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Change in Fiduciary Rules to Encourage Social Investing by Pension Funds Sought at OECD

There has lately been a strong push in international bodies that deal with pension investing to encourage pension funds to take into account environmental, social, ethical and governance factors (commonly referred to ESGs, generally similar to the concept of socially responsible investing) in their investing, and to report on their use of such factors.

This effort appears to be in conjunction with similar efforts such as in the revised Institutions for Occupational Retirement Provisions (IORP II) Directive passed in November, 2016 by the European Parliament which also encourages pension funds to consider ESGs. (For more on IORP II, see our article here: http://www.groom.com/resources-1078.html.)

Similarly, in June 2016, the OECD Working Party on Private Pensions (OECD WPPP) issued a "progress report" on investment governance and the intergration of ESG factors. (For more information on the June OECD WPPP Meeting, see our article here: http://www.groom.com/resources-1066.html.)

Now, at the December meeting of the OECD WPPP, a new paper supporting the enhanced use of ESG factors entitled "Investment Governance and the Integration of ESG Factors" has been presented.

The paper generally questions whether the traditional fiduciary rule (usually found in common law countries, less so in civil law countries) is too "narrow" and hindering the application of ESG factors in investing, and therefore should be modified, whether there should be reporting on how ESG factors are taken into account, and whether there should be other disclosure or policies that should be applied to support integration of ESG factors in pension investing (e.g., CalPERS and CalSTRS legal restrictions on investing in companies that derive a certain amount of revenues from mining thermal coal). As in the prior presentation to the OECD, the "universal owner" theory of investing (investing to support "global economic health") is mentioned as an alternative to modern portfolio theory.

Comments on the paper have included that it does not define what ESG factors are, though there is certainly an emphasis on environmental factors. Nor does it address the effect of different investors coming to different conclusions regarding whether a particular investment is good or bad for environmental, social, ethical or governance reasons.

The paper also surveys whether the application of ESG factors improves investment returns, but does not come to a conclusion.

The paper also does not address potential additional expenses of active ESG screening and reporting at a time when plans are being challenged to reduce expenses, and, in some quarters, to discourage active investing in favor of passive investing.

Indications are that the proponents of ESG investing will continue to try to push for pension funds to invest based on ESG factors and have particular factors in mind for being good or bad, though that is not yet clearly expressed. Such efforts could spill over to the US where social investing continues to be a matter for debate, particularly if ingrained as a global best practice, and particularly for multinational corporations.

If your pension funds are concerned about the effect of a possible watering down of the fiduciary rules to encourage ESG investing and wish more information or to follow the efforts more closely, please call David Powell or your other Groom lawyer.