



## PERSPECTIVE

## The Increasingly Politicized World of ESG Investing

BY KATHERINE BARRETT AND RICHARD GREENE



**W**hen people think about the management of pension plans, they typically focus on the importance of getting the best possible returns on the dollars contributed to the plans by both governmental entities and the employees themselves.

But increasingly there's more to it than that in the form of so-called ESG investing, an acronym which stands

for the environmental, social, and governance factors that can be taken into account when considering an investment's risks and benefits. This method of selecting investments has gotten a fair amount of attention in the states of New York and California, and New York City, and it appears to be an increasingly prevalent practice across all levels of local government.

"I don't have empirical evidence to support it," Hank Kim, executive director of the National Conference on Public Employee Retirement Systems, said, "but when I think of the leading local plans, they are just as active in ESG as the California Public Employees' Retirement System or New York State, but they fly a little bit under the radar, which is to their benefit."

A lower profile in the world of ESG investing is likely advantageous because the practice has become politically charged over the past few years. In mid-April, to cite one

particularly extreme example, an article in *The American Conservative* claimed that "progressives have succeeded in manipulating the \$5.8 trillion state pension system into a vehicle for imposing their political agenda, while simultaneously fostering a lucrative system of patronage around it to co-opt non-believers into playing along."<sup>1</sup>

This perspective is disputed by Dave Wallack, executive director of For the Long Term, a nonprofit, nonpartisan group that advises state, city, county, and tribal treasurers. "I work with a broad group of state and municipal treasurers and comptrollers, and no one I'm talking to about ESG sees it as a morality issue," he said. "From a long-term perspective, they're talking about how we can do the best for our beneficiaries. Be it climate or good governance, it's the ability to mitigate risk. None of this is about morality."

A fiduciary's job is to act in their beneficiaries' best interest, and that's fundamentally the opposite of closing your eyes to ESG or anything else."

Though the National Association of State Retirement Administrators (NASRA) hasn't taken a position on the utility of ESG investing, it lays out the logic behind the arguments made by mainstream pension fund managers who either do or do not believe this kind of investing is the way to go.

"ESG investing has been challenged by some who believe that this approach is contrary to fiduciary duty, including the duties of prudence and loyalty," according to NASRA's website ([nasra.org/esg](https://nasra.org/esg)). "Advocates of ESG investing generally contend that ESG factors may be considered as part of a broader assessment of an industry or individual security and have pointed to guidance provided by the Department of Labor's Employee Benefits Security Administration to support this view."

Supporters of ESG argue that entities don't need to forgo principles of wise investing when they consider environmental, social and governance factors. This is particularly true for pension funds that aren't looking for short-term, quarterly profits from the companies they invest in, but rather long-term, sustainable returns.

This is very much the logic set forth by New York State Comptroller Tom DiNapoli. "It's pretty clear from our perspective that the risk of climate change is a financial risk," he explained. "So, when we consider the impact of climate change and the disruptions it will cause, it makes sense in terms of helping make investment choices that for the long term will be profitable and benefit your pension fund."

On the other side of the fence, Texas Comptroller Glenn Hegar is supportive of a legislative injunction in that state which "prohibits the state from contracting with or investing in companies that divest from oil, natural gas and coal companies," according to *The Texas Tribune*.<sup>2</sup>

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Hegar thinks a day may come when fossil fuels will be out of fashion, but that day is far away, and so ignoring the potential of fossil fuel investments is a mistake right now.

"For individuals who want to invest in ESG, that's their right and their privilege, Hegar said. "But people make choices based on their own decision-making process. In Texas, we take a stand that artificially saying 'No, we're not going to invest in this area because we believe the world should transition away from fossil fuels as quickly as possible' harms the economy and the average citizen."

Though questions over the environment have tended to dominate coverage of ESG investing, there are other factors as well. For example, governments that invest in ESG attempt to put money into companies that have diverse boards of directors.

Massachusetts Treasurer Deborah Goldberg has been guiding her state's pension money toward companies with boards that are diverse, both in terms of gender and race. "We know from outside data<sup>3</sup> that companies that have boards that are more diverse and have more women are more financially productive. Today, we have a guideline that says we invest in companies with boards that are 35 percent women and/or people of color."

As for other elements of ESG investing, Goldberg's office is working with researchers at the Massachusetts Institute of Technology to gather all the data it can in a project aptly called the Aggregate Confusion Project.

According to its website ([mitsloan.mit.edu/sustainability-initiative/aggregate-confusion-project](https://mitsloan.mit.edu/sustainability-initiative/aggregate-confusion-project)), the project's fundamental goals are to:

- Reduce the level of noise in measuring specific ESG categories such as labor treatment, carbon emissions, and product safety.
- Understand the effect of ESG-driven investment flows on stock price and firm behavior.
- Develop smarter ways to aggregate ESG factors into composite indexes.
- Reliably assess investor preferences to enable ESG indexes to be more customized and attuned to investors' values.

This is precisely the kind of effort that can help guide other governments' ESG policies by providing clear-cut data and retrieving the topic from a boiling cauldron of political fire.

As Heidi Welsh, executive director of the Sustainable Investments Institute, said: "Some time ago people were talking about ethical investing. Then they used the phrase 'sustainable investing.' Now people are talking about environmental, social, and corporate governance. But it's all just investing." 

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<sup>1</sup> Kevin Stocklin, "State Pension Funds Gamble Workers' Retirement on ESG," *The American Conservative*, April 15, 2022. <https://www.theamericanconservative.com/articles/state-pension-funds-gamble-workers-retirement-on-esg/>

<sup>2</sup> Emily Hernandez, "Texas warns firms they could lose state contracts for divesting from fossil fuels," *The Texas Tribune*, March 16, 2022. <https://www.texastribune.org/2022/03/16/texas-fossil-fuel-divestment-ban-inquiry/>

<sup>3</sup> "Diversity Wins: How Inclusion Matters," McKinsey & Co., May 2020. <https://www.mckinsey.com/-/media/mckinsey/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters/diversity-wins-how-inclusion-matters-vf.pdf>