Thoughts and Links for Public Funds from James McRitchie, CorpGov.net

Politics – ESG

1. Calls for or against divestment are often based on the ill-informed misconception among members of the general public that stock purchases add to corporate treasuries. Since most stock transactions occur in secondary markets, divestment generally has little impact or no on targeted companies. https://www.unpri.org/stewardship/discussing-divestment-developing-an-approach-when-pursuing-sustainability-outcomes-in-listed-equities/9594.article
2. Divestment vs engagement shouldn't be seen as a binary choice. Funds can reduce holdings, without fully divesting. Timed reductions based on failing to reach targets, such as earnings, sales or climate impact could be more effective than quick sale. Divestments have cost California pension funds billions. https://www.calstrs.com/files/54965536f/SB1173-amended-4-21-22.pdf Divesting from financial institutions that commit to an aggressive reduction in fossil fuel emissions with goals of "net zero" prior to 2050 could cost Texas funds a lot of money as well. https://www.marketsmedia.com/texas-includes-blackrock-in-financial-companies-that-boycott-energy-companies/
3. ESG on a company-by-company basis is inadequate. Given that most investors don't just invest in one company and that governments are unable to adequately address many environmental and social issues, shareholders should take a portfolio-wide approach to value and ESG. https://www.institutionalinvestor.com/article/b1zh8gsv8hssjh/From-Meta-to-Twitter-What-Everyone-Gets-Wrong-About-ESG-And-Why-It-Matters

Pension Fund Trustee Elections

Some funds allow plan participants to select trustees. Be mindful; this can lead to very costly election contests. Recent campaigns for the CalPERS board, for example, have involved independent expenditure committees raising up to $500,000 in a single election cycle. https://www.sacbee.com/news/politics-government/the-state-worker/article264708009.html

One small measure I took to try to level the playing field at CalPERS was to initiate candidate forums conducted by an independent third-party, the League of Women Voters. I rented a hall the first year and used the CalSTRS auditorium the second. Now CalPERS holds the forums and posts them on its website. Example at https://www.youtube.com/watch?v=f9gGtEp0PUY Of course, motivating members to vote is critical. In the latest race for the seat elected by public agency members, less than 5% of those eligible actually voted. https://www.calpers.ca.gov/docs/circular-letters/2022/310-038-22-attach1.pdf

I also suggested to CalPERS they could save up to $1M per election cycle by using instant runoff voting (IRV, https://en.wikipedia.org/wiki/Instant-runoff_voting), instead of holding runoff elections if none gets a majority vote. Another advantage is reduced acrimony since candidates will not want to alienate voters who view them as their second choice.

I considered running for the CalPERS board in 2022 and posted some thoughts at https://www.corpgov.net/calpers/

Member Input & Proxy Voting

The INDEX Act would prohibit any fund which is more than "40% Indexed" — or which makes claims about being passively managed — from voting proxies if the advisor (considering all its total advised assets), owns more than 1% of an issuer's shares. The exception would be for those voting based on specific instructions from the underlying individual shareholder. Further, to collect that voting intention, they have to guarantee that they have delivered voting materials to all shareholders and can only vote on what responses they get back. https://etfdb.com/news/2022/08/05/the-index-act-the-upcoming-esg-battle-is-for-your-vote/ While the Index Act, in its current form, would not apply directly to public funds, the movement to require at least surveying investors/beneficiaries is expected to gain popularity.

Even if not required, surveying members offers both an opportunity to educate them on the issues and to learn if a fund's voting policies are aligned with member values. Several companies are developing tools primarily aimed at helping retail shareholders vote that could also be adopted by funds. A few examples follow:

iconik - https://www.iconikapp.com Intelligent proxy voting on the cheap

I'm working with the California State Retirees on their own investments and proxy voting — hoping to increase the organization's returns and shape their lobbying efforts with CalPERS.

We may soon be working with iconik to set up a voting policy based on answers by the organization's board members to a brief values survey. Our proxies would then be automatically voted based on the survey and, of course, can be overridden if we disagree with any. Currently, our proxies go unvoted because it is not worth the effort to vote manually. The cost is a very small fraction of hiring proxy advisor. Already, the process is helping the organization explore its values and take more of an interest in how CalPERS votes. The following is directly from iconic:

> Public funds are increasingly under pressure to align their investments with the values of their stakeholders. iconik helps public funds meet this demand through the power of the proxy, giving funds a stronger voice in the companies they invest in. Our services fall into two categories:
>
> Customized, Automated Shareholder Voting: through iconik, funds can easily create customized voting profiles that automatically vote shares to match values. As shares are voted, iconik reports the impact the fund is having in the

areas it has weighed in on, for example, climate change proposals passed or executive compensation plans rejected. It works with every brokerage/custodian.

Investor Engagement: investors want their voices to be heard. iconik allows funds to easily poll investors on the key environmental, social, and governance issues of our time. As new issues emerge and key votes arise, investors have an opportunity to weigh in. Fund managers and stewards can use this data to better understand their investor base, make adjustments to investment and voting decisions, and demonstrate their commitment to empowering their members.

Fennel https://fennel.com Invest, engage, make change.
Another startup company is a brokerage. Fennel is aiming to be something like Robinhood but without selling order flow or allowing the purchase of fractional shares. Their emphasis will be on advocacy by providing access to several ratings by other providers on ESG and other issues. Investing and using your shares to make a better world will be the driving points. It will have very low fees and will provide automated proxy voting at minimal cost.

Civex - https://www.civex.io "have an impact with companies on issues that matter to you."

Civex will allow anyone with an ownership interest to collaborate on issues they are passionate about, pool their collective voting power, and drive change. Users who engage with the platform will identify their values/issues important to them, build community, and align to influencers who are close to the corporations and able to drive change. Not only will this democratize corporate governance, but it will also disrupt the current and archaic proxy advisory service construct which doesn't meet today's needs and is wrought with conflicted interests.

Employee Ownership

Public funds should emphasize or at least explore employee ownership investment opportunities

The IMF finds GDP growth 0.08% lower in five years following a 1% increase concentration of wealth. Increasing the share of income to the bottom 20% by 1% is associated with a 0.38% rise in GDP.
https://www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf We need to move pay and stock (with votes) from executives to workers to grow portfolios, economy, voice, and the wealth of workers.

If businesses were 30% employee-owned, wealth going to those with below-median wealth would increase from 1% to 6% of total wealth. The net wealth of the average black family would increase by more than 400%, from $24,100 to $106,271.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3942536 We won't get 30% employee ownership soon but could target 5-10%.

Wealth inequality is directly correlated with political polarization. https://www.princeton.edu/~nmccarty/ineqpold.pdf Government's ability to act depends on addressing this problem.

Investors have voted on corporate equity plans since 2003. https://www.nyse.com/publicdocs/nyse/regulation/nyse/equitycompfaqs.pdf Institutional investors evaluate the dilutive impact of plans but don't often consider who will benefit (mostly "named executives" and board members). Companies do not routinely report where those shares go below the level of named executives and board members. Investors could request such reports. That would encourage them to broaden equity plans to include more workers, which would increase profits, the economy and our tax-base.

If your fund is investing in private equity, consider funds investing in employee ownership. https://www.newprivatemarkets.com/kkr-records-a-10x-win-for-employee-ownership/