Recent Trends and Regulatory Implications of Socially Responsible Investment

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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
**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).

*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

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**Figure 4: Growth in Screening and Shareholder Activism**

SRI in the United States from 1997-2001

![Bar chart showing growth in Screening and Shareholder Activism from 1997 to 2001.](source: Social Investment Forum (2003))
## Shareholder Engagement

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<th>Conflictual</th>
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<td><strong>Shareholder</strong></td>
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<td>Norges Bank v Walmart</td>
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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 persuasion 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?”

*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**

![Chart showing proportion of pension fund assets to GDP in selected OECD countries](chart.png)

**Source:** OECD

**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

(So far at EU Level)

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
- Avropalilastiramadiklaramizdanmısınız?
  - 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!)