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Part 5: Conflicts and failures of investment managers and corporate executives to advance SRI/ESG interests

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Acceptance of and preference for SRI/ESG investing is growing rapidly. While much of the money flowing into this space is due to investors who want to express personal values in their investment strategies, the SRI/ESG investment landscape is not without conflict or controversy.

Conflicts and failures are apparent among company executives, investment management firms and government entities.

Many company executives are so focused on short-term profit results and stock price performance that they are less inclined to think about bigger picture societal and sustainability issues. SRI/ESG evaluators would suggest that companies can reduce their risk and improve future profitability by acting responsibly. In reality, not all companies follow this direction.

In 2013, the consulting firm Accenture surveyed 1,000 CEOs from 103 countries and 27 industries. Approximately 80% of CEOs viewed sustainability initiatives as a way to gain a competitive advantage over their peers. Additionally, 81% of respondents believed that the sustainability reputation of their company is important to a customer's decision to purchase their product or service. However, Accenture's study found that only 33% of these CEOs believed that their company is "making efforts to address global sustainability challenges." Only those leadership teams that take a longer-term view have committed to improvements in sustainability, social issues and their own corporate governance opportunities.

Of course, any competitive advantage would theoretically be diminished if all companies committed effort to sustainability or any other initiative they felt would give them an edge. For now, there is still less competition on the high road.

Part of the reason that CEOs aren't more actively changing the nature of their businesses and pursuing opportunities to reduce risk is that their largest shareholders are not putting any pressure on them to do so.

In many cases, some of the largest shareholders of publicly traded companies are investment managers. Vanguard and Blackrock manage more than $11 trillion between them meaning that they own significant shares of most publicly-traded companies. They and other prominent money managers have been generally passive in their ownership.

According to the Chartered SRI Counselor™ curriculum: "An analysis of how 42 leading mutual funds voted in 2015 revealed that nine firms— Vanguard, American Funds, American Century, BlackRock, Fidelity, ING (Voya), Lord Abbett, Pioneer, and Putnam— failed to support any shareholder proposals on climate change. There can be a conflict of interest with large firms in that many of the companies they hold in their mutual funds and managed accounts are also clients. For example, a mutual fund company might also be managing the 401(k) plan for a large employer and be concerned that if they vote for a proxy that alienates the company's management, they may take their 401(k) business elsewhere."

There has been small improvement since the 2015 analysis. According to Ceres, a non-profit sustainability advocacy organization, some money managers have begun to actively participate in votes on behalf of their shareholders. But Ceres found that even some mutual funds that have a publicly-stated ESG mandate, have not participated in shareholder votes regarding ESG issues.

In addition to climate change resolutions and impact on corporate finances, fair and reasonable executive pay is another prominent topic for investors who are concerned about corporate governance. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 included a mandate that publicly-traded companies must hold an "advisory vote" of shareholders at least once every three years to review executive pay. This is primarily known as "Say on Pay" and many companies facilitate the advisory vote annually, instead of every three years. Regardless of the formality of having shareholders participate in the "Say on Pay" vote, executive pay has continued to rise in relation to average worker pay.

As You Sow, a non-profit leader in shareholder advocacy, noted that while the "Say on Pay" votes provide the opportunity for feedback to the company, actual impact may be light because of "investors who fail to exercise their discretion appropriately. It points out that some major mutual funds, including BlackRock and TIAA, approve close to 97%

of the executive pay packages on which they vote." Large investment firms are more likely to "rubber stamp" vote their proxy issues.

Shareholders may understandably have difficulty independently raising and passing a resolution for change. To help maintain independent oversight of a company, investors concerned with corporate governance prefer to have more company directors clearly independent. The CSRIC curriculum indicates that "there is an inherent degree of conservativism among boards of directors that would usually block proposals related to liberal or progressive issues or drastic change. Since executives or former executives of firms tend to sit on the boards of directors for other corporations, there can be conflicts of interest that arise. These voting members may be reluctant to vote on issues against corporations with interlocking business relationships, and so they will generally abstain from voting."

In addition to climate change and sustainability, the topic that has generated the fastest growing interest is political contributions and lobbying practices Although some publicly-traded companies have begun to disclose political ties, these disclosures are not yet mandated by the Securities and Exchange Commission (SEC). Investors are currently seeking voluntary disclosures for all direct and indirect political contributions since corporate "dark money" is being funneled to entities that aren't required by law to disclose the sources of their income.

As of spring 2019, there were approximately 1.2 million comments that have been submitted to the SEC to mandate that companies disclose the flows of political and lobbying spending. Corporate political spending and lobbying was the greatest single ESG concern raised by shareholders with 377 shareholder resolutions filed between 2014 and August 2016

One last counter-intuitive thought about encouraging companies to engage in more responsible business practices applies to where investors should be applying their efforts. If SRI/ESG investors don't invest in companies that do not fit their preferences, then they miss an opportunity to actively engage with those most objectionable companies. Because those companies are ignored by SRI/ESG investors, there is limited dialogue or pressure placed on aspects of their business that could be improved for the greater good. In many cases, the larger impact of shareholder advocacy could be experienced with companies that don't show up in SRI/ESG funds. All it takes to file a shareholder resolution is $2,000 worth of the company's stock held for at least one year.

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