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Recent Trends and Regulatory Implications of Socially Responsible Investment
Recent Trends and Regulatory Implications of Social Responsibility Investment for Pension Funds: Some Lessons for Turkey

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What is SRI and Why Do We Care?

- Many definitions, but “Socially Responsible Investment (SRI) combines investors' financial objectives with their concerns about social, environmental and ethical (SEE) issues.”
  
  UK Social Investment Forum

Addresses a social (asymmetric harms), economic (externalities), and political (power) problem
**Figure 3: Socially Responsible Strategies practiced by European Investment Organisations**

(in billions of euro)

- **Weapons Screen**
- **Other simple screens**
- **Human rights/norm-based**
- **Other positive screens**
- **Best in class**
- **Ethical exclusions**

**Source:** European Social Investment (2005)

**Social factors:** Labour’s working conditions…health-impacts

**Environmental factors:** pollution and/or climate change … harm to forests and animals

**Ethical factors:** violations of human rights…concerns around pornography, alcohol and gambling.

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**SRI investments roughly $2 trillion in US and another $1 trillion in EU.**
Types of Screening

- **Positive screening**: Funding investments with positive social, environmental (or ethical) impacts
- **Negative screening**: Starving investments with negative SEE impacts from investment
- **Passive screening**: Relying on the SRI screening criteria of an SRI fund
- **Activism** involves “voice” instead of “exit”, encourage SRI-related change via shareholder resolutions

![Figure 4: Growth in Screening and Shareholder Activism](chart.png)

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<th>Stakeholder</th>
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- the process by which institutional investors and their agents seek to improve investee companies' corporate governance and/or social, environmental and ethical (SEE) performance
- Pensions exercise suasion as both shareholder and as stakeholder
  - CalPERS decisions attract attention because of social power as well as financial power
SRI funds' risk and return

- **SRI portfolios have higher long-run returns**
  - Good management is good management
  - Builds value instead of redistributes it
  - Guerard (1997) -- no statistically significant differences in SRI and non-SRI samples.
  - Geczy *et al.* (2005) – an SRI “constraint” can cost investors at least 30 basis points per month.

- **SRI portfolios are either less risky or price risk more fully**
  - Social and systemic risks not accounted for in present risk-adj. returns.
  - New risks of consumer activism and regulatory risk make SRI-related risks larger
  - Schroder (2005) – fewer SRI funds have had poor performance (good maximin investment strategy)
  - Who says you can’t “push the efficient frontier?”

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At economic heart of SRI is the pricing of social/systemic risk
Why Should Private Pension Funds Care About SRI?

Figure 5: Proportion of Pension Fund Assets to GDP in Selected OECD Countries

Three camps:
1. They should not (Arrow-Debreu/Friedman view): max returns help all
2. They can help overcome externalities
3. They have a fiduciary responsibility (political SRI as embodied in international Work and SRI Fora)

Their size ensures their SRI decisions (or lack of) will impact on capital markets
What Guidance Exists So Far?

Possible Critiques
1. vague language and their lack of enforcement mechanisms
2. weaknesses of self-regulation (insufficient and profit max regulation, self-enforcement)
3. Problems of incentive compatibility

Profit max, duty of care, and politics are real drivers?
Possible and current regulatory responses to SRI

Complete Deregulation (or policed) self-enforcement

Non-Policed (or policed) self-enforcement

Facilitating Regulations (disclosure and Triple Bottom Line)

Minimum SRI portfolio requirements

Minimum SRI portfolio requirements] Plus shareholder Activism as Fiduciary responsibility

SRI as policy instrument

Further OECD work will usefully poll regulators using standard criteria
Regulatory Options

- Should companies/investors or intermediaries be regulated?
  - Savers/investors: They know best their own risk profiles
  - Intermediaries: can be contributors to systemic/social risks
- Do what extent is SRI a policy tool for addressing market failures?
  - Private pension funds’ investment decisions may help address externalities in social and environmental “markets” (MBprivate → MBpublic)
  - A Pigouvian tax in disguise
- Dead weight loss and a harm shared is a harm squared
- Regulation or moral suasion directed toward company pension trusts instead of funds themselves
Options for Turkish Policymakers?

- Should ESG regulation be applied in Turkey’s present environment?
  - Distortion vs. investment promotion
- *Avropalilastiramadiklaramizdanmisiniz?*
  - Need to conform with international norms versus capacity to set those norms
- **Low hanging fruit**
  - Educating investment professional
  - Use of trade associations
  - CSR!
- **Differences in Turkey’s economic structure** and government capacity may make an interventionist policy welfare-improving (though more data needed!)

*Ne mutlu Türkum diyene*