Retirement News Highlights

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Public Pensions Find Wiggle Room on ESG Despite State Crackdowns

Prohibitions from conservative-leaning state officials appear to focus more on investing in ESG products than using ESG factors to measure risk, allowing pensions a path forward.

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FUNDfire
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While leaders in several states are taking measures to prevent their pension funds from using environmental, social and governance factors when making investment decisions, fund staff and their boards are finding they still have some leeway if they determine the factors to be material to their investment returns.

Several conservative states, including Texas, Idaho, and West Virginia, have recently passed laws blacklisting certain firms that "boycott" fossil fuels or other controversial market sectors, while officials in others have announced more general restrictions or prohibitions on considering "ESG" in any shape or form. However, some pensions may have ways to get around the restrictions.

At the Teacher Retirement System of Texas' board meeting last month, Executive Director Brian Guthrie outlined how the board may approach compliance with two recent state laws, one banning managers or banks that divest from firearms makers and another restricting business with those that spurn fossil fuel companies.

The fossil fuels bill "does not apply to governmental entities that determine the requirements are inconsistent with constitutional or statutory details," he said. "We do have, as a trust fund, the ability to say that following this statute would be inconsistent with our fiduciary responsibility to the fund, and therefore we can't follow it."

While the board did discuss this topic later in executive session, no action was taken, said a spokesperson who declined to comment further.

The pension's investment policy statement says that ESG factors "influence the performance of TRS' investments. In making investment decisions, the Investment Division will consider ESG factors that are material to long-term returns and levels of risk."

It goes on to say investments "must be made prudently and in accordance with fiduciary and ethical standards, without promoting interests unrelated to the portfolio's stated objectives of controlling risk and achieving a long-term rate of return."

Texas Comptroller Glenn Hegar has published a list of companies he claims "boycott" fossil fuels, as reported, including industry heavyweights like BlackRock and Credit Suisse. In response, several other

Texas pensions have taken steps to catalogue their holdings with these companies, according to sister site MandateWire. The $40 billion Texas Permanent School Fund disclosed it did have holdings in some of those companies, while the $34.8 billion Texas Municipal Retirement System, or TMRS, revealed it had only indirect holdings, and the $40.7 billion Texas County & District Retirement System said it had "no direct holdings" in any of them.

The Employee Retirement System of Texas shared its own holdings directly with FundFire. The fund has just under $40 million in direct stock holdings in several of the blacklisted managers, including BlackRock, and indirect holdings with Schroders and Danske Bank. A spokesperson declined to provide details on how the fund planned to proceed.

Hegar's own office has released a "frequently asked questions" document that appears to provide public funds a potential way out of having to divest from these managers, MandateWire reported.

"A state governmental entity is not subject to the divestment requirements if the state governmental entity determines divesting would be inconsistent with its fiduciary responsibilities with respect to the assets under its management or other duties imposed by law relating to the investment of the entity's assets," the document says. The policy also does not require divestment from indirect holdings, such as those held by a private equity fund in which a public fund is invested as a limited partner.

A Texas Teachers spokesperson confirmed this was the "exemption" to which Guthrie was referring.

Hegar's office did not respond to a request for comment. A TMRS spokesperson said the fund was not required to divest any of its indirect holdings, but did not address the exemption. The other funds did not respond to requests for comment.

Florida Governor Ron DeSantis and the two other trustees overseeing the Florida State Board of Administration also gained headlines by restricting the board from considering ESG factors when making investments.

At a meeting of Florida's investment advisory committee on Sept. 13, General Counsel Maureen Hazen gave a presentation on fiduciary duty. She indicated that the language provided by the trustees requiring them to consider only "pecuniary factors" when considering investments refers only to the "furtherance of social, political, or ideological interests," according to the resolution passed by its trustees.

"[The resolution] doesn't talk about risk there. It just says, pecuniary factors are factors that impact risk or return, but it can't be factors that further social, political or ideological interests," she said.

When asked by a board member whether or not the fund would be allowed to invest in an ESG or impact investment fund that promised higher returns as long as the fund believed that to be true, Hazen said, "We'd better believe it – otherwise we shouldn't be investing in it. We shouldn't even be taking the meeting."

A Florida spokesperson declined to comment further.

Idaho recently passed its own law restricting the use of ESG investments, while at the same time apparently leaving a similar opening for staff to include those criteria when considering risk.

"No public entity engaged in investment activities shall consider environmental, social, or governance characteristics in a manner that could override the prudent investor rule," the text of the bill, signed into law earlier this year, says. “A public entity serving as a fiduciary to select investment options for investors may offer environmental, social, and governance preferred investment alternatives, but such investments shall not be required and sufficient alternatives must be also offered.”

The $20.8 billion Public Employee Retirement System of Idaho did not respond to a request for comment about how this affects its investment process.

The ongoing political controversy over ESG has caused a conflation of the use of those criteria as a risk management tool and the appeal of so-called “ESG products,” said Kirsten Spalding, senior program director of the Investor Network at Ceres, a Boston-based nonprofit that advocates for sustainability.

“The largest pension funds in my network generally aren’t looking for ESG products, they’re looking for ways to seize opportunity and ameliorate, manage risk across their portfolios, and they’re using good analytics to do that,” she said. “Investors recognize that climate change and human rights abuses and poor governance are material risks that need to be addressed, and they’re not going to stop doing that.”

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[Back to top](#)