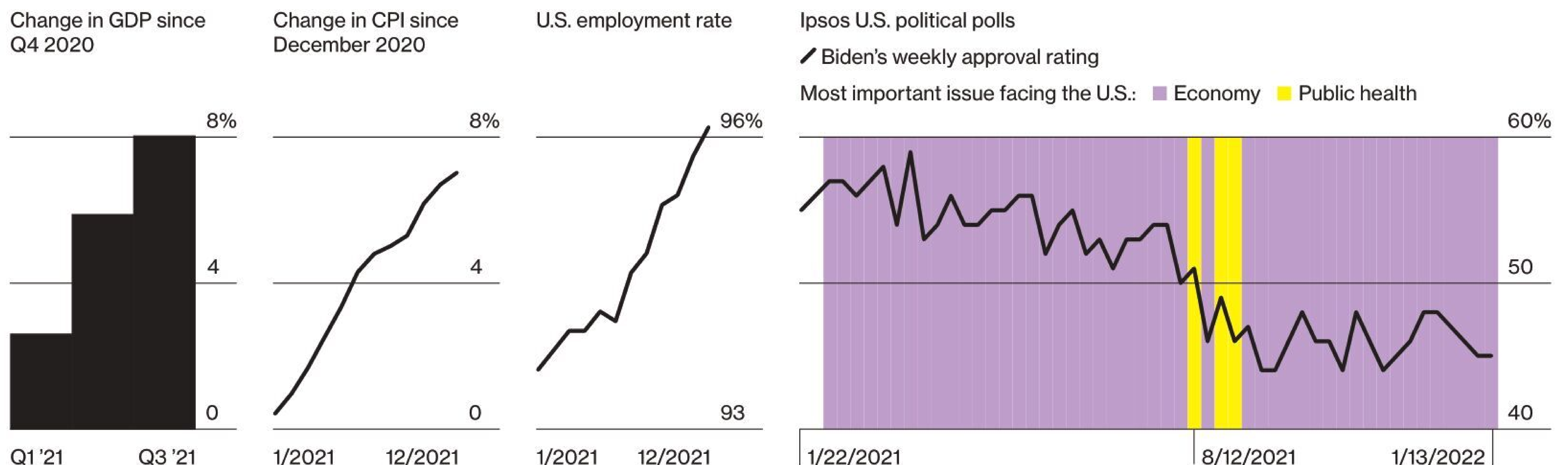
"The big question—the meta question—is, do people a few months out from Election Day feel like life is substantially or even marginally better than when Trump was president?" says Rahna Epting, executive director of MoveOn.org. "If they are murky or a definite 'no,' we have a problem. That comes down to policy," she says, "but it comes down to how people feel" as well.

In the late fall, the White House began to pivot to more of a political attack mode. Biden's team decided they needed to draw more ▶

**"If Democrats show up to midterms with a message of 'We tried, vote for us,' they're going to lose"**



As GDP and jobs improve, Biden's approval falls

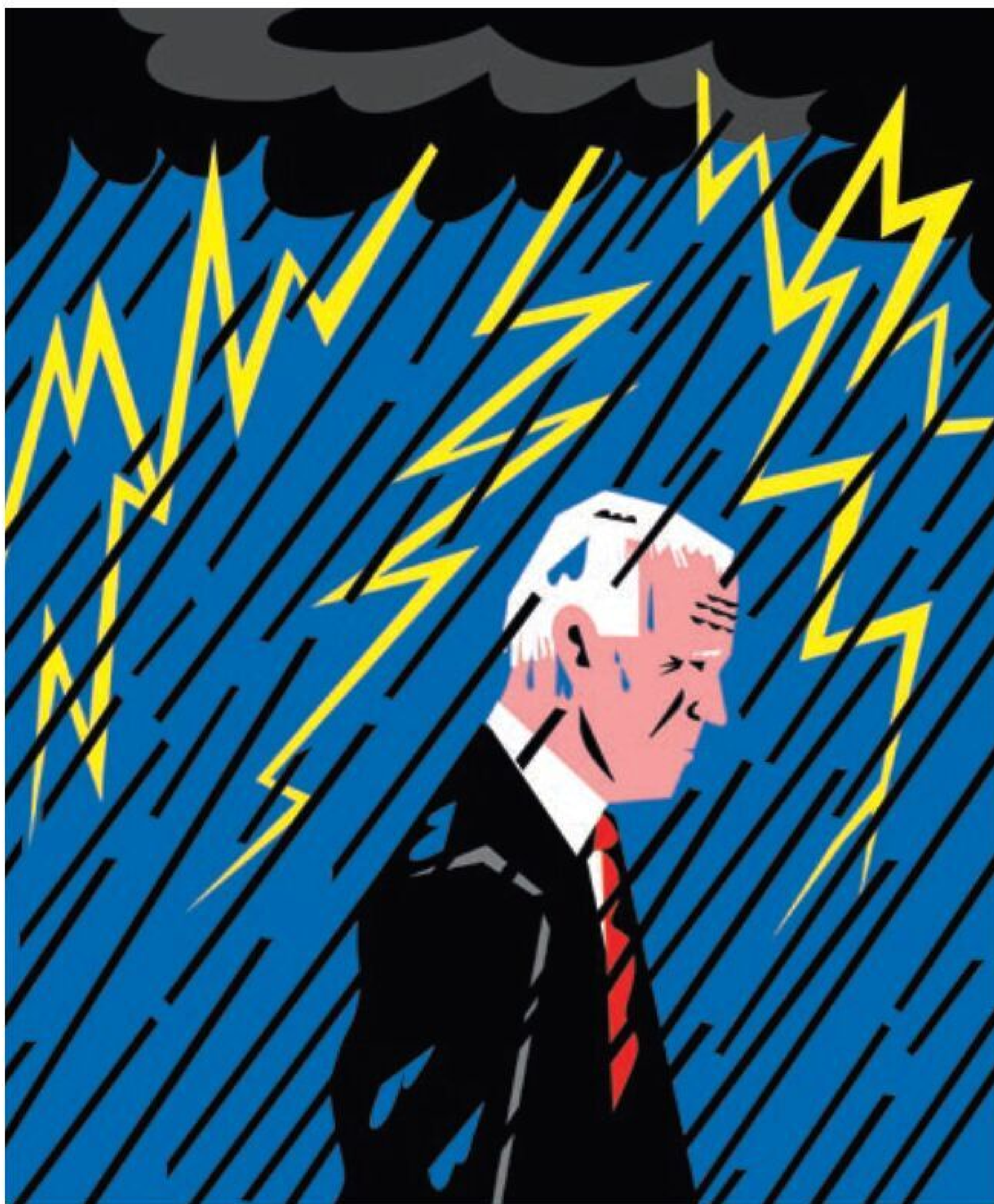



DATA: U.S. BUREAU OF ECONOMIC ANALYSIS; U.S. BUREAU OF LABOR STATISTICS; IPSOS

◀ direct contrasts with Trump personally and Republicans generally, aides say. That's something of a shift for a veteran senator who arrived in the Oval Office with a fundamental confidence in bipartisanship. But he took aim at Trump on the anniversary of the Capitol riot and blasted Republican senators over voting rights. At the recent press conference, he assailed the party for obstructionism. Asked about his first year in office, he replied, "I did not anticipate that there'd be such a stalwart effort to make sure that the most important thing was that President Biden didn't get anything done. Think about this: What are Republicans for? What are they for? Name me one thing they're for."

Allies including Coons and Clyburn say they're confident a slimmed-down version of Build Back Better will pass. To make it resonate with voters, they acknowledge that Team Biden and Democrats need to ramp up their salesmanship. "We will do so much better to the extent we focus on a few concrete ways that what we're doing helps middle-class Americans," Coons says. "What I think didn't work was talking about the numbers, and talking about a 'massive bill' or a 'transformative bill.'"

Whatever happens with BBB, the administration will spend much of this year rolling out funding from the infrastructure law—which was supported by only



a handful of House Republicans. "Every voter in the country needs to be reminded of that, again and again and again," Malinowski says.

Biden aides acknowledge that the president is frustrated, in particular with the Covid testing shortage. "Joe Biden tends to take a long view on most things," White House senior adviser Mike Donilon says. "I think he believes that there has been a foundation laid that has put the country in a good position going forward."

A senior official maintains that the administration has painstakingly set the groundwork for further economic recovery and is ready to handle new flare-ups of Covid.

Privately, Biden aides are beginning to express cautious relief about omicron, which despite its spread is proving less deadly than first feared and is showing signs of having crested. One aide, speaking on condition of anonymity, says they feel good about where things stand, immediately adding that they know that sounds strange. But, in the aide's view, a billion tests are coming and supply of Pfizer Inc.'s Covid pill is ramping up, while all the fundamentals—treatments, tests, vaccines, a strong economy—are in place to return to normal.

In November, as the economy's growing pains coughed up good and bad news, politically, Coons says he consoled Biden: "I put my arm around him and said, 'Mr. President, a few months ago the problem was we didn't have enough jobs. Now the problem is we don't have enough workers. That's a better problem to have.'"

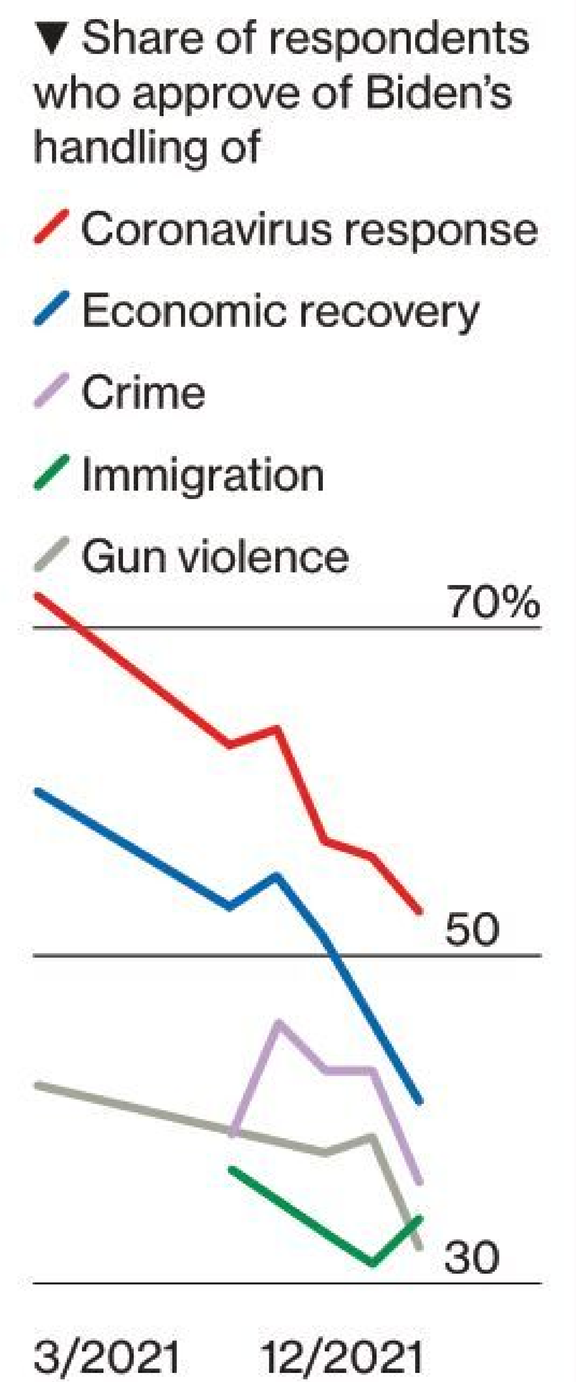
There are events that could turn things around for Biden, namely a fall in Covid cases, easing inflation, and a continued rebound of the economy. But there are wild cards, too. Inflation could continue to rise or stay high. Another Covid variant could emerge. Relations with Russia or China could take a worrying turn. Supreme Court Justice Stephen Breyer could announce his retirement. Meanwhile, Trump looms in the background as the GOP kingmaker, both encouraging Republicans to stonewall Biden and offering himself as a helpful foil—and potential 2024 opponent.

If Democrats suffer in the midterms, as they did in 2010 under Obama, Biden's options will be severely curtailed. The spotlight will then shift to another question, particularly as Trump gears up for his own potential bid: Will Biden seek reelection in 2024, a year when he'll turn 82? If not, who could succeed him as the Democratic candidate?

Last month, Biden said he'd be guided by health, fate, and Trump himself. "I'm a great respecter of fate. Fate has intervened in my life many, many times," Biden told ABC, when asked if he'd run. "If I'm in the health I'm in now, if I'm in good health, then in fact I would run again." And if Trump ran? "You're trying to tempt me now," he said. *—Nancy Cook and Josh Wingrove*

THE BOTTOM LINE The White House will draw sharper contrasts with Republicans and bet on a strong economy and fading pandemic in Democrats' bid to hold on to Congress in November.

▼ Share of respondents who approve of Biden's handling of




DATA: IPSOS. ILLUSTRATION BY KATI SZILÁGYI

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# How Did Blake Hall Get Between You



## During the pandemic his online-authentication company, ID.me, became the government's digital gatekeeper. And its grip is only getting tighter

**If you were writing a techno-thriller, you'd give your hero a** backstory like Blake Hall's. He's a Harvard MBA, an alumnus of McKinsey & Co.'s ultracompetitive summer associate program, and comes from a family with a proud military tradition. He's a decorated Army Ranger who saw action in Iraq; his dad was an Army brigade commander; his grandfather fought off a Nazi assault in World War II. Now he's the co-founder of a cybersecurity company who peppers his conversations with battlefield jargon, offering his mea culpas with pledges to do pushups as self-inflicted punishment. "I feel a moral duty because I still have the DNA of a soldier," Hall said in an October interview.

So this past June, when he very publicly claimed that his company, ID.me, a player in the booming online identity-verification business, had uncovered one of the biggest heists in U.S. history—a $400 billion theft of pandemic unemployment payments perpetuated by cybercriminal gangs—it came with a certain veneer of credibility.

Within minutes of Axios publishing the interview with Hall, the $400 billion figure went viral. It generated news stories of a nefarious dark web inhabited by Nigerian criminal syndicates out to massively defraud the U.S. government. It was seized on by think tanks on both the left and right that are trying to reimagine the delivery of government benefits. It caused a nervous shifting in seats among officials at the U.S. Department of Labor and state agencies overwhelmed by an unprecedented volume of unemployment claims. Republicans latched onto it as an example of obscene government waste.

"The greatest theft of American tax dollars in history has risen unabated to $400 billion, with nearly half of all pandemic unemployment spending lost to fraud by criminals," declared

**By Shawn Donnan and Dina Bass**

**Photographs by Schaun Champion**

Kevin Brady, the top Republican on the House Ways and Means Committee. It was an almost unimaginable amount, a sum larger than the combined annual budgets of the U.S. Army and Navy and five times what the federal government collects annually in taxes to fund the unemployment system.

It's also a number that, with the benefit of time, data, and a little interrogation, looks increasingly hyperbolic. Hall's key allegation was that half of the money the government paid out—more than $800 billion by then—had been stolen by fraudsters. But the states' own accounting doesn't back that up. In December, California, by far the largest state payee of benefits, said it had identified $20 billion in fraudulent unemployment payments during the pandemic, 11% of what it paid out overall. California was responsible for a quarter of all pandemic unemployment payouts in the U.S.; if its fraud experience held nationally over the past two years it would translate into roughly $95 billion. That's a big sum, but still only a quarter of what Hall was estimating. And other states like Ohio and Texas have reported lower levels of fraudulent payments than California.

But Hall's $400 billion figure set two things in motion: It fed a fear of criminal activity—some of it legitimate—that caused states to impose new checks and flag often innocent claims as fraudulent, freezing payments for weeks and sometimes months to legions of people in dire need of help in the middle of an epochal crisis. It also helped solidify ID.me's move from a little-known, decade-old company with a few niche government contracts into a swaggering industry leader now valued at $1.5 billion with ambitions to be America's digital gatekeeper.

Hall is emphatic to this day that the $400 billion estimate ▶

◀ is accurate. It is, he says, confirmed in patterns in the data the company has gathered through its work for the labor departments of California, Florida, New York, Pennsylvania, Texas, and 22 other states. If state agencies are reporting far lower levels of fraud publicly, well, they're wrong. "The data we have is very clear—this is the largest cyberattack in terms of fraud in American history," Hall wrote in an October email to *Bloomberg Businessweek*, one in a series that he and spokespeople for ID.me sent over weeks offering circumstantial evidence to back up their math. "Just like a recon platoon leader on the battlefield, our duty is to report truthfully what we see. If people react negatively to the truth, then that's on them."

For Hall, the number has to be accurate, because his company's ambitions are riding on it. He wants ID.me to control what he calls the identity layer of the internet, which would make it the equivalent of a digital bouncer, albeit one whose software doesn't always work. "Our goal is to be everywhere you want to be in the future," he says.

For most people, creating an ID.me account is a hassle-free process. ID.me combines data from the phone you're using, selfies you're asked to send, and scans of government documents to verify you are who you say you are. Once you've done that, goes Hall's pitch, you'll be able to do everything online from banking and filing your taxes to accessing your health records and checking into a hotel room, without constantly being asked for credentials and passwords. Eventually, every U.S. citizen could be armed with an ID.me digital passport.



Hall's vision has attracted $275.5 million in investments from the likes of Alphabet Inc., Morgan Stanley, and former U.S. Secretary of Commerce Penny Pritzker. It's won votes of confidence not only from the 27 states that have hired ID.me during the pandemic but also from the U.S. Department of Labor, which last year awarded it $1 billion to modernize state computer systems. The IRS, too, used ID.me to help people register for monthly child tax credit payments introduced last July.

But the company's tightening national grip also raises no shortage of troubling questions, starting with: Should we be entrusting private companies with a responsibility that would naturally fall on governments—such as verifying the identities of their own citizens? Just as we probably don't want Amazon or Facebook controlling access to our tax records or a government lifeline when things go wrong, it isn't clear we should want ID.me to be everywhere we want to be.

**ID.me began 12 years ago as TroopSwap, a Craigslist knockoff for** the military community. Hall and his business partner, a fellow soldier turned MBA student named Matt Thompson, later turned it into more of a Groupon-style discount service. Then they realized the real asset of TroopSwap was the software, which allowed veterans to prove their eligibility without presenting documents bearing Social Security numbers or other sensitive personal information. Hall says that ex-military people often had to show those papers not only to get access to Department of Veterans Affairs-backed mortgages or health-care benefits but also "to get a free Bloomin' Onion at Outback Steakhouse on Veterans Day. It is not a good trade to show your Social to a stranger to get a free fried onion."

In 2012, Hall and Thompson, neither of whom had a tech background, saw an opportunity. The Obama administration had announced the National Strategy for Trusted Identities in Cyberspace, a push to get private-sector companies to develop ID-verification technologies. The TroopSwap team bought the ID.me domain, rebranded, and won a $2.6 million grant from the Commerce Department's National Institute of Standards and Technology.

By 2016, Hall was using that seal of approval to win government contracts, including one to verify identities for Veterans Affairs. Thompson says Hall was also pushing ahead with an affiliate marketing strategy, offering deals to people whose identities ID.me had verified—ultimately the key reason, Thompson says, he left the company in 2015. "You shouldn't be targeted for marketing because now I know you're military so I can market military deals," says Thompson, now CEO of Socure, a competing identity verification and fraud detection company. (Hall disputes Thompson's characterization of his departure. He also says that ID.me users have to opt in to any marketing, which accounts for about 10% of the company's revenue, and that no third party gets access to its user data.)

ID.me's big break came in 2020, when the pandemic triggered a tsunami of job losses just as government offices that handle unemployment claims went totally remote. As states scrambled to upgrade online processes for doling out expanded unemployment relief, they were besieged by fraudsters. That June the company struck its first deal with a state agency, doing identity verification for Florida's employment office, which set off a hiring binge by ID.me to keep up with the demand. The company, headquartered in the Virginia suburbs of Washington, opened its first satellite office in Tampa, which would eventually house about 500 employees. Over the next 13 months, ID.me closed deals with 26 other states.

When the software is working the way it's supposed to, users are able within minutes to create a profile that will allow them to apply for unemployment benefits or set up an online account with the IRS. When it isn't working, though, things get Kafkaesque. An algorithm asks you to prove who you are. Only you can't, because the software decides you don't look like the picture you had taken years ago at the DMV, or it can't understand why you've changed addresses since or why you're using your daughter's iPhone. Which in turn means your access to unemployment benefits, your tax information, or even your health-care records if you're a veteran, can be frozen.

"It's just like opening the door that's there, but when you open it up it's all bricked up behind it," is how Annette Wright-Warmington describes being trapped in ID.me's identity purgatory. The 65-year-old health-care administrator tried to register on the app in the spring of 2021 so she could receive benefits she'd applied for in Pennsylvania after losing her job. She found herself staring into her phone watching an animated crimson waterfall run down its screen every time she tried to take the selfie ID.me asked for. Every three failed attempts,

the software would lock her out for 72 hours. That went on for weeks. Eventually she gave up and got in touch with a lawyer at Philadelphia Legal Assistance who, after multiple tries, was finally able to arrange a video call with one of ID.me's "trusted referees," the company's name for its customer-support personnel, who finally sorted out the problems.

"Getting through to a 'trusted referee' is like winning the lottery for our clients," says Julia Simon-Mishel, the attorney in charge of Philadelphia Legal Assistance's Unemployment Compensation Unit, which saw complaints tick up after the state's Department of Labor & Industry signed a contract with the company in September 2020. Simon-Mishel says it sometimes took weeks for her staff to help secure video appointments with ID.me. "There has to be a better way," she says.

Those most likely to face these problems also tended to be the most vulnerable. Simon-Mishel and other lawyers and activists around the country say ID.me's process disadvantages those who have poor internet service at home, rely on computers in public libraries, or use old phones. Then there are people who are forced to relocate when they lose a job and can't update their driver's license quickly enough. Or users who don't speak English or just struggle with simple digital tasks such as uploading a document.

Facial-recognition software notoriously performs poorly on people with darker skin, misidentifying Black women as men or getting tripped up if a Black woman changes her hairstyle, says Nicol Turner Lee, director of the Center for Technology Innovation at the Brookings Institution. Anecdotally at least, ID.me has faced versions of this problem. It uses facial recognition to verify that photos on user-submitted identifying documents, such as a driver's license, match the selfie taken via the app. Hall says the company isn't running images through a preexisting database, the way law enforcement does, and that it selects facial-recognition vendors that comply with federal standards, though he wouldn't name them. The company also says ID.me put its facial-recognition software through two separate tests for racial bias in 2021 and found no evidence of discrimination. But Clare Garvie, senior associate at the Center on Privacy & Technology at Georgetown University's law school, says an internal company review without public transparency doesn't prove much. "They didn't show their work," she says. "They haven't submitted their tests to any sort of publication."

Problems with ID.me's verification systems haven't been limited to Pennsylvania. A log of complaints for California's Employment Development Department (EDD), which signed up with ID.me in September 2020, details issues ranging from a transgender person being blocked from accessing benefits because the gender on their driver's license didn't match their passport to an applicant who went through ID.me's verification process only to find their claim still on hold six weeks later. In a January 2021 letter to the EDD, California state Senator Anthony Portantino complained that his staff had been "inundated with urgent pleas" from constituents whose benefits were on hold as a result of problems with ID.me. "This recent purge has put thousands of legitimate claims in limbo, with no instructions for how to get out of 'ID verification jail,'" Portantino wrote.

Wright-Warmington

**"It's just like opening the door that's there, but when you open it up it's all bricked up behind it"**

Hall says the company has since added staff and brought down customer service wait times to a matter of minutes. But he largely dismisses criticisms like these as relatively minor, chalking up many of the issues to aging state IT systems. The company says it's identified 11,000 false positives—people it unfairly flagged for fraud—in the 27 states it works in, just a fraction of the millions of false claims its systems intercepted. In one interview last summer, he likened ID.me's role in assisting employment offices—and any challenges his company has faced—to the experiences of other overwhelmed institutions. "The media wouldn't go to an overridden ICU and blame that ICU wing for being overrun," he says. "The pandemic and the strain that it put in the system is the root ▶

◀ cause of all this." Unlike ID.me, hospitals generally aren't marketing themselves as the solution to a surge.

**When Hall dropped the $400 billion fraud bomb last summer, very** few people publicly pushed back. State labor officials around the country remained overwhelmed with a backlog of claims and what was a very real surge in attempted fraud. Politics played a role, with governors in Republican-led states pulling out of emergency federal programs that they complained were too generous and kept people from going back to work. Massive and rampant fraud fit the partisan narrative that the pandemic unemployment benefits themselves amounted to an irresponsible waste of taxpayer funds.

The publicly available data on any of this is strikingly sparse. The U.S. Department of Labor says it still doesn't have a precise accounting of what was lost to fraud nationally. The closest thing available is a White House Office of Management and Budget report, which, at the end of December, found that "improper" payments—including those caused by bureaucratic and other errors—represented 18.7% of the unemployment payments that went out from July 2020 to June 2021.

State agencies are also loath to share data about fraud or ID.me's performance. In Pennsylvania, officials have declined to release any detailed data showing how ID.me delivered on its contract. In a letter fighting a *Businessweek* request for information, ID.me's general counsel, Michelle Graffum, argued that transparency risked "allowing the fraud data to fall into the hands of large criminal organizations."

Hall maintains that the $400 billion figure isn't an estimate of the fraud prevented but rather what was actually stolen. He says his estimate that half of all claims paid out were fraudulent was reasonably extrapolated from a representative sample—namely, what ID.me saw in the first five states where it went to work. He also argues that data ID.me continues to gather confirms the estimate and that it has been validated by others, including experts at the conservative Heritage Foundation, which was critical of the expanded unemployment benefits.

But the math to get to $400 billion, in a way, depends on ignoring ID.me's apparent success in identifying and preventing potential fraud in places such as California, where officials early in the pandemic complained they were receiving claims from inmates in state jails. According to the state, California actually stopped $125 billion in fraudulent claims during the pandemic, or more than six times the $20 billion in fraud it succumbed to. That was partly thanks to ID.me and other contractors, such as Thomson Reuters and Accenture—and it's a success being celebrated. "Today the UI [unemployment insurance] program fraud rates are lower than pre-pandemic levels," the California EDD said in a December email.

But even California's fraud numbers should come with an asterisk, advocates for unemployed workers say. ID.me's fraud case largely rests on the reliability of its own algorithms and seems to ignore the problems users have had. For example, between Jan. 28 and March 8, 2021, ID.me had 654,292 users start its verification process in California, according to data Hall provided. Just half of those users completed ID.me's checks. Hall argues that any users who didn't complete the process were clearly scammers.

Redacted confidential reports filed to officials by ID.me in California and obtained via a Bloomberg open records request offer a more nuanced reading. On Nov. 17, 2020, for example, ID.me reported that the prior week, 101,050 people in California attempted to verify their identities with ID.me. Of those, just 40% succeeded. But you could see the frustrations unemployed workers and their advocates complain about playing out in the data: Almost a quarter of the people ID.me dealt with in California that week tried to get on a video call with a company rep, but only 10% of that group succeeded. More than 7,000 people also abandoned the ID.me process by either closing their browser midway through or having their session time out. Both situations are as easily attributable to tech glitches as fraud.

Cynthia Rice, director of litigation, advocacy, and training for California Rural Legal Assistance, warned state officials early in September 2020 that she had serious concerns about the impact of ID.me on low-wage workers. More than a year later, Rice and her colleagues are still dealing with the fallout among their low-income clients. Farm laborers and other workers who were wrongly flagged for fraud by ID.me had benefits cut off, waiting months for appeals. All because an algorithm had made a decision. "I mean, we're never going to let our criminal courts just convict someone based on the fact that you've got a digital record that they did or did not respond to something, or that shows X, Y, and Z," Rice says. "But essentially that's where we are with these fraud determinations."

The picture has been muddied further by how the fraud has evolved over time. ID.me's original purpose—its whole sales pitch—was as an impervious barrier to scams. But by the middle of last year it was itself being used as a conduit for scams.

In July, Erica Worthy clicked on a Facebook ad offering $2,000 a day to clean JetBlue planes in Chicago. The unemployed Florida resident filled out an application and soon heard from a JetBlue recruiter, who directed her to a link. "All you need to do is click on the link and take a selfie," he told her. Worthy was taken to ID.me's website, where she uploaded documents and scanned her face. Then she sat back and waited for a job offer. It never came.

Worthy had just had her digital identity stolen by criminals who'd filed a claim with the California employment office using her name. When the California claim was identified as potentially fraudulent, her Florida unemployment payments were suspended. Each attempt to reach ID.me drew an automated response with a new seven-digit ticket number and then nothing else. "I've sent so many requests to these people," Worthy says. "I have so many ticket numbers." (After weeks of calls, she finally got it resolved.)

According to Hall, ID.me does everything it can to prevent fraud. He describes incidents like Worthy's as garden-variety phishing attacks of the type every business must contend with. "This is not an attack that's unique to ID.me," he says. He's

**"If they want to say that their product is preventing fraud, they need to open that to public accountability"**

right that these attacks aren't unusual, but the consequences to ordinary citizens certainly are.

**The questions about ID.me matter more and more as it extends** its reach into the lives of Americans. The unemployment crisis gave it critical mass. It now boasts more than 68 million users, or almost 1 in 4 adults in the U.S., and it's adding people at the rate of 145,000 a day. It has contracts with big government players including the Social Security Administration and the IRS.

Hall says that after ID.me won an IRS contract last year for the Biden administration's enhanced child tax credit, he was able to mobilize on short notice. "We had about 70 days, which isn't a lot, and we hired 1,400 people in Q2, and we solved it."

But as the first monthly child tax credit payments went out in July, social media lit up again with complaints about ID.me. "I called the IRS and they have no idea why I am receiving this error or what it is," one frustrated user, tacticalrandy1, posted on Reddit on July 17. "I have been swearing like a sailor over here, I'm so frustrated with this process," replied another user. By November, ID.me was starting to address such complaints by adding an in-person verification option in New Jersey. Missing from its announcement was a sense of irony: It had just re-created an analog function that DMVs and banks had been performing for decades.

And the investor money keeps pouring in. Last March, ID.me raised $100 million in funding from Viking Global Investors and SoftBank Group Chief Executive Officer Marcelo Claure, followed by an additional $100 million in debt from Fortress Investment Group LLC in September.

Which problems the government should tackle on its own, and which are best left to the private sector has long been the subject of a fierce debate in America. It's a partisan divide seen with President Biden's attempts to get a new social spending package through Congress. But when technology is involved, there's often a more united belief that the marketplace is better equipped to deliver a solution—whether it's transporting supplies to the International Space Station or developing vaccines.

That idea was reinforced with the Obama administration, when it struggled to roll out effective insurance portals after the Affordable Care Act took effect in 2010, and then the following year with the National Institute of Standards and Technology's digital identity plan. Jeremy Grant, who oversaw that implementation, says when Obama ceded the task of policing digital identities to the private sector, aware that anything resembling a national identity card would be a hard sell with conservatives, "the thesis was that you could have industry solve this for you."

A decade later, though, Grant thinks Washington relinquished too much control to companies like ID.me. He now leads the Better Identity Coalition, which is composed largely of financial-services firms such as JPMorgan Chase, Wells Fargo, and Equifax. It's pushing legislation in Congress that would require a bigger government role in verifying digital identities, for fear that for-profit contractors such as ID.me may come to dominate the function.

Representative Bill Foster, the Illinois Democrat who's the lead sponsor of the legislation, says verifying people's digital identities should be treated as a "fundamental government responsibility." It has consequences for everything from cybersecurity to central banks' ability to establish viable digital currencies. Foster also believes Americans ultimately won't accept having the private sector take on such a sensitive function. "If the future is that you have to log in using Google, or log in using your Apple ID, and that is the gatekeeper for asserting your digital identity, then that is not a future that most people in the U.S. are comfortable with," he says.

There are also concerns that ID.me and companies like it could act as ideological tools used to limit access to government benefits. "States are using these systems to make benefits harder to get," says Kevin De Liban, director of advocacy at Legal Aid of Arkansas, which is suing that state to get information on how software from a company called ProTech Solutions Inc. is used there. "If they want to say that their product is preventing fraud, they need to open that to public accountability."

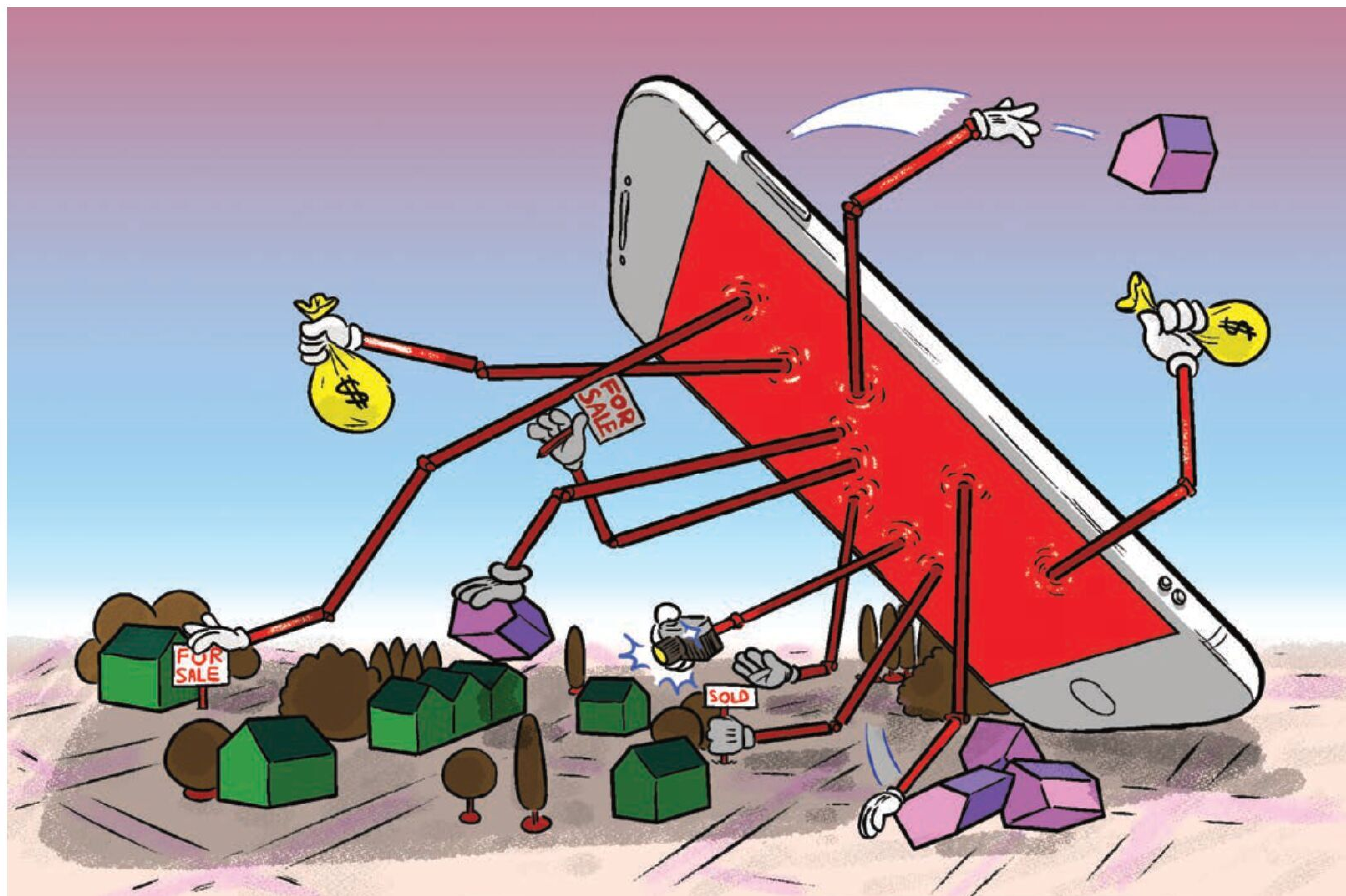
Others are just worried about what they see as profiteering. "Any time you add an outsourcing component—even a technological component—to a government function, you have to ask who is benefiting financially from that," says Lorena Gonzalez, a California assemblywoman who's helped unemployed constituents struggling to get verified by ID.me. "These are vendors. They make a lot of money."

Hall says ID.me actually lost money fighting fraud during the pandemic. But the company clearly knows it's emerging from the crisis with other baggage. In a Jan. 14 interview, Hall said ID.me would soon release a report detailing its experiences with the unemployment system that would show it had seen things even the FBI couldn't. "We're the first ones to have a bird's eye view," he said. "The truth is on our side." In early January, its public-relations team also began circulating a white paper defending the company's facial-recognition technology and touting a "No Identity Left Behind" initiative.

"As services and transactions increasingly move online and the economy becomes ever more digital, we have an enduring obligation to ensure everyone has the opportunity to participate," the paper began. That's a laudable mission, one worthy of an indisputably patriotic CEO. It's just not one many of ID.me's involuntary customers think the company has lived up to. Ⓑ —*With Jennah Haque*

# A FIGHT OVER DISCRIMINATION IN THE AGE OF ALGORITHMS

# Redfin has staked its reputation on making a racist industry more equitable.




## Critics say it's been denying services to Black homebuyers and sellers

BY PETER ROBISON AND NOAH BUHAYAR ILLUSTRATIONS BY MICHAEL KENNEDY

TO UNDERSTAND HOW INEQUITIES IN REAL ESTATE PERSIST IN the U.S., consider two homes in Chicago. The first is a brick bungalow with five bedrooms and 2 1/2 bathrooms on the city's predominantly Black South Side. The home has more than 2,000 square feet and sits on a pretty, tree-lined street, a short walk from a Nigerian restaurant. The second property is an 800-square-foot, two-bedroom condominium unit in Glencoe, a mostly White suburb.

The South Side house is worth $187,000, about $20,000 more than the Glencoe condo, according to a recent visit to the website of Redfin Corp., the real estate technology company. Based in Seattle, Redfin provides home listings and valuation estimates to buyers and sellers. The company also operates one of the country's largest real estate brokerages—but it doesn't provide its services to just anyone. On its page describing the more expensive house in an overwhelmingly Black part of the city, Redfin's site noted that "customer demand is through the roof right now," so it couldn't provide one of its real estate agents to help broker a sale. It offered a referral to another company instead. For the less expensive apartment in the overwhelmingly White suburb, Redfin promised a lot more. "We'll handcraft your analysis," the site said, offering a call from an agent and comprehensive market data within two days.



The striking contrast in Redfin's treatment of these two homes—and similar disparities in the level of service the company provides in majority-White and non-White neighborhoods—can be found in cities across the country. It is, Redfin's detractors say, a sort of digital redlining that harkens back to the days when loan officers shaded no-go areas red on maps. The critics include fair-housing groups, which are in talks with the company to settle a federal lawsuit they filed that could force changes in how Redfin manages its business, and at least some of its own employees, who've pushed for more service in minority neighborhoods.

These people trace the apparent racial disparities in part to Redfin's software, which is supposed to help managers smooth out demand from consumers and direct the efforts of its growing workforce of salaried agents. For inquiries through its website and app, Redfin sets a minimum valuation in every market before it will sell a home on behalf of a seller or buy one on behalf of a buyer. The threshold can vary by the part of town and even by the day, based on Redfin agents' workload and the volume of leads.

Sellers whose homes are worth more than whatever the minimum happens to be when they sign up for Redfin's service get professional photos, 3D walk-throughs, data analysis, and added visibility on its site—all while paying less in commissions than they would with a typical real estate brokerage. Sellers of homes that are below the company's minimum threshold get a referral to a non-Redfin agent, which the company calls a "partner agent," or no service at all. As a result, fair-housing groups contend, these sellers may have to pay a bigger commission for an inferior listing and may ultimately accept a lower price.

Redfin says its own data show that it doesn't discriminate by race. In a statement, the company calls it "sensationalistic and wrong" to describe its policies as the equivalent of redlining, a discriminatory practice in which lenders, insurers, and others withhold service from certain communities based on race. "Being fair is more important to Redfin than making money," the company says. "We recognize that systemic racism affects who can pay for a broker, a book, or an airline ticket, but using price to determine which homes we can sell is not only legally permitted, it is the only fair way to make that determination." Redfin also disputes the idea that third-party agents would offer inferior service, saying that it carefully vets them and that for many lower-priced properties, they offer a better deal than its own employees can provide.

Redfin's potential to influence home prices comes from its size and scale. Since its website went live in 2004, the company has grown into the fifth-largest real estate broker in the U.S., with sales volume of $37 billion in 2020, according to the trade publication *RealTrends*. Redfin's site and app attract more than 49 million people each month to view its listings and valuations. This part of its offering helps shape perceptions about home prices and drives thousands of leads to agents every day.

Fair-housing groups argue that, by withholding service disproportionately to lower-priced homes that tend to be in minority neighborhoods, Redfin's policy perpetuates unequal treatment that has persisted for generations and led to a huge loss of wealth for many non-White homeowners. "This is not just happening one time in one city," says Diane Houk, a lawyer for the National Fair Housing Alliance in Washington, a plaintiff in the suit.

Redfin has promoted its technology-enabled business as a way of bringing racial justice to real estate. The idea that it might actually be doing the opposite has troubled some of its own employees. During a Zoom call for a few dozen staffers in Chicago in September 2020, Chief Executive Officer Glenn Kelman was asked about pay disparities among Redfin agents. It was just a few months after the murder of George Floyd by a Minneapolis police officer set off protests in many U.S. cities. Redfin had been through its own turmoil, dismissing 41% of its agents in the first weeks of the pandemic, only to bring many back within months.

One agent asked Kelman how the company could improve pay for those who worked and lived downtown and on the city's majority Black South Side, where lower home values meant bonuses were often smaller than those earned by colleagues in White neighborhoods. Kelman said Redfin would allow the best agents in the city to work in higher-end areas that brought more profit, according to people on the call, who

## *"This is not just happening one time in one city"*

asked for anonymity discussing the private conversation. One later told colleagues that Kelman didn't seem to get it at all. Under the proposal he floated, minority communities would get even worse service. According to Redfin, Kelman was simply trying to make sure everyone had an opportunity to work on "the most lucrative deals." Redfin calls this "the only fair way to run a company in an industry where the amount agents earn is linked to the sale price of the homes they sell."

A month later, the National Fair Housing Alliance and nine other fair-housing groups argued that the racial dynamic the employees had observed in Chicago was much broader. In a lawsuit filed in federal court in Seattle, the groups alleged that Redfin was discriminating against buyers and sellers, violating the Fair Housing Act. They say their suit is based on a two-year analysis of how Redfin had applied its minimum price thresholds in markets across the country—including Chicago, Detroit, Baltimore, Memphis, Kansas City, Mo., and New York's Long Island.

The price minimums, the suit alleged, systematically deny service in places where a large proportion of residents aren't White. These are often the same areas once deemed risky on maps produced by the federal Home Owners' Loan Corp. in the 1930s to determine who could get government-backed mortgages. In greater Chicago in June 2020, for instance, Redfin was five times more likely to provide the best services and rebates in ZIP codes in which 70% or more of the residents were White, compared with ZIP codes where 70% or more of the residents were not White, according to the groups' analysis. At the time, the suit says, Redfin didn't make its own brokerage services available at all within Chicago's city limits unless prices reached $400,000—but it did so in majority-White DuPage County, in the Chicago suburbs, for homes priced above $275,000. In majority-Black Detroit, prices had to reach $700,000 for buyers and sellers to get Redfin's offering, according to the suit. But in the mostly White suburbs in Wayne County and adjacent Oakland County, Redfin was available to anyone selling a home worth at least $250,000.

Kelman declined to comment for this story, which is based on interviews with two dozen current and former Redfin staffers as well as data presented in the lawsuit. He hasn't said much about the suit publicly, other than in a letter sent to employees that was also published on Redfin's website. In it, he wrote that there were legitimate business reasons for setting minimum prices and that Redfin has expanded the range of properties it can profitably sell as it's grown. He added that part of the company's challenge in serving lower-priced markets—including some urban neighborhoods and rural towns—stems from its compensation model. Unlike agents at rival brokerages that operate solely on commission, those at Redfin get health benefits and a base salary (starting at $12,000), in addition to bonuses.

In a statement, Redfin says it's being unfairly targeted because it publishes online what service it will provide to a property. It adds that its commitment to lowering the price thresholds means that "every year, by design, we lose money selling low-priced homes. The only issue in this case is whether we should lose more. We know of no other major brokerage with that commitment; the rest let each agent decide whom to serve."

**TO SOME IN THE REAL ESTATE INDUSTRY, THE MOST SHOCKING** element of the lawsuit was its target. It's hard to name an American business leader more attuned to issues of racial justice than Kelman. In 2018, long before George Floyd's murder, he hosted a "Race and Real Estate Symposium" during which he interviewed a prominent academic on stage about racially coded language still prevalent in the industry, which has long used words like "unsafe" to mean neighborhoods with lots of Black or Latino residents. He assigned agents to unconscious bias training and spoke out against some brokers' practice of selling homes within their own exclusive, often predominantly White networks instead of listing them more widely.

During the Black Lives Matter protests of 2020, Kelman published a blog post in which he wrote that "equal service should be the norm in our industry, but it isn't." The company, he said, would tie executive bonuses in part to meeting goals to increase the diversity of its workforce, 37% of whom are people of color. Kelman continued: "Our first obligation is to fight for you the Black homebuyer—and also the veteran homebuyer, the Latinx homebuyer, the Asian homebuyer, the gay homebuyer, every homebuyer—using all our capabilities as top-producing local agents and lenders, and all our technology: to embrace your aspirations, and to give you every advantage when buying a home, especially in neighborhoods where you've historically been shut out."

KELMAN

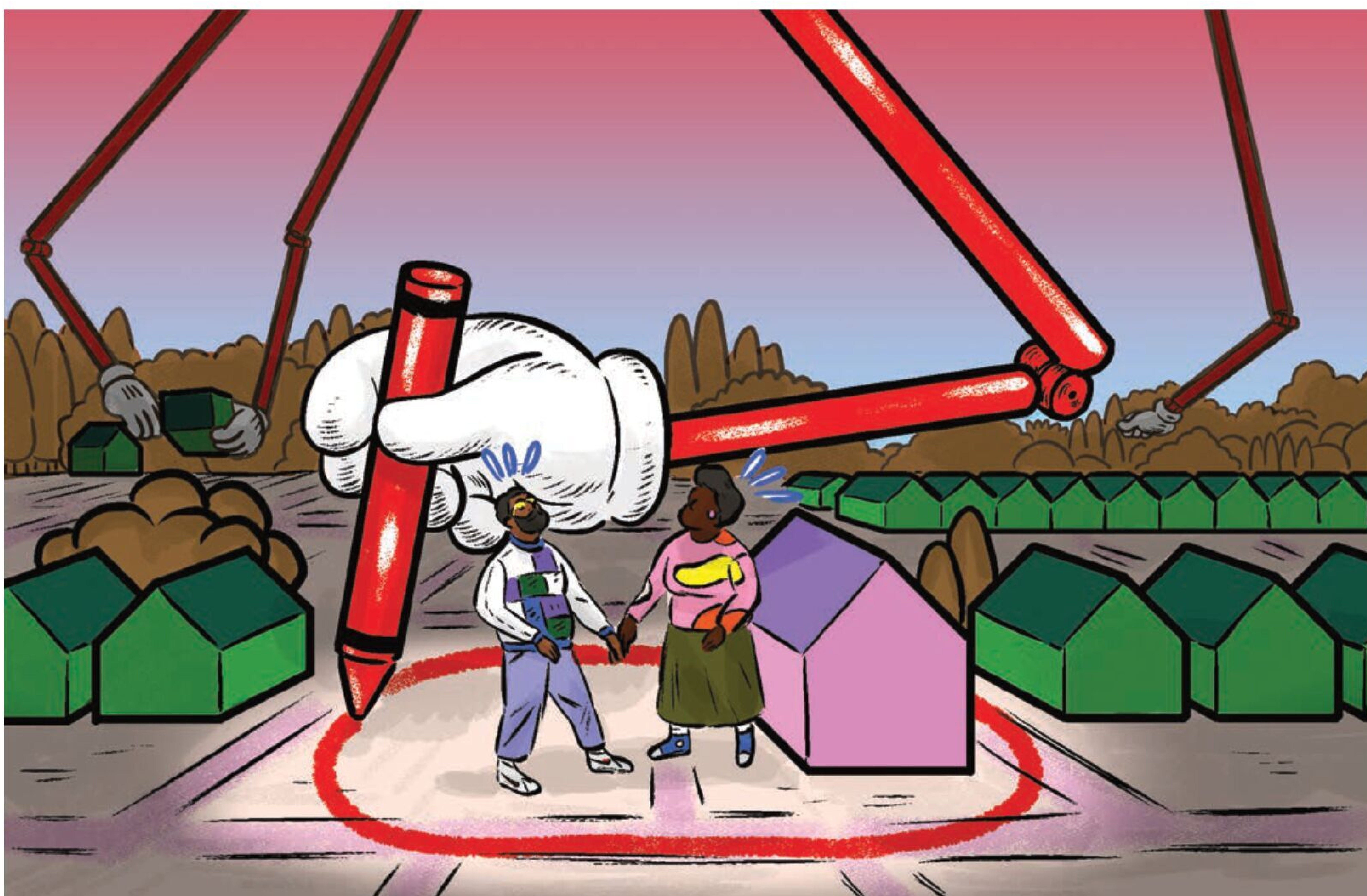
The message was in keeping with how Kelman has promoted Redfin since joining the company in 2005, when it was viewed as a digitally powered antidote to a traditional industry beset with the legacy of segregation and high costs. "Real estate, by far, is the most screwed-up industry in America," Kelman told *60 Minutes* in 2007. He compared Redfin to Amazon.com Inc. and other tech disruptors, suggesting it would make the industry cheaper and more transparent.

Americans pay average commissions of almost 5% on home sales, according to *RealTrends*. (Half of that typically goes to the buyer's agent and half to the seller's, paid by the seller out of the proceeds of the sale.) This structure is partly to blame for the stark racial disparities in U.S. housing, causing brokers to compete to service the highest-priced homes, which are more typically found in majority White neighborhoods, while devoting fewer resources to those in less-expensive (often non-White) neighborhoods. The location of brick-and-mortar offices shows the industry's priorities. In Illinois, for instance, a *Bloomberg Businessweek* analysis found that more than one-third of neighborhoods have a majority ▶

COURTESY REDFIN

◀ of non-White residents—yet those places accounted for just 13% of more than 1,000 realty offices.

Early on, Redfin charged sellers a flat $3,000 fee, instead of a commission, for a no-frills service. (Home tours cost $250 extra.) But after finding that customers wanted more service, it raised the fees and adopted a version of the commission structure it had once sought to replace. Redfin is still relatively inexpensive, but more recently it's charged sellers 1.5% of the total sale price. (When Redfin agents represent buyers, it provides a further discount, paying out a portion of the buyers' agent commission—$1,750 on average—as a rebate, as long as the commission exceeds $6,500.)



From its start in Seattle and a handful of other big cities, Redfin has grown to serve more than 100 markets in the U.S. and Canada, with an agent workforce numbering 2,370 in the third quarter. For these agents, Redfin's website and easy-to-use internal sales checklists simplified their days. Instead of spending time drumming up new clients, they closed deals—as many as 50 or 60 a year. "You go to Redfin, and it's like you're on crack—jeez, keep bringing it to me," says Michael Robertson, a former Redfin agent in the San Francisco Bay Area.

As it expanded, Redfin adopted tools to help it match the potential revenue in each city with the number of employees—hiring enough to meet demand without having too many idle agents during slow times. Senior analysts and executives at Redfin track many of these measures centrally, but the company also entrusts midlevel "market managers" in each city with some discretion over decisions. For example, a "busyness" meter for each agent is intended to help them find the sweet spot—when they're engaged in profitable business without spreading themselves too thin to serve customers. Such measures informed the managers' use of their most powerful tool: the ability to raise or lower the minimum home-value thresholds to bring in more or fewer leads. That kept the company working on profitable sales, but it also caused some internal consternation.

Some agents bristled at instances when their market managers set the minimum thresholds at prices they felt left business on the table. Bobby Maguire, a former Redfin agent in the Boston area, says he was shocked when the minimum value in his area reached $600,000 in 2018. He told managers he still saw plenty of opportunities for buyers of starter homes down as low as $380,000. Still, he could understand the business rationale. "A first-time buyer for a $200,000 condo in a tough area is going to take just as much time as a million-dollar house for a fourth-time buyer," he says. "So why would they do that?"

Two former agents in Chicago say the leads they got from Redfin made them question the way the company was setting minimum values in more diverse neighborhoods, such as Hyde Park and Woodlawn, near the planned Barack Obama

Presidential Center. "It was weird how we would handle South Side business—it was almost like the minimum threshold was different," says one of the former agents, who recalled that at one point, Redfin would provide service to properties valued at $225,000 or more in the South Loop, when similar-value properties would get passed to a non-Redfin agent in Woodlawn. Redfin says its policy explicitly forbids market managers from routing more or less business to partners based on a neighborhood's racial composition. "We've never heard of a market manager doing that," it adds, "and we'd fire one who did."

Discrepancies in where the company served customers at times reflected labor shortages, according to several former employees. Minimum thresholds might go up if agents had recently quit—or were simply out sick. In parts of Seattle, Redfin struggled to recruit native Mandarin speakers who could help it tap into the city's Chinese-speaking population, according to one former employee. The company's decision to let go of more than two-fifths of its agents at the start of the pandemic (before later hiring many of them back) also affected which markets it could serve in 2020. "This made it easy for a plaintiff to find two areas, side by side, where our employee capacity was uneven," Redfin says in a statement. "We're far from the only business that relied on partners more than usual because of staffing shortages."

Still, when the fair-housing groups filed their lawsuit later that year, at least some Redfin employees commented privately that they'd seen it coming, according to text messages viewed by *Businessweek*. One put a facepalm emoji in a text to a colleague, then wrote: "We tried to warn them." Redfin says Kelman hasn't heard any questions from employees about its price thresholds.

IN 2018, MORGAN WILLIAMS, GENERAL COUNSEL AT THE National Fair Housing Alliance in Washington, talked with a colleague who'd recently attended a panel on housing. One of the panel discussions had been about the way Redfin structured its business. He hadn't known that the company used minimum home values to define service areas. "A price-based policy sent up a big red flag," he says. As he well knew, it could be cause for a lawsuit.

After targeting banks, insurers, and agents for much of its history, Williams's nonprofit had recently turned its attention to technology companies, which are playing an increasingly important role in the real estate market. Four years ago, the group sued Facebook under the Fair Housing Act over targeted ads that, the nonprofit said, allowed landlords to filter for potential tenants by race. (Facebook settled the suit after making changes to its filtering policies and agreeing to future monitoring while denying wrongdoing.) The law, passed in the wake of Martin Luther King Jr.'s assassination in 1968, makes it illegal for owners and intermediaries, including brokerages, to "refuse to sell or rent ... or otherwise make unavailable" any dwelling because of race.

> *"It was weird how we would handle South Side business"*

The Fair Housing Act is written so that even if a company's policies are unintentionally racist, they still may not be permissible. It doesn't matter if bankers or brokers aren't trying to redline; if their policies have a "disparate impact" on a minority community and there's no legitimate business reason for the policies, they're still breaking the law. In the 1990s the nonprofit brought successful complaints against insurers over policies tied to the age and value of homes that disproportionately affected minority neighborhoods. Federal banking regulators created a further precedent by cautioning against using minimum loan amounts to determine service.

Over two years, Williams helped coordinate staffers from the National Fair Housing Alliance and groups including Long Island Housing Services and the Fair Housing Center of Metropolitan Detroit to gather data from Redfin's website. They found that in predominantly White ZIP codes, people were anywhere from 2.5 to 69 times more likely to be offered Redfin's best service compared to those in predominantly non-White ZIP codes. "The differences were stark and, in fact, statistically significant," says Houk, the lawyer for the fair-housing groups. She adds that they were "not likely to have happened by chance."

Redfin says it doesn't deny service to any neighborhood based on demographic characteristics; instead, it uses a "neutral pricing policy." In response to questions, Redfin says it reviewed data for 2021 and determined its thresholds were twice as likely to be higher in predominantly White areas compared to predominantly non-White areas. In other words, the company contends, its treatment of the bungalow on Chicago's South Side is hardly the norm.

More than a year after the suit was filed, the two sides remain in settlement talks, and Redfin has yet to file a formal response to the complaint. The parties said in a January court filing that they have a "framework" for resolving the lawsuit but are still working through details. How Redfin responds should matter to all homeowners, regardless of race, because its policies "bleed through the whole neighborhood," says Shanna Smith, the retired former executive director of the National Fair Housing Alliance. "It doesn't matter about my race—if I'm the neighbor to a Black family that's been discriminated against in that way, I lose money as well," she says.

Many of Redfin's critics acknowledge the irony of the dispute. The advent of online real estate services had the potential to eliminate many of the face-to-face encounters in which bias often occurs, says Cara Hendrickson, executive director of BPI, a public-interest law and policy center in Chicago. As the housing market shifts further to the internet as a result of the pandemic, the risk is that new services will instead propel longstanding bias into the age of algorithms. "This is the moment not to let history repeat itself," she says. Ⓑ —*With Ann Choi*

# Ponzi Schemer On the Pacific

*Gina Champion-Cain was a beloved friend, mentor, and pillar of the San Diego business community. But her successful image and lavish lifestyle were fueled by a $400 million fraud*



By Chris Pomorski

In late 2012, Kim Peterson, a San Diego real estate developer and lawyer, got a call from a friend and colleague named Gina Champion-Cain. Peterson was in his 60s; in 1982 he left behind a high-profile criminal defense practice in Chicago to build shopping centers, pharmacies, and luxury homes. With his wife, Laurie, he lived in a stylish Mediterranean villa with views of the Pacific and traveled on his own plane. In business circles, Peterson was known for probity and sound judgment. Through mutual acquaintances, he'd met Champion-Cain, roughly 15 years his junior, around 2005. They became close, playing golf at the exclusive Rancho Santa Fe country club where they were members and dining together with their spouses. Now she had an investment opportunity to tell him about.

Champion-Cain owned a real estate company, American National Investments Inc., and had recently bought her first restaurant. She was learning about liquor license regulations. When a license is transferred from one owner to another, she told Peterson, California law requires that the buyer and seller apply for approval to the California Department of Alcoholic Beverage Control. Within 30 days of applying, the parties are obliged to open an escrow account, into which the buyer must deposit the purchase price of the license. California liquor licenses can be more than $100,000. Many buyers, Champion-Cain said, are caught off guard by quickly having to come up with so much cash. She told Peterson that she'd recently met with a liquor license attorney who wished that his clients could get financing to cover their deposits while they waited for approval.

Here was the opportunity. By collecting money from investors, including wealthy acquaintances and friends, Champion-Cain had created a fund to provide short-term, high-interest loans to liquor license applicants. When, upon approval of a transfer, the buyer provided the cash for the purchase and the escrow closed, the loan principal and interest flowed back to the fund. Returns varied depending on a loan's duration but could hit 25%. The liquor license attorney, Champion-Cain said, had a steady supply of worthy applicants, and Chicago Title, one of the largest title insurance providers in the U.S., was overseeing the escrow accounts. (Chicago Title has headquarters in Los Angeles and Jacksonville, Fla.)

To Peterson, it sounded as though his friend had identified an overlooked, potentially lucrative niche. And he'd done business with Champion-Cain before, lending her money that was repaid with interest. He made a few relatively modest investments in the fund, and after those paid off, he put in more capital. He also spread the word, first to well-heeled associates and later to banks and hedge funds. Collectively, they would invest about $140 million. In 2015, in recognition of his role as the fund's principal rainmaker, Peterson got a small ownership interest in Champion-Cain's company and the right to 80% of the fund's profits.

In fall 2016, Peterson invited a promising visitor to his office in Del Mar, a beach town north of San Diego. Michael Brewer was president of Alcoholic Beverage Consulting Service, a company that offers liquor licensing assistance. Brewer was one of the foremost liquor license experts in the state, and he had name brand clients: CVS Pharmacy, Marriott International, Outback Steakhouse. Such large corporations had no need for Champion-Cain's fund. But Peterson hoped Brewer's smaller clients might be interested in borrowing money. Before describing his idea to Brewer, Peterson asked him to sign a nondisclosure agreement. "He thought he found the golden goose," Brewer tells me.

Peterson explained things to Brewer much as Champion-Cain had explained them to him. But Brewer was perplexed: There's a difference between the letter of the law and how California liquor licensing really works. Yes, buyers are supposed to deposit the full purchase price of their license into escrow within 30 days of filing an application. In practice, almost no one deposits more than 10%. The agency in charge "never pressures anybody to fund within that 30-day time frame," Brewer says. Only on the eve of approval are applicants required to have the full amount. That lets them avoid tying up significant resources in non-interest-bearing accounts during a review process that can take a year.

Brewer could think of few circumstances in which he would recommend that clients cover their escrow needs with high-interest loans. "I told Kim Peterson it made no sense," he says. "He didn't believe me." By then, Peterson had been investing with Champion-Cain for about four years. Millions of dollars had flowed through the fund. Peterson had made a handsome profit, and he felt sure of his returns. He was confident that Chicago Title was protecting the loan principal for which he was responsible. Brewer says that Peterson told him, "I've got $8 million in loans on the street right now." (Peterson, who denies naming a specific figure, tells me that before taking on a larger role in the fund, he consulted with multiple law firms and visited the Alcoholic Beverage Control district office in Sacramento to confirm the legality of the lending model. The office didn't respond to a request for comment.) As far as Brewer was concerned, the problem that Champion-Cain's fund purported to solve didn't exist.

Amid the surfboards, flip-flops, and fish tacos, it's easy to forget that San Diego is a Navy town, and its largest employer is the U.S. military. This helps explain the city's relatively conservative politics and, with the twentysomethings who alight for a few years to enjoy the craft beer scene before seeking fortunes elsewhere, its transience. The motto on San Diego's seal is *Semper Vigilans* (Always Vigilant), but boosters prefer a public-relations slogan dreamed up in the '70s after San Diego was spurned by the Republican National Convention: America's Finest City.

Until 2019, when she was revealed to be the architect of an almost $400 million Ponzi scheme—a distinction that likely makes her the most prolific female Ponzi artist in history—no one channeled the local *je ne sais quoi* better than Champion-Cain. She arrived in 1987, tired of winters in Ann Arbor, where she had grown up and recently graduated from the University of Michigan. Seven years later, having added an MBA to her ▶



CHAMPION-CAIN: EDUARDO CONTRERAS/SAN DIEGO UNION-TRIBUNE/ZUMA PRESS. LANDSCAPE: ALAMY

◀ résumé, she took a job with Koll Co., a large developer. Lynda McMillen, then a regional president, hired her. "She is bright. She is articulate. She has confidence and poise," McMillen says. "She could go anywhere she wanted to go."

Champion-Cain inherited a passion for real estate from her father, a developer in Michigan. But she didn't find the overwhelmingly male world welcoming. Petite, tan, and athletic, with flowing dark hair, she was once told by a senior executive that she was too good-looking to be taken seriously. Plum assignments seemed to go to men, while she was stuck with troubled projects. "I made a name for myself for being able to do complex negotiations and turn around distressed assets," she said in a 2016 interview for a podcast hosted by psychologist Nancy O'Reilly. But it was a lonely education. "I couldn't ask the men for help. They would have seen it as weakness."

Among the notable projects Champion-Cain worked on at Koll were a trio of San Diego retail centers, including the massive La Jolla Village Square. If she felt intimidated by male colleagues, it didn't show. "She played cards, she drank bourbon, she smoked cigars, she was into going to Vegas," recalls Howard Greenberg, president of Trilogy Real Estate Management, a prominent landlord. "She could walk into a room full of guys and hold her own."

In 1997, Champion-Cain left Koll to found American National Investments (ANI), eventually renting a small office above the Onyx Room, a nightclub in the Gaslamp Quarter, in downtown San Diego. The Gaslamp, which encompasses about 16 blocks adjacent to San Diego Bay, was once known for its brothels, gambling halls, porno palaces, massage parlors, and sailor saloons. Since becoming an historic landmark in 1978, the neighborhood had attracted developers, including Trilogy, that were converting its Victorian-era buildings to live-work lofts. The city poured in cash. In 1998 voters approved an expansion of the San Diego Convention Center, along the Gaslamp's southwest border, and backed a deal for a new ballpark for the Padres blocks away.

The area remained scruffy, but Champion-Cain remembered her father's perseverance through economic doldrums. In the Gaslamp's dilapidated buildings she saw a chance to improve her own fortunes and those of her adopted hometown. In 1998, ANI bought the old Woolworth Building at the northern edge of the Gaslamp for $2.5 million. With partners, she spent several years redeveloping a chunk of the block for mixed use, with dining, retail, residential lofts, and a House of Blues.

The project elevated Champion-Cain's profile, providing a calling card she'd use for the rest of her career. "To see an old, rundown building in the center of town become a completely different type of venue was quite rewarding," she told the *San Diego Union-Tribune*. "No one thought I could pull it off." (After agreeing through an intermediary to be interviewed for this article, Champion-Cain backed out when I declined to sign over any potential film and TV adaptation rights to the intermediary.)

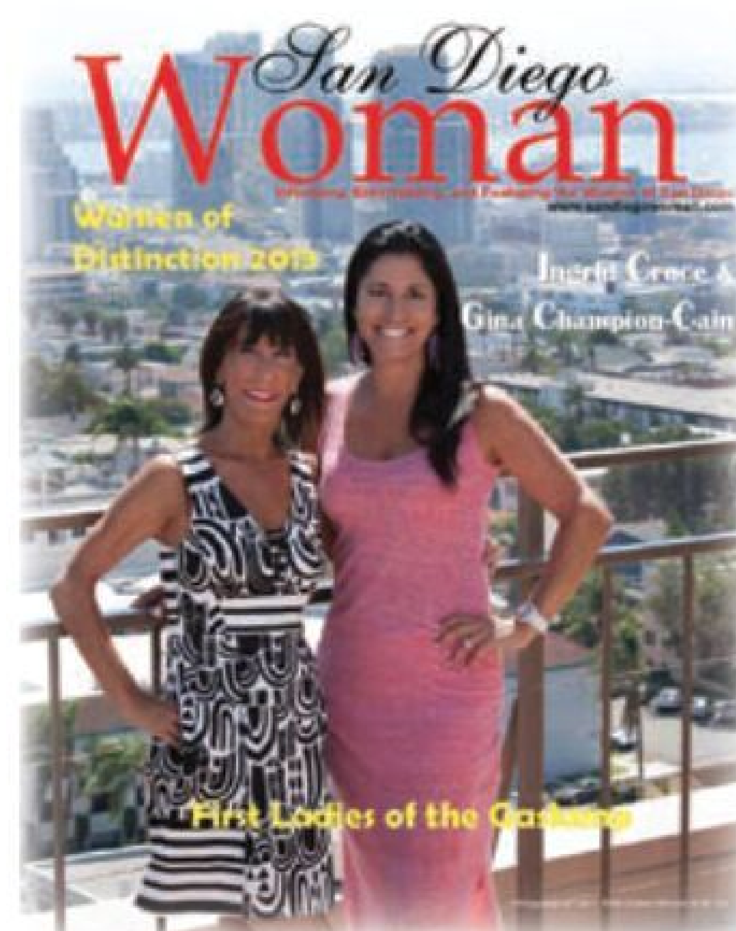
No less instrumental in Champion-Cain's rise was her relationship with Jack Berkman, a sought-after PR man. Berkman was an early chairman of the Gaslamp's business improvement district and a co-owner of the now-shuttered Fio's Cucina Italiana, a beloved, much imitated Italian restaurant on Fifth Avenue. When Champion-Cain approached him about representing her in the late '90s, he saw a kindred spirit and a highly marketable product.

One morning in July, I meet Berkman at a power breakfast spot not far from the San Diego Zoo. He's seated at a booth beneath a painting of the principals from *The Wizard of Oz* following the Yellow Brick Road. "There weren't a lot of women leading organizations in real estate back then," he tells me. "Gina stood out. She was warm. She was very charismatic, and she embraced wanting to make a difference."

They devised a strategy to establish her as a major figure in San Diego and a face of the Gaslamp, which was mutating into a tourist landscape of generic restaurants and Disneyfied historic lanterns and trolley buses. Champion-Cain began picking up awards and appearing on splashy lists: *San Diego Business Journal*'s Women Who Mean Business award, *San Diego Metropolitan*'s 40 Under 40, *San Diego* magazine's 50 People to Watch. She chaired the Executive Committee board for the Downtown San Diego Partnership, got appointed to the powerful Centre City Development Corp., and associated herself with charities, including the American Lung Association. In recognition of her good works, the mayor once declared June 28 "Gina Champion-Cain Day."

In July 2003, Champion-Cain appeared on the cover of *San Diego* magazine beneath the question, "Who Owns Downtown?" Standing beside her was Bud Fischer, a co-founder of Trilogy with Howard Greenberg. Greenberg found the pairing odd. At 71, Fischer was a bona fide mogul with decades of experience developing downtown real estate. "And here is Gina, next to him, as if they're somehow equal," Greenberg says. The article identified only a single building that Champion-Cain owned—and she didn't actually own it. "She was the empress with no clothes," he says.

After pausing her work during the financial crisis, Champion-Cain reemerged with plans to move into retail and hospitality. In 2011 she bought a sleepy restaurant in Pacific Beach, a low-key oceanfront neighborhood, and converted it into the Patio on Lamont. With an outdoor fireplace, a wall of living plants, and a cheeky cocktail list, it was a hit. In 2014 she opened a second Patio in Mission Hills, the upscale enclave where she lived with her husband, Steve, the owner of a manufacturing company. During the same period she acquired several beachfront homes, converting them into short-term rentals. She opened a boutique, Luv Surf, and teamed up with former *Baywatch* actress Melissa Scott Clark to open a home goods store. Rapturous news coverage often emphasized Champion-Cain's fortitude. "When the recession came along, I needed to reinvent myself," she told *San Diego Business Journal*. "I had to figure out something else to do besides play golf every day."



Champion-Cain (center, in 2015) got a lot of attention in the local press for her entrepreneurial endeavors (top), which included boutiques such as Luv Surf (bottom)

In 2015, Champion-Cain hired Hilary Rossi to oversee ANI's expanding food and beverage division. She had recently acquired Rossi's restaurant, Surf Rider Pizza Co., and Rossi was smitten. "She had this crazy energy that was super infectious," Rossi says when we meet for lunch in San Diego's Little Italy. Champion-Cain told Rossi about developing Acqua Vista, a well-known condo project nearby. Rossi was impressed: "As a woman in business, I admired the shit out of that."

In just a few years, ANI had gone from having five employees to hundreds. The walls of a new 26,000-square-foot corporate office were adorned with Champion-Cain's awards and magazine covers. Soon after Rossi was hired, Champion-Cain gave her a tour. As they descended to the basement, she described a commercial kitchen Rossi was about to see. But when they arrived, they found an unfinished warehouse in disarray. "There was stuff everywhere," Rossi recalls. "Equipment, boxes of plates, a torn-down wall. Gina had no idea this stuff was there." Rossi attributed the misunderstanding to Champion-Cain being busy. "But looking back on it," she says, "what business owner wouldn't know what's underneath their feet?"

As she settled in, Rossi, like four other former ANI executives I spoke to, saw a company in chaos. New hires, partners, or consultants seemed to arrive daily, many with ill-defined roles or superfluous assignments. Champion-Cain's assistant had an assistant. The assistant's assistant had two assistants. A former vice president says that his assistant's main responsibility seemed to be walking Champion-Cain's golden retrievers. Nepotism figured prominently. "Many of these people were friends, or friends of friends," says Jarrod Zimpfer, a former ANI events manager. "They were definitely not qualified," and often overpaid. A wine buyer for the Patio restaurants, Zimpfer says, had never studied wine. Until arriving at ANI, the general counsel, an old friend of Champion-Cain's, spent her career as a public defender.

Employees and potential partners frequently presented Champion-Cain with entrepreneurial ideas. But her enthusiasm for a project often had less to do with merit than the person who proposed it, and ANI was riven by rivalry for her attention. "For one and a half years, I loved working for Gina," Rossi says. When she flew to Maine to care for her sick mother, Champion-Cain checked in regularly. And like others who enjoyed favorite-child status, Rossi was given far more responsibility than she'd had in previous jobs (restaurant build-outs, franchising plans, a food truck, a coffee company), which made her invested in ANI's success. Champion-Cain promised that they would get rich together, Rossi says, telling her, "You're going to retire with me!"

But Champion-Cain appeared uninterested in the basics of running a company. Business plans, inventory management, and projections were shoddily executed or absent; the former vice president says that she seemed unable to parse basic corporate documents. Few ANI businesses turned a profit. Many hemorrhaged cash. Pamela Corey, a former Luv Surf manager, says, "Everybody eventually wondered, 'Why are we opening another place when the ones we have aren't making money?' " Yet Champion-Cain continued to expand, often with ill-conceived ventures: a CBD line, a chocolatier, and more boutiques and restaurants, including a costly boondoggle in Petaluma known as Chicken Pharm. Champion-Cain had a habit of insulting less favored employees behind their backs. "She'd say, 'That guy's an asshole,' " Rossi recalls. Like other executives, Rossi was constantly reassigned to handle emergencies and eventually found she couldn't keep up: "I was in the doghouse. I was like, I get it, now I'm the asshole."

Life as a minor hospitality magnate was intoxicating for Champion-Cain. "She got the bug," Holly Cloud, a friend, says. "Having her own restaurant was sexy: 'When I walk in, people know me.' " Zimpfer says that Champion-Cain hosted political fundraisers at Patio restaurants featuring "the crème de la crème of San Diego society" and footed the bill for friends. Among the frequent beneficiaries were Della DuCharme and Betty Elixman, the Chicago Title escrow officers who handled ANI business. Evenings were often alcohol-fueled, and executives got used to wee-hours, all-caps emails. "She'd be texting during a meeting, and two days later you'd get an email," Rossi says. "You'd be like, 'Ugh, this is what I just went over.' "

ANI executives exchanged theories about what was keeping the company afloat. Some guessed it was Champion-Cain's real estate business. A former development executive says that during his job interview, Champion-Cain indicated that Jack McGrory, a major San Diego investor, would back her development deals. (The ex-executive, like several others, agreed to be interviewed on the condition of anonymity because of nondisclosure agreements or concern that ▶

ANDREW OH; JOHN GASTALDO/SAN DIEGO UNION-TRIBUNE/ZUMA PRESS

*"I panicked and felt I needed to support an image of who people believed Gina Champion-Cain was"*

◀ further association with ANI might be career-damaging.)

That proved false. On deal after deal, Champion-Cain backed out at the last moment, antagonizing brokers and lenders. In some instances, the former executive says, she misrepresented facts to wriggle out of agreements. In the case of one short-term rental property, ANI knocked down a building, which the company planned to replace with new construction, before the lender could inspect it, violating the terms of the loan. Expenditures on other purported rental homes appeared dubious. One property was in Carmel, which prohibits short-term rentals in residential areas. Another, a palatial $3.2 million estate near Palm Desert, seemed intended for personal use.

One day the former executive met with other developers about a potential project in Little Italy. To present ANI as an attractive partner, he spoke about Champion-Cain's commitment to the neighborhood, citing Acqua Vista, the condo she liked to highlight. A representative from Watt Cos., a large developer, looked at him strangely. "He goes, 'Dude, wait a second. I was there. Gina didn't do shit. We had to buy her out of that project!'"

Filings from dueling, now-settled lawsuits between Watt and ANI appear to bear that out. A 2008 statement by a Watt vice president describes Champion-Cain as an intermediary—a recipient of fees for locating the site and "obtaining permits and entitlements." The vice president said in the statement that ANI was never owner of the Acqua Vista project, "never contributed any funds toward the project, and never had any equity interest whatsoever in Acqua Vista."

By 2019 former partners and investors had accused Champion-Cain of fraud and breach of contract in almost a dozen lawsuits going back a decade. A 2012 complaint filed by Gary Pace, a pharmaceutical executive, described a $200,000 loan he made to ANI for a project in Oregon. The suit alleged that Champion-Cain used that money to pay other investors, stay current on an Arizona mortgage, and make payments on an option for land. Lawsuits filed by a former partner in 2016 and 2017 accused her of misallocating assets. (Champion-Cain and ANI largely disputed the allegations in suits against them.)

The lawsuits settled quietly. Champion-Cain's rise overlapped with contractions in the local press that have afflicted newsrooms across the U.S., with the paper of record, the *Union-Tribune*, cutting more than half its staff between 2006 and 2010. Apparently unnoticed by the media, her legal troubles didn't tarnish her public image. In photos accompanying celebratory articles about her, she wore patterned dresses and beaded jewelry: an exemplar of a tastefully prosperous San Diego lifestyle. "There's plenty of people who promote themselves as something that they're not," says Greenberg, the Trinity president. "So if she said she did this or that? Maybe she did. And if she didn't, who's that harming?"

In January 2019, Brewer, the Alcoholic Beverage Consulting Service president, got a call from a private equity firm that intended to invest about $100 million in Champion-Cain's liquor license fund. Before pulling the trigger, the firm wanted his read. Brewer drove to the firm's office in San Diego, where the client showed him the offering documents. He hadn't forgotten his meeting with Kim Peterson almost seven years earlier. The paperwork deepened his sense that something was off.

The first thing Brewer noticed was that the explanation of escrows omitted that the Department of Alcoholic Beverage Control doesn't immediately require buyers to deposit the full price of licenses. Again, this suggested urgent demand for short-term loans where none existed. A spreadsheet enumerated loans ostensibly made by Champion-Cain's fund. Several licenses were for wholesalers such as winemakers and breweries. But wholesale licenses don't require escrows. Why would a business take out a high-interest loan to cover a nonexistent cost? And the prices for many licenses struck Brewer as wildly inflated.

But Brewer's clients had FOMO. "They were very much wanting to do the investment," he says. "They felt everybody was getting rich and they were getting left out." They asked him to help with due diligence. The team contacted every liquor license lawyer and consultant in the state to ask if their clients were using Champion-Cain's fund. None were. Next, they reviewed about six months of records for liquor license transfers. For every transaction in which Chicago Title—the insurer affiliated with the fund—handled escrow services, the team contacted the buyers and asked if they were using the platform. Again, nothing. To get anywhere near the millions in loans she claimed to be funding, Champion-Cain would have had to be responsible for every single liquor license escrow at Chicago Title. Brewer's investigation suggested that she was behind none of them. In March 2019, his clients concluded that the likely explanation for the inconsistency was that Champion-Cain was running a Ponzi scheme.

That August the U.S. Securities and Exchange Commission filed a complaint accusing Champion-Cain of embezzling more than $300 million from investors across the U.S. She hadn't made a single loan to a liquor license applicant. Instead, investors' cash was deposited in a Chicago Title account that she controlled exclusively. A U.S. Department of Justice complaint followed. In July 2020, Champion-Cain pleaded guilty to securities fraud, obstruction of justice, and conspiracy. In all, almost $400 million flowed through her fund. All but about $11 million left in her account was used to prop up her businesses, pay off existing investors, and cover expenses including jewelry, cars, credit cards, travel, box seats for the Padres and Chargers, and a $22,000 golf cart.

In a statement submitted to the court, Champion-Cain promised to help investors recoup losses and wrote that she was "seduced and addicted to the appearance that I was enhancing peoples' lives. Ever since I was a little girl my Mom has told me that all I ever wanted was to take care of people. To be 'Mama Gina.'" At sentencing in March, she described how her self-reliance curdled into something toxic. "I kept trying to pull deals together, to be creative in the re-creation of my business, but I kept failing," she said. "I panicked and

felt I needed to support an image of who people believed Gina Champion-Cain was."

Unmoved, U.S. District Judge Larry Burns sentenced her to 15 years in federal prison, about four more than prosecutors recommended. It rankled the judge that Champion-Cain's victims included friends, family, and employees. "This wasn't just strangers hoping to get rich," he said, explaining how her "deceit and betrayal" played into his sentencing rationale.

Still, much of the money came from supposedly sophisticated investors and financial institutions. They'd put their trust in Chicago Title, the company theoretically safeguarding their capital. By the time of Champion-Cain's indictment, ANI had little value and Chicago Title had become the target of lawsuits. Several have settled, with Chicago Title paying about 65¢ on the dollar against losses without admitting wrongdoing. Others are ongoing, including a joint suit by Banc of California Inc. and the Texas hedge fund Ovation Partners, as well as one by Kim Peterson. (Peterson has never been accused of wrongdoing by the SEC or Justice Department.) Chicago Title didn't respond to requests for comment.

The lawsuits turn on the company's evident failure to safeguard against fraud and investigate obvious irregularities with Champion-Cain's account. The most glaring was that hers had no finite purpose. Escrows generally close within months, but Champion-Cain's stayed open for years. In an unusual arrangement, Chicago Title collected steep usage fees; one lawsuit estimates that the company made hundreds of thousands of dollars, if not millions, from its relationship with Champion-Cain. Effectively, these were very profitable checking services.

To deceive investors, Champion-Cain impersonated Chicago Title employees, creating fake email addresses and forging documents and signatures. But she had inside help. The escrow officers who handled ANI business, DuCharme and Elixman, were aware of her impersonations. Documentation presented in lawsuits against Chicago Title suggests that they also lied to investors and auditors—confirming, for example, the value of investments held in escrow accounts that didn't exist. In return, they got plane tickets, personal checks, and Patio dinner parties on the house.

In much the way she groomed employees, Champion-Cain nurtured her relationship with DuCharme in particular, holding out the promise of a life that, absent their association, would've been impossible. Champion-Cain paid for DuCharme's son to fly to Michigan to visit Champion-Cain's alma mater. DuCharme badly wanted to own a home, and Champion-Cain arranged to buy a four-bedroom house in the desirable neighborhood of Point Loma Heights and rent it to DuCharme cheaply on a lease-to-own basis. Right around this time, the scheme was exposed, and DuCharme never moved in.

Champion-Cain called DuCharme and Elixman endearing nicknames—Lovie and the Boopster, respectively—and denigrated mutual acquaintances: Prick, Idiot, Grumpy, the Doughboy. Their correspondence speaks to the foxhole psychology of an embattled sisterhood. "No matter what I would kick asses for you G!" DuCharme wrote to Champion-Cain in November 2015. At ANI, Champion-Cain insisted that all real estate escrow work go to DuCharme. "She would not do a deal unless Della was involved," the former development executive says. "Gina was protective of her, like a mother bear." Benjamin Galdston, a lawyer representing investors in a suit against Chicago Title and the two women, says, "Gina made them feel special. She made them feel valued." He adds: "They had this secret together. They were truly co-conspirators." (Both women were fired from Chicago Title. Elixman's lawyer declined to comment. DuCharme's lawyer didn't respond to a request for comment. According to court filings, both women are being investigated in the ongoing Department of Justice probe that resulted in Champion-Cain's indictment.)

In November 2019, before Champion-Cain's sentencing, Pamela Corey, the former Luv Surf manager, went to her home for Thanksgiving. It was a small gathering that included Champion-Cain's parents. Corey, who was in her early 30s, had moved to San Diego from outside Boston in 2014 to work at the boutique. She'd read about Champion-Cain in magazines. From a distance, she looked up to her; when they met, Corey found Champion-Cain warm and compassionate. Corey's father died in October 2018. She didn't have family nearby, and Champion-Cain invited her over for holidays and Super Bowl parties. Corey loved her job—the parties she hosted at the shop, the buying trips to Los Angeles, the fact that she could bring her labradoodle to work. Champion-Cain always turned up at her events, and Corey saw a promising future with ANI. "Gina would say, 'We're looking for another boutique for you,'" she recalls.

Earlier in 2019, Corey had invested $20,000 in Champion-Cain's fund, money she inherited after her father's death. When reports of a Ponzi scheme surfaced, she was shocked. She thought it was a misunderstanding that her friend and mentor would surely correct. "We were like family," Corey says. "Your mind tricks you." By Thanksgiving the truth had become clear. "She told me she felt relieved, that she didn't have to be anxious anymore," Corey says. But Corey remained attached. Like many in Champion-Cain's orbit, she struggled to square the person she knew with what that person had done.

Now, Champion-Cain had one last plan to make things right. Her house in Mission Hills was elegant but homey. In the kitchen before dinner, standing at the sink working on a meal of mashed potatoes, turkey, and cranberry sauce, she explained her vision. "She said, 'I'm going to get all your money back,'" Corey recalls. There would be a film about her life, Champion-Cain said, a deal with Amazon.com Inc. or Netflix Inc. worth millions of dollars. Champion-Cain's part might be right for a big-name actress—maybe Demi Moore, to whom she bore some resemblance. Corey, Champion-Cain assured her, could play herself. How the project would come together was unclear. There was no evidence that it existed. But when she described the movie, it seemed real. For a while, Corey believed her. Champion-Cain had always been a wonderful storyteller. Ⓑ

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A rendering of the Core: NYC rooftop

# WHEN THE JET SET'S AT HOME

New York's Core club is expanding around the globe. It's a weird time
*By James Tarmy*





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January 24, 2022

Edited by Chris Rovzar

Businessweek.com

When the Core club reopens its doors for power lunches and power cocktails and power workouts in a new location on Fifth Avenue, it will face more competition than ever before. A new class of members-only clubhouses has cropped up in the past two years, already tweaking the way New York's rich eat, play, and work. The revamped Core will join a field that includes Casa Cipriani, Zero Bond, three outposts of the Soho House empire, and an Aman Club, which will open a block away from Core in Midtown.

This band of upstarts is loosely modeled on the city's longtime members' clubs, which were founded in the 19th century in the style of a British gentleman's club. New Yorkers, after all, also enjoyed reading a paper by the fire, meeting friends for lunch, conducting brief, collegial business deals over Scotch, and partaking in boozy, boisterous dinners served by waiters in uniform.

But whereas the Metropolitan, University, Union, and Knickerbocker clubs share the same imposing facades, wood-paneled libraries, and inedible food as their London forebears, Core and its peers are aiming for something different. They're not stodgy institutions populated by blazer-wearing octogenarians speaking in murmurs; they're sleek social hubs offering top-quality dining, vibrant nightlife, state-of-the-art gyms, wellness centers, and year-round cultural programming.

All of that is attractive but also not exactly hard to come by in New York, a city nearly buckling under the weight of its gyms, restaurants, nightlife venues, and theaters. If the allure of the old membership clubs was simple—exclusivity combined with an aversion to the crushing, carpeted silence of domestic life—the appeal of these clubs is more layered.

A performance at Ludlow House

A few, such as Zero Bond, have just a single location that primarily offers members something to do while they're in town. Although it and its downtown counterpart Casa Cipriani were planned pre-pandemic, they opened in a city where residents who couldn't travel were faced with vastly diminished options for going out. They've both become places to see and be seen, and are already carrying the torch for Eric Adams, New York's new, nightlife-loving mayor. (The night after he won, he celebrated at Zero Bond.) But Core, which is soon opening outposts in San Francisco and Milan, has set its sights on the Soho House model, aiming to capture and serve a more itinerant demographic.

In a way, Core and Soho House address an age-old need: helping traveling businesspeople get plugged into a local network. It's at least partially why Anglo-Saxon social clubs became so successful in the first place. "They were particularly attractive for migrants and newcomers to the city," says Peter Clark, a professor emeritus of European urban history at the University of Helsinki and the author of *British Clubs and Societies 1580-1800: The Origins of an Associational World*. The point of many clubs, he says, was to serve as "an important foothold in the social life of the communities they're joining."

In that scenario, a man arrives at a club in, say, 18th century Boston with proof of membership from its branch in London and is welcomed with open arms. "It gave a newcomer economic and financial credibility, as well as social standing," Clark says. Core could be seen in a similar light—a friendly entry point for an international social and professional class eager to find its footing in a safe space with like-minded people.

Whereas about 60% of the single-venue Casa Cipriani's 2,300 members are from New York, according to a club representative, at Core, "our members have always been international," says its founder, Jennie Enterprise. Of its 1,500 members, only 30% are locals.

Founded in 2005, the club has an initiation fee that ranges from $15,000 to $100,000 and annual dues that range from $15,000 to $18,000. Originally located on East 55th Street, it announced during the pandemic that it would be moving to what was formerly known as the Coca-Cola building on Fifth Avenue.

The space, set to open in September, will occupy the building's top four floors and span about 60,000 square feet. Touring the interior on a recent winter afternoon, Enterprise, energetic and undeterred by the city's recent surge in Covid-19 cases, outlines a mission surprisingly close to its forebears'. "We encourage our members to conduct the business of their lives at Core," she says.

Core: New York will include 11 hotel-style suites, five

PREVIOUS PAGE: COURTESY CORE CLUB. SINGER: COURTESY SOHO HOUSE

# THE NEW NEW YORK CLUB

**▲ CASA CIPRIANI**
Members: About 2,300
Initiation fee: $2,000
Annual dues: $3,900
Main draws: The part-hotel, part-club in the historic Battery Maritime Building at the foot of Manhattan showcases exquisite wood and marble details throughout. The restaurant features views of New York Harbor, and the 15,000-square-foot spa offers everything from reflexology to cryotherapy.

**ZERO BOND**
Members: Undisclosed number
Initiation fee: $1,000
Annual dues: $3,000
Putting the "club" in members club, this moody space built into the former Brooks Brothers headquarters in NoHo puts an emphasis on late nights and celebrity culture. Launched by nightlife impresario Scott Sartiano of 1 Oak, the club has Kim Kardashian, Liev Schreiber, and Tom Brady as members.

**▼ SOHO HOUSE**
Members: 145,000, as of November 2021
Initiation fee: About $700
Annual dues: From about $2,500 to $4,000
The global powerhouse among the business-meets-pleasure set, Soho House offers three buzzy options: the original Meatpacking District location, with its crowded as-seen-on-*Sex and the City* rooftop pool; the cozy and flirty Ludlow House on the Lower East Side; and Brooklyn's Dumbo House, offering postcard views from its restaurant and outdoor pool.

**AMAN CLUB**
Members: Undisclosed number, though a rep says there's already a waiting list
Initiation fee: $100,000
Annual dues: $15,000
Located in the Crown Building, just a block south of Bergdorf Goodman on Fifth Avenue, the club is part of a soon-to-open Aman resort—the first in New York from the ultraluxury hotel chain. The space includes a cigar club and private wine library, but its real draws are specialized services and access to amenities at other branches of the group.

CIPRIANI: COURTESY CASA CIPRIANI. SOHO: COURTESY SOHO HOUSE

private meeting rooms, a spa, gym, beauty salon, health bar, theater, library, two dining rooms, and something called the Dangene Institute, a service founded by Enterprise's wife that handles what Enterprise describes as "noninvasive, nonsurgical kinds of age-optimization, longevity, and just imperfections, generally."

Core has plans to open a Milan outpost in December, which will inhabit 40,000 square feet within an historic building on the Corso Giacomo Matteotti. "We have the entire palazzo," Enterprise says. "Tallest bell tower in all of Milano, with cascading terraces and a courtyard behind." A third location, a 45,000-square-foot branch in San Francisco's Transamerica Pyramid, is scheduled to open in 2023.

The three cities, she explains, "are gateway cities, cities that we feel are internationally vibrant and culturally relevant." The Core member, as Enterprise envisions it, is already traveling between Milan, New York, and San Francisco; she's simply providing an enhanced way for them to do so.

But so are Enterprise's peers, most notably the much cheaper Soho House, which has branches in many more cities, including Chicago, Hong Kong, and Mumbai. The Aman Club, an outgrowth of the cult luxury hotel chain's global loyalty program, will soon have private spaces in Miami, Bangkok, and elsewhere.

And because of Covid, these locations' normal clientele isn't traveling nearly as often, meaning the competition for people (and wallets) is even stiffer.

Enterprise is undaunted. If anything, she says, the pandemic is responsible for the rise in members-only spaces. "One of the reasons why there is a proliferation of private clubs is perhaps because there is this feeling that people want to be in a safer, more secure environment," she says. Enterprise envisions the Core member joining multiple clubs rather than sticking with just one.

"What is interesting about clubs, no matter how many there are, is that people can identify with how those communities are being developed," she says. Zero Bond might find adherents for its buzzy nightlife; Dumbo House, for its weekend lounge scene. Core, in Enterprise's vision, will always remain its members' focal point, a safe berth on their endless march between Centurion Lounges and conference rooms.

"I've often thought," she says, "if every single one of our members is changing the world in their own way, imagine what can happen when we bring everybody together?" Ⓑ

# Do You Really Need Travel Insurance?



## As usual, it depends on the fine print

*By Sara Clemence*

Travel insurance gets a bad rap. It's so confusing, many travelers see it as a sucker's game—an upsell with so much fine print it's practically worthless.

Now it's very much in demand, however. Pick the right policy, and you can potentially avoid being stuck in a foreign hospital with a serious illness, footing the hotel bill for a mandatory quarantine, or paying for a cruise you missed because of a canceled flight. That's been especially appealing in uncertain times. In a recent survey from Berkshire Hathaway Travel Protection, 29% of respondents said they were buying insurance for most trips, compared with 7% in 2020. Medjet Assistance LLC, which provides medical evacuations, had the best month of its nearly 30-year history in November.

You may not even need insurance: Airlines and hotels still offer travelers a lot of flexibility. "With how lenient many travel suppliers are being, [travel insurance] might not make sense," says Megan Moncrief, chief marketing officer at comparison site Squaremouth. Unless you've purchased the cheapest class of ticket, flights can often be changed or canceled for a credit. Ditto for hotel stays, though vacation rentals typically have stricter policies that are left to the discretion of individual hosts. Your existing health insurance, further, may cover medical costs incurred while traveling. (You'll need to confirm that your plan includes treatment outside the U.S.) Many premium credit cards, including Chase Sapphire Reserve and American Express Platinum, include travel insurance as well.

If you do go for it, there are two primary kinds: trip protection, which pays back nonrefundable costs if a trip is canceled; and travel medical insurance, which covers treatment and possibly evacuation if you get sick or injured.

Ancillary plans can cover luggage, rental cars, and even adventure sports. "You don't want to pay for coverage you won't need," says Carol Mueller, vice president at Berkshire Hathaway Travel Protection. "Likewise, you want to [be] adequately covered for the type of trip you're taking."

**Start with a comparison shopping site.** Squaremouth gives instant quotes from more than 30 providers; InsureMyTrip and Aardy.com offer similar services. But before you browse, use this breakdown to figure out what types of policies are right for you.

**Concerned about testing positive before traveling?** Trip cancellation insurance pays back nonrefundable costs if you have to call off a trip because of a serious illness or injury, natural disaster, death in the family, or other major event. Most policies now also cover you if you contract Covid-19—even if you're asymptomatic. "They look at it like any other illness or injury," Moncrief says.

**Concerned about getting stuck abroad?** Look for a travel delay and trip interruption policy that includes coverage for mandatory quarantine. Travel delay covers the cost of meals and accommodations if you have to be isolated; trip interruption reimburses the nonrefundable costs for any travel you must forgo. Check that your policy provides a high enough payout to minimize your out-of-pocket cost. Some cap quarantine expenses at, say, $7,000 rather than $2,000—important when extending a stay at that $800-a-night hotel.

**Concerned about medical care overseas?** Repatriation services such as Medjet or Covac Global can cost less than $200 per policy and will transport customers to a hospital back home if they're seriously sick or injured. Covac, which was founded in response to the pandemic, is the only one that doesn't require travelers to be hospitalized to qualify for Covid transport, says Ross Thompson, the company's chief executive officer. It does come at a higher cost, though: Covid coverage for a single 15-day trip is $745.

**Concerned about shifting border policies?** Most insurance only kicks in under very specific circumstances. Murmurs of impending border closures don't count; nor do skyrocketing Covid rates in the destination. An exception is cancel-for-any-reason (CFAR) coverage, which is normally bought as an add-on to trip protection and can increase a standard policy's cost by 40% to 50%. Two substantial caveats: While CFAR insurance does let you cancel a trip at will, it won't reimburse your full costs. Historically the plans covered up to 75% of nonrefundable costs, but Moncrief says that for some policies, that's now only 50%. Plus, CFAR insurance must be bought soon after you start paying for your trip—generally within 21 days of the first payment—to keep travelers from gaming the system. B

ILLUSTRATION BY TIAGO MAJUELOS

# Old Money, Old Problems

## HBO Max's new series *The Gilded Age* atones for some of *Downton Abbey*'s flaws. *By Patia Braithwaite*

If you enjoy escaping into low-stakes, long-simmering historical dramas, HBO Max's *The Gilded Age*, which begins airing on Jan. 24, might be your new favorite show. This time, *Downton Abbey* creator Julian Fellowes sets his plot in New York City in the late-1800s, an era marked by industrialization, newfound affluence, and immigration—perfect conditions for a class-conscious drama about affluent, anxious White people.

*The Gilded Age* contends with race in uniquely American ways. We enter the series alongside young Marian Brook (Louisa Jacobson), who discovers she's penniless and must move from Pennsylvania to live with her wealthy aunts, Agnes van Rhijn (Christine Baranski) and Ada Brook (Cynthia Nixon).

Marian's purse and ticket are stolen on the train platform, so Peggy Scott (Denée Benton), a middle-class Black woman, pays her fare. As they ride to New York together in a segregated car, an unlikely friendship blooms that leads to Peggy working as Agnes's secretary.

Does a burgeoning relationship between a White damsel in distress and her savvy Black sidekick make you bristle? Well, let's revisit *Downton Abbey*'s earliest attempt at diversity. In 2013 the show introduced jazz singer Jack Ross, who falls in love with free-spirited Lady Rose MacClare and forces everyone to confront their racial biases. (Spoiler: They overcome them.)

I've often wondered why Jack popped over from Chicago for his three-episode arc on *Downton*. Was it because the show was a colossal hit in the U.S.? Was it responding to British appetites for a Black visitor at the estate? Either way, what I distinctly remember is how unsatisfying it was to watch.

Benton and Jacobson in *The Gilded Age*

ALISON ROSA/HBO

I'm always thrilled to see Black actors employed. But often, when Black characters show up on predominantly White television shows, Black viewers must brace themselves as those characters become testaments to trauma or, worse, plot devices to help White characters (and viewers) grow. Watching the first few episodes of *The Gilded Age* reminded me that I'm still upset about Jack Ross.

But the show also feels like atonement. Dr. Erica Armstrong Dunbar, a historian who specializes in 18th and 19th century American history, is a co-executive producer and consultant for the series, and great care has been taken with small details. The behavior of a hostile Irish maid reflects historical tensions between working-class immigrants and Black Americans. A public conversation between Peggy and her father, Arthur Scott (John Douglas Thompson), features body language familiar to generations of Black people: Suddenly aware that they're arguing among White pedestrians, they stiffen and grow silent while strangers pass.

It's through Benton's quiet performance as Peggy, however, rife with thin smiles and graceful exits, that what's easily missed becomes clear: This young woman is self-possessed. Peggy doesn't mind the people she works among, but she doesn't appear to need them either. Nor is she bound to the hopes and dreams her father and mother impose.

In the four episodes I saw, *The Gilded Age* rises above *Downton Abbey*'s missteps, but not because it gets racial dynamics right. It's because Peggy has something we rarely see on television, a quality the poet Elizabeth Alexander calls "the black interior," a metaphorical "black life and creativity behind the public face of stereotype and limited imagination." It's incredibly hard for an actress to convey something so intangible and even rarer for a White writer to craft a Black character who possesses it.

*The Gilded Age* is richer because Peggy Scott appears to be in capable hands. She's full of secrets (there's a meeting with a White lawyer that the viewer doesn't hear) and will likely take us places a period piece wouldn't usually go. Through her eyes, maybe we'll see slices of Black middle-class life. We might explore how Black women powered the suffragist movement. If we're lucky, we can watch her fall in love.

The best part? Peggy Scott isn't even the most interesting character on the show. Ⓑ

GO HERE NOW

# Sheltered Paradise

With spectacular beaches, top-tier resorts, and a stellar Covid record, Anguilla is growing even more irresistible. *By Nikki Ekstein*

The Aurora Anguilla Resort & Golf Club

COURTESY AURORA ANGUILLA RESORT & GOLF CLUB



Anguilla, like an African safari camp or St. Barts with its dive-bomb approach via plane, is one of those places made more special by being difficult to reach. The rare Caribbean island without a cruise marina, it has a tiny airport that only last month started welcoming one major U.S. carrier—American Airlines, with a direct flight from Miami.

Unless you're among the visitors with a private jet, arrival is typically by a small Caribbean airline that flies noisy charter planes or by a choppy 45-minute ferry ride from nearby St. Maarten.

"Anguilla has always had an issue with access," says Kenroy Herbert, chairman of the Anguilla Tourist Board. "But we don't want to open the floodgates, so to speak." That's a pretty unconventional thing for a tourism executive to say, particularly one in service of a 14,000-person island the size of Manhattan that claims virtually no industry beyond, well, tourism.

But Herbert has made that stance—which prioritizes a low-volume tourism strategy focusing on high-spending visitors—a selling point, especially during the pandemic. In August 2020, Anguilla reopened its borders with a unique "bubble" concept designed to insulate travelers and locals from transmission risk by requiring visitors to test aggressively before and after arrival in addition to remaining quarantined in villas for at least 10 days before being allowed to explore.

The bubble worked. From April to December 2020, Anguilla didn't record a single case of Covid-19, according to the World Health Organization. For a certain traveler—both time- and cash-rich yet also Covid-cautious—that made it irresistible. "Other Caribbean islands were calling to get details as to how we made it all work," Herbert says. The rules have since been relaxed, but they remain strict compared with other countries.

Even in the busiest of times, Anguilla is uncrowded (remember, no big cruise ships), with 33 beaches and an especially

A fruit and coconut sabayon dish at Aurora

intimate vibe—the island's small size and population mean everyone knows everyone. Most visitors are regulars, but even first-timers will quickly become acquainted with locals, many of whom work more than one hospitality job and have a good memory for faces. And the luxury quotient is high; hotel prices, which hover around $1,000 per night at many spots, are rivaled in the region only by jet-set magnet St. Barts.

The bubble has set up Anguilla for an exciting new chapter, in which it can use the spotlight to increase its tourism footprint slowly, with an eye toward exclusivity and inventive amenities.

Take Aurora Anguilla, the island's newest hotel and a reimagination of the former 300-acre CuisinArt resort. Its claim to fame (besides the bad name) was that it had Anguilla's only golf course featuring 18 sea-facing holes designed by Greg Norman. The new owner, billionaire and Best Buy Co. founder Richard Schulze, has added a culinary team led by veterans of New York's Eleven Madison Park and introduced a rare opportunity: packaged hotel rooms and flights on Aurora Anguilla's private jet direct from either Teterboro, N.J., or Opa-Locka, Fla. (Round trips from Teterboro start at $800.)

"We want to be the best hotel in Anguilla," Managing Director Simon Fricker told me over Zoom the week the property was set to open in early December. That's a high bar: Anguilla already claims Belmond's Cap Juluca, a beloved Four Seasons, and Auberge's whimsically designed Malliouhana. And opening during a pandemic that's led to a supply chain crisis hasn't been easy.

But when I arrive in early January, Aurora has it surprisingly together. A new golf club and a hydroponic farm to supply the kitchen are delayed until April, but the butler service is impeccable, and the restaurants are excellent.

Eventide, the hotel's marquee venue, is set against the gentle waves of Rendezvous Bay—rated by many surveys as the Caribbean's best beach. It's the only restaurant on the island built around a *prix fixe* menu, and for $160 per person it promises such dishes as grilled watermelon with fermented cream, shallots, and toasted milk bread. Kitchen Table, the hotel's all-day eatery, offers spiny lobster-topped gazpacho, basil-crusted mahi-mahi, and burnt sour cherry cheesecake, mostly prepared in the open kitchen's twin hearths. (My toddler tries to order the mahi-mahi repeatedly at other restaurants.)

The morning after my arrival, Fricker greets me by the vast cabana-lined pool. After a busy couple of weeks over Christmas and New Year's, he's both reveling in the relative quietude—the resort feels half-full at best—and surveying the work that's left to do. He takes me on a tour of the resort grounds, past some incomplete villas and the golf course to the opposite side of the property. There, the former Reef by CuisinArt, a sibling to the original resort, forms a section of Aurora Anguilla called Merrywing Bay, which sits on a separate beach with better waves for water sports. It's anchored by an eyesore of a tower that looks like an architectural remnant of the 1980s (it has updated nautical interiors). Behind it is a fallow, grassy area, where Fricker says management eventually plans an amphitheater, water park, lazy river, and entertainment complex.

Later in the week, when I meet Stacey Liburd, Anguilla's tourism director, at the beachside fine-dining spot Jacala, she compliments Schulze's vision as "filling Anguilla's gaps," especially in terms of the amphitheater, which will help draw meetings and convention business. All this, she says, will feed into a master plan whose capstone will be direct flights from New York. At least one major carrier, she adds, has entered negotiations.

Personally, I welcome that news. Avoiding the transfer in St. Maarten and flying direct, I tell her, would get me here more often. But then I wonder how much the island will change when its logistical inconveniences are wiped away. After I excuse myself from the table and walk out to the frothy shore, I kick off my Birkenstocks and find myself in near-complete privacy. In this moment it's easy to see why more people would want to soak up Anguilla—and why I'm lucky to have it to myself for now. Ⓑ

# Anguilla Dreaming

**WHERE TO STAY**

Newcomer **Aurora** may find its niche with families: Adjacent to its pool are two bocce courts, a large playground, and a surprisingly fun splash pad. A kids club is forthcoming. Nearby, on an equally serene beach, is **Belmond's Cap Juluca**, a honeymoon haven with Greco-Moorish architecture, wood-shuttered windows, and Beni Ourain-style rugs. Head to the island's choppier Atlantic side to find the **Four Seasons**, where pools are the main draw. One, by the hotel's Sunset Lounge, offers the best evening views. And 63-room **Malliouhana**, an Auberge resort, has a colorful cabinet-of-wonders aesthetic that's like Anthropologie on steroids. Use the house bikes to explore nearby Meads Bay, or join the scene at the hotel's lively beach bar, Leon's.

**WHERE TO EAT**

Anguilla prides itself on its quality restaurants, like the excellent **Jacala** in Meads Bay, near Malliouhana, and many are quite expensive. But the most impressive can be the most casual. The **SunShine Shack**, just down Rendezvous Bay from Aurora, was this writer's hands-down favorite. Locals call it "Garvey's," after its jack-of-all-trades proprietor: He fires up barbecue ribs and spiny lobster on outdoor smokers on the sand, then serves his guests before strumming reggae on his guitar. (Bonus: The restaurant stocks Minuty rosé and Laurent-Perrier Champagne.) For Anguillian food, try **Sharky's** on the namesake chef-owner's home patio. His savory, aromatic curries, which coat chicken, shrimp, and fish, linger on the palate and in your mind.

MICHAEL PISARRI

# A Napoleonic Pour

## Like pre-Prohibition bourbon? Here comes pre-phylloxera cognac

*By Kara Newman*

In the whiskey world, "taste of history" bottles abound, whether made from heritage grains, distilled on antique-style stills, or blended to mimic pre-Prohibition flavors. But in the world of cognac, not so much. Some eaux-de-vie may be very, very old, but "history" here hits a wall: Much as Prohibition decimated U.S. distillers and consolidated taste and style around a few key survivors, so did the Great French Wine Blight of the mid-1800s with cognac. In the region, a handful of houses endured—and just one vital grape variety.

Before phylloxera, an insect, wiped out 85% of France's grape vines, cognacs used a wide range of native varieties, such as Montils, sémillon, folle blanche, and colombard. Afterward most producers switched to an Italian strain, the hardy ugni blanc, which thrived when grafted on American rootstock (the technique that ultimately beat phylloxera). As all fruit must originate in Cognac, it became commercially infeasible to distill at scale with any other grape; ugni blanc now accounts for 98% of vines in the region.

Sazerac de Forge & Fils "Finest Original" cognac ($130, releasing across the U.S. on Feb. 1) offers something different: a style of brandy that Napoleon—or the contemporaries of *Bridgerton*—might have sipped. As in pre-phylloxera times, it incorporates a variety of rarer native French grapes. Other, more subtle differences come into play, too: There's no caramel coloring or added sweetener, nor does it use chill-filtration, a modern technique that increases clarity but makes for a less robust and less creamy texture.

The new old bottle comes just as cognac interest is surging. According to the Bureau National Interprofessionnel du Cognac, the U.S. is the leading export market for the spirit: In the 12 months through Nov. 30, 2021, 113 million bottles shipped—a 9.2% increase from the prior-year period. Almost half of that is in the XO range (extra old, aged 10 years or more).

To make the historic blend, Clive Carpenter, general manager of Domaine Sazerac de Segonzac (formerly Domaine Breuil) in the Cognac region, was given access to the cellar master's books from Sazerac de Forge, a now-defunct maison founded in 1782. It's a distant cousin to Sazerac Co., in Louisville, which acquired the Breuil vineyards in 2016. With Drew Mayville, a master blender, and Brian Prewitt, a master distiller and expert in California brandy, Carpenter set about to decipher the blends, dated from 1830 to 1850.

Sourcing spirit made from Cognac's rare native grapes proved to be a "needle in a haystack" mission, he says. Not just finding it, but finding enough aged stock for the blend, "so that once we launched it, we would be able to sustain it." They had to rely on small producers—and only those who were willing to part with their liquid.

To be clear, none of the eaux-de-vie in the blend dates to the pre-phylloxera era. But cognac from that period does still exist; when it surfaces from old cellars it can fetch up to $26,000 a bottle at auction. Carpenter has tasted numerous such spirits over a nearly 50-year career. To make the new blend, he lets sense memory be his guide.

About two-thirds of the Forge & Fils is a 12- to 13-year-old spirit made primarily with ugni blanc. The oldest eau-de-vie dates to the mid-1960s, adding weight and the savory, bitter walnut *rancio* flavor prized by brandy aficionados.

"In terms of taste profile, it's definitely an XO cognac," Carpenter says, though small amounts of folle blanche and colombard, some as young as seven years old, have been added to give the blend vibrancy. (These prevent it from being labeled XO; instead the brand uses FO—finest original—which doesn't actually mean anything in the modern-day alphabet soup of cognac acronyms.)

A sampling reminded me of Armagnac, a French brandy from the Gascony region just to the south, which, having better weathered the phylloxera, still uses many of the old grape varietals. It tasted of dried apricot, butterscotch, and incense-like spice, with a distinct floral exhale. "There's a much wider palette of aromas and flavors," Carpenter says of the heritage grapes. "White flower notes like honeysuckle and jasmine, redder flowers like rose petals." A light hand with the oak lets those shine, while keeping cloying vanilla and puckery tannins at bay.

Bottled at 47% alcohol by volume, Forge & Fils is a bit stronger than most cognacs on the market, retaining its punch when mixed into cocktails, like—you guessed it—the Sazerac. Ⓑ

PHOTO ILLUSTRATION BY 731. PHOTOS: GETTY IMAGES (1); COURTESY SAZERAC DE FORGE (1)

# Back to Nature

## Erem's new hiking boots take eco-friendly to another level. *By Matthew Kronsberg Photograph by Naila Ruechel*

Just as there's a shoe for every foot, there's a boot for every terrain. In hot, arid environments, you don't need high-tech waterproofing and thermal insulation, but you do need comfort and breathability. That's where Erem's Xerocole expedition boots ($200) come in. Their 7.25-inch height and reserve full-grain leather construction offer support and protection from cactuses and other ankle dangers, while the 6-millimeter lugs on the 70%-recycled-rubber soles give you a solid grip, even on shifting sand. The brand also follows a "bio-circular" standard for sustainability: Every element used in the boots has a "proven path back to nature."

PHOTOGRAPH BY NAILA RUECHEL FOR BLOOMBERG BUSINESSWEEK

**THE COMPETITION**

• When there are streams to cross–or just a puddle to ford—Lowa's $245 Gore-Tex-lined Renegade GTX Mid hiking boots will keep your socks dry.

• Hoka's $260 TenNine Hike GTX will keep you comfortable over long distances. The style is polarizing, though: A Hubble heel designed for an easier stride protrudes from the back.

• The only thing worse than getting cold feet before a big hike is getting them during it. Vasque's $200 Breeze WT GTX boots have 200-gram Thinsulate, Gore-Tex waterproofing, and Vibram Megagrip soles.

**THE CASE**

Erem is the brainchild of Noah Swartz and his dad, Jeff, former chief executive officer of Timberland and the grandson of its founder. The family sold the business in 2011, but the Swartzes have applied their knowledge of environmental impact to make a boot a step ahead of most eco-friendly footwear. In practice, that means using brass shoelace aglets rather than plastic; stitching with linen instead of nylon; and using a cork footbed. Of course, ecological promises matter little if your boots are poorly designed. These walk the walk. *$200; eremlife.com*

# Work From Home Is Here to Stay

By Justin Fox



In the second-to-last week of December, 42.4% of U.S. workdays were worked at home. That's according to a monthly survey commissioned by a trio of economists studying remote work, who couldn't get the answers they needed from government data. It's probably the best measure we have of how entrenched working from home has become since the arrival of Covid-19.

Before the pandemic, WFH accounted for about 5% of U.S. paid full workdays, Jose Maria Barrero of the Instituto Tecnológico Autónomo de México, Nicholas Bloom of Stanford, and Steven Davis of the University of Chicago estimated on the basis of a government survey conducted in 2017 and 2018. That share catapulted past 60% in spring 2020, according to their Survey of Working Arrangements and Attitudes, and has held remarkably steady at a bit above 40% since May 2021, not long after vaccines became available to all working-age Americans.

The percentage has likely jumped in January, because of the omicron wave. As for what happens after, the survey also asks workers about their expectations for post-pandemic arrangements. Last spring the responses indicated they expected to work from home on 21% of workdays. By December that was 29%, and Barrero says he expects it to keep rising in coming months. The new normal we appear to be settling into, then, is one in which 30% to 40% of workdays are remote. That's for the entire workforce, including those with jobs that can't be done remotely, meaning the percentage is even higher for white-collar positions. It's the biggest change in generations in how Americans do their jobs. Ⓑ —*Fox is a columnist for Bloomberg Opinion*

● OMICRON IMPACT
In the first week of January, office occupancy was just 27.9% of the pre-pandemic norm in the 10 cities tracked by access systems provider Kastle Systems International LLC, down from 40.6% at the beginning of December.

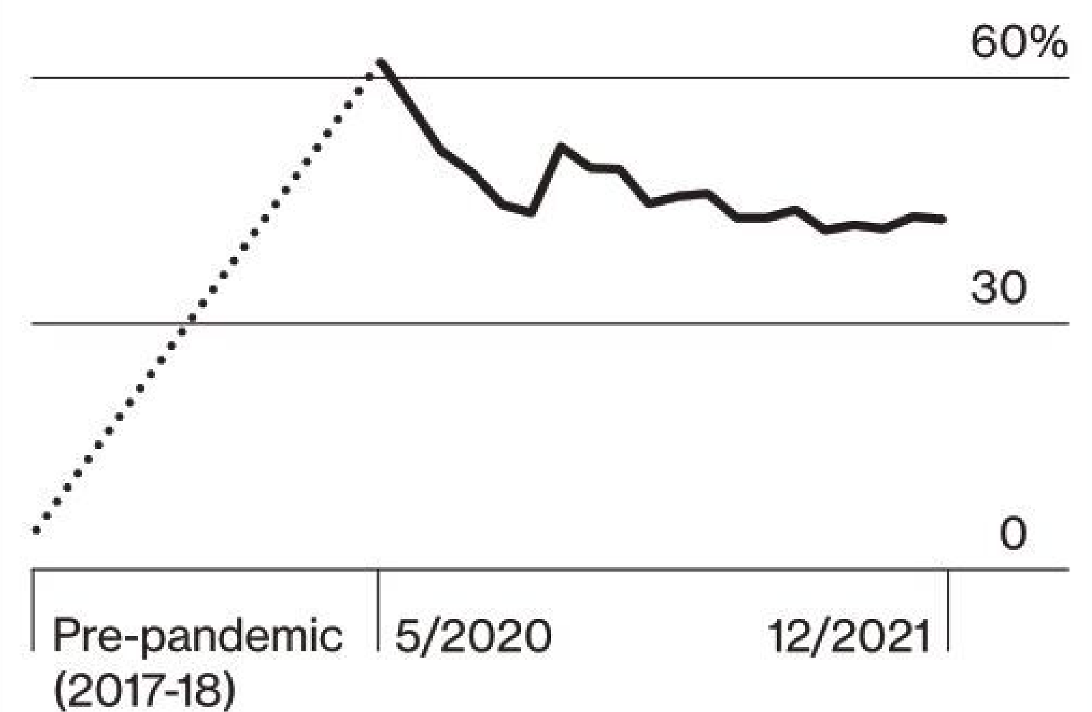
● NOT JUST COVID
In mid-December just

**11.1%**

of employed Americans reported doing any work remotely "because of the coronavirus pandemic," the Bureau of Labor Statistics reported.

● EDUCATION GAP
In a 2017-18 BLS survey, 51.9% of those with a bachelor's degree or higher said they could work from home, while only 11.1% of those with a high school degree or less could.

● Percentage of U.S. paid full workdays worked from home




● FULL-TIMERS
In a survey that the Census Bureau warned was unreliable because of low response rates during the pandemic, 15.8% of employed Americans said they worked primarily from home in 2020, up from 5.7% in 2019.

ILLUSTRATION BY GEORGE WYLESOL. DATA: CHICAGO-ITAM-MIT-STANFORD SURVEY OF WORKING ARRANGEMENTS AND ATTITUDES; PRE-2020 FIGURE IS AN ESTIMATE BASED ON THE 2017-2018 AMERICAN TIME USE SURVEY

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