Responsible investing requires full disclosure

BY DAVID HESS

Not long ago, I attended a conference for public pension fund trustees where the keynote speaker was former Securities and Exchange Commission Chairman Richard Breeden. Mr. Breeden gave a lively and interesting talk on how he came to be the chair of the SEC and his take on current issues related to corporate governance and regulation.

At the end of the address, he opened the floor for questions. The first trustee asked Mr. Breeden if he thought pension funds should be engaging in “social investing.” After expressing a significant concern about social investing, Mr. Breeden took the next question. The second trustee asked Mr. Breeden for his view on “green investing.”

As this anecdote shows, pension trustees are very interested in issues related to social and environmental investing. Their questions raise issues related to fiduciary duties, financial returns and socially appropriate behavior. Unfortunately, trustees are getting mixed answers. Adding to the confusion is the significant attention given to the issue of divestment from companies that do business in Sudan. It has the unintended effect of causing social investing to become synonymous with divestment.

Social investing, however, is much more than divestment. It is about engaging with corporations to push them to consider issues related to human rights and sustainable development. It is about voting proxies on social and environmental issues in an informed manner, and pushing investment managers to consider these so-called non-financial issues. Social investing for public pension funds involves positive social change, but it is more about shareholder value over the long-term than it is about social values. That is why I prefer the term long-term responsible investing. This reflects a growing recognition that proactive management of social and environmental issues by corporations will have a material impact on their long-term value.

To clear up these misconceptions, reform is necessary. The goal of any intervention should simply be to ensure that trustees are making fully informed decisions when they decide whether to include LTRI issues in their investment process. This is best done by requiring that pension funds provide public disclosure on the extent to which (if at all) LTRI issues are taken into account in investment-related decisions, including proxy voting policies, selection of investments, engagement with companies or regulators, and selection of investment managers. Such disclosure is mandatory in the United Kingdom and several other countries, and has had a significant impact. This proposal would not require pension funds to engage in LTRI, but it ensures that a decision on whether to do so is fully informed.

Requiring disclosure on LTRI is important for several reasons. First, it correctly informs trustees that acting upon non-financial issues is not a breach of their fiduciary duties. Second, a disclosure requirement will encourage trustees to learn more about what LTRI actually involves, as well as allow trustees of different funds to learn from the actions of each other. Third, beneficiaries will have a better understanding of how their pension funds are (or are not) being invested with respect to these issues of growing concern. Finally, if pension funds do take action, that can be a catalyst for change throughout the financial industry, including investment managers, consultants, analysts and ratings companies.

Under a reform approach that focuses only on disclosure, trustees can make an informed decision. Are they free to decide and then state that they do not take LTRI issues into consideration when making investment-related decisions. That decision, however, is more likely to be an informed one and not one based on current widespread misconceptions. Those that decide to act, however, can be a catalyst for significant change.

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