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EXECUTIVE SUMMARY

Public pensions are increasingly being politicized and used as a means to affect social or political change. These actions act directly against the fiduciary responsibility that fund managers have to their plan beneficiaries. One of the most common tools used in these cases is divestment, or stripping plans of investments deemed to be against a social or political goal. Public pensions at all levels across the country are facing calls to divest of everything from fossil fuels to tobacco to private prisons and other industries.

At the forefront of the divestment movement are Mayor Bill de Blasio and Comptroller Scott Stringer of New York City. It has been one year since Mayor de Blasio announced that NYC would divest from fossil fuels within the next five years. Furthering his efforts to strip New York City’s five pension plans of fossil fuel stocks, the city issued a request for information (RFI) to gather public input to inform their divestment plans. What has resulted is a mixed bag, with some stark opposition to the plan, considering that the cost would be detrimental to the retirees. In response to the RFI, IPFI provided a report detailing the costs, ineffectiveness, and inherently wrong nature of the City’s plan to divest. Subsequently in December 2018, the New York City’s Comptroller issued a request for proposals (RFP) to support the city’s intended divestment strategy for three of the city’s five public pension funds. Proposals are due by February 8, 2019 and the contract is reported to begin in December 2019. While IPFI as an organization steadfastly opposes any plan that politicizes a public pension fund, the issue of divestment requires a closer look, particularly in light of divestment’s costly effects on pensioners and their retirement savings. The public deserves to know the facts about this misguided strategy.

Through a close analysis of academic research and case studies, we explain the inherent problems of divestment.

- **Divestment is rooted in arguments based on global urgency, political necessity, or morality.** This is inherently against the fiduciary responsibility of public pension fund managers. While there may be a financial pretext to support the divestment argument, it is ultimately a tool to affect corporate, social, or political change; not a tool to increase financial returns of the fund.

- **Divestment as a means of creating change is ineffective.** Numerous studies have found that divestment campaigns produce no discernible impact on share prices or company valuations, therefore having a minimal effect on the corporate behavior that divestment movements are looking to change.

- **Expert financial management firms disagree on divestment strategies.** In New York City, financial management firms questioned the effectiveness of divestment and disagreed on the divestment strategies. If such experienced firms are questioning divestment, then public pensions should as well.

- **There are real, expensive costs associated with divestment which directly harmed public pensions.** Past pension divestments in California show the loss of returns associated with divesting from specific industries. Furthermore, studies show that pension funds would lose millions of dollars if they divest from fossil fuels.


As demonstrated throughout the following report, divestment should not be a part of the repertoire of public pension funds. Pensions serve to provide a secure retirement to the millions of hardworking Americans who have dedicated their lives to serving their communities. Any management decisions regarding pensions should adhere to the fund’s fiduciary responsibility and should ensure that the fund will be able to meet the obligations that it has already promised to its beneficiaries. Public pension funds cannot, and should not, be politicized and should reject any politically motivated divestment movements.

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Today, political activists and politicians are using pension funds and pension beneficiaries as political pawns in a highly polarized and partisan political battle. This trend affects investment stewards of all sorts, including pension funds, endowments, treasury agencies, labor unions, and mutual funds, urging them to leverage their financial stakes in companies to influence larger political battles on guns, workers’ rights, fossil fuels, private prisons and tobacco, among other issues. As public pension fund managers increasingly choose to politicize the funds, they are moving crucial attention away from maximizing returns. Divestment is in most cases contrary to the fiduciary responsibility held by fund managers to public service retirees and plan beneficiaries, serving only to weaken the fund, without making the social and political statements proponents promise.

The reality is that most divestment movements are out of step with best practices of fiduciary responsibility to which public pension funds are beholden. These standards include safeguarding assets and maximizing returns above all other considerations. Often, the politicization of funds is a knee-jerk reaction to an acute political storm rather than a deliberate part of an investment strategy. Politically motivated divesting could have major consequences for the solvency of public pensions.
THE BASICS OF DIVESTMENT

Divestment is typically defined as the act of selling off investments or refraining from making additional investments primarily to achieve a social or political goal. The main objective of divestment is to pursue a political or societal goal that is not purely investment-related, and as such, represents a departure from an investment steward’s core fiduciary responsibility while also politicizing the fund.

Divestment campaigns often focus on companies that do business in a specific country (e.g. Sudan, Iran, etc.), operate in a certain industry (e.g. tobacco, guns, etc.), or engage in practices deemed undesirable by federal, state or international law (e.g. human rights violations). Accordingly, the case for divestment is often rooted in arguments based on global urgency, political necessity, or morality, though the argument may carry a financial pretense.

Divestment, more than affecting corporate bottom lines, tends to act as a public relations function by damaging a company or industry’s reputation. Divestment concentrates negative attention on a company or industry, often in the form of undesirable media exposure. Not only does this reduce consumer confidence and public support, but it can also negatively affect a firm or industry’s public engagement leverage. For example, in the 1990s and 2000s, there was a strong movement to divest assets from the tobacco industry. One of the core proponents of this plan, was the California Public Employees’ Retirement System (CalPERS), which decided to remove its assets from tobacco companies, costing the fund $3 billion over the course of 13 years. Furthermore, this cost CalPERS the opportunity to engage with tobacco companies directly, such as through shareholder resolutions. As a communications tool and grassroots effort, divestment can undercut a company’s reputation and build support for special interest causes. However, these divestment campaigns often lack the financial windfall they argue for, and result in fund managers neglecting their fiduciary responsibility to maximize returns for fund beneficiaries.

Numerous studies have found that divestment campaigns produce no discernible impact on share prices or company valuations. This occurs because of the open, competitive nature of capital markets. When shares are sold at a bargain rate by socially conscious investors, other investors (without moral imperatives) buy the stocks at the reduced rate.

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3 https://californiapolicycenter.org/calpers-social-investing-comes-steep-cost-paid-california-taxpayers/
THE INEFFECTICITY OF DIVESTMENT

While divestment campaigns seek to hit companies where it hurts (i.e. the cost of capital), it is very difficult to isolate the impact and efficacy of divestment initiatives. In theory, if a critical mass of investors sells, or refuses to buy, shares of a company, reduced demand should drive down share prices and increase the cost of capital, thus incentivizing the company to change course. There is, however, little evidence to back this claim. Numerous studies have found that divestment campaigns produce no discernible impact on share prices or company valuations.\textsuperscript{4,5,6} This occurs because of the open, competitive nature of capital markets. When shares are sold at a bargain rate by socially conscious investors, other investors (without moral imperatives) buy the stocks at the reduced rate. Thus, the target company will not experience a negative financial impact. As William MacAskill from the University of Oxford puts it,

“As long as there are economic incentives to invest in a certain stock, there will be individuals and groups – most of whom are not under any pressure to act in a socially responsible way – willing to jump on the opportunity. These people will undo the good that socially conscious investors are trying to do.”\textsuperscript{7}

Additionally, most pension funds have substantial holdings in mutual funds, index funds or other passively-managed investment vehicles. For these investments, it is imprudent or impractical to pursue divestment from specific holdings that are integral to the underlying investment strategy. In this way, divestment is often unfeasible, or it would severely compromise a core investment strategy within an established asset allocation model, which clearly runs counter to a pension fund’s underlying fiduciary duties.

The literature seems to agree that divestment as a means of creating change is ineffective, and more and more, pension funds are rejecting calls to divest. For example, in November 2018, the Canada Pension Plan Investment Board (CPPIB) refused to give into political pressure to divest its assets from private prison companies.\textsuperscript{8} Within the United States, both the New York City Police Pension Fund and the Fire Pension Fund have expressed their opposition to the intentions of their sister funds to divest their assets from fossil fuels.\textsuperscript{9} The actions of these funds demonstrate their commitment to making investment decisions solely on the basis of financial performance.

While some funds have recognized the ineffectiveness of divestment, movements urging divestment continue gaining traction across the country. It’s important to understand the real cost that divestment has, both on public pension funds directly, but also on retirees themselves.

\textsuperscript{8} https://www.bnnbloomberg.ca/canada-pension-keeps-u-s-prison-stakes-amid-immigration-controversy-1.1174294
\textsuperscript{9} https://www.pionline.com/article/20180419/ONLINE/180419794/nyc-comptroller-mayor-seek-information-as-3-pension-funds-consider-divestment
THE REAL COST OF DIVESTMENT

New York

Increasing concerns about climate change and the perceived inability of governments to respond to them have led socially conscious investors to increasingly rely on divestment from the fossil fuel sector to pursue their political and environmental goals. In the case of public pension funds, however, this strategy is a gamble with thousands of civil servants’ hard-earned money, and, as stated above, usually proves ineffective in creating the desired changes. In January 2018, New York City Mayor Bill de Blasio proclaimed his intention to divest the city’s five pension funds from fossil fuel companies within five years – five billion dollars’ worth of investments.\(^{10}\) With explicitly political intentions, de Blasio seeks to wield the funds to send a message about what is ‘right.’

The implications of such an action, however, could be massively detrimental to NYC pensioners who are already in an increasingly precarious situation. New York City’s various funds are only funded at about 70 percent of what is necessary to pay promised benefits.\(^{11}\) Divestment in the next five years, however, will add to these woes by increasing short-term frictional costs, limiting fund diversification, and reducing fund growth by between $1.2 billion and $1.5 billion over the coming decades.

“\[The implications of such an action, however, could be massively detrimental to NYC pensioners who are already in an increasingly precarious situation. New York City’s various funds are only funded at about 70 percent of what is necessary to pay promised benefits.\]\n
Related, a vast majority of New Yorkers (almost 4 in 5) believe the city’s only consideration should be its fiduciary duty to the Big Apple’s public servants.\(^{12}\) Furthermore, two of the city’s five pension funds oppose de Blasio’s divestment plan. The New York City Police Pension Fund and the New York City Fire Pension Fund have opposed the plan, in part because of the cost and politicization of the fund, which they disagree with.\(^{13,14}\)

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Beyond the direct opposition to the plan by fund stakeholders, de Blasio and Stringer issued an RFI to help inform the divestment strategy, which resulted in mixed reviews. NYC received at least five anti-divestment reports to inform de Blasio and Stringer. Beyond that, even such established financial managers and institutional investors like Goldman Sachs, PricewaterhouseCoopers Public Sector LLP, and S&P Dow Jones Indices were mixed in their recommendations to the city, questioning if divestment is the most effective way to impact climate change.¹⁵

Beyond NYC politicians urging divestment, there have been some calls at the state level to do the same. If New York State were to divest from fossil fuels, it is estimated that the New York State Common Retirement Fund would lose between $188 million to $303 million over five years.¹⁶ Thankfully, New York State Comptroller Tom DiNapoli has not given into the political pressure, instead prioritizing his fiduciary responsibility to the retirees of the state.

DiNapoli is currently facing pressure from several sides as interest groups and stakeholders urge him to take an activist approach to his financial management, much like New York City’s Comptroller Stringer. For instance, former First Deputy Comptroller Thomas Sanzillo is reportedly advocating for DiNapoli to divest state assets from fossil fuel companies.¹⁷ Thus far, DiNapoli has remained steadfast in his commitment to fiduciary responsibility and has pushed back against Sanzillo and Governor Andrew Cuomo, when Cuomo raised the prospects of divestment.¹⁸ Though DiNapoli believes in taking steps to address climate change, he recognizes that divestment is both ineffective and harmful. Instead of simply removing investments from energy companies, DiNapoli has instead chosen to engage with these firms to work together on addressing the issue of climate change.¹⁹ DiNapoli’s stance should be seen as a model for other officials who are being pressured to enact politically-motivated acts of divestment.

Clearly, divestment efforts across New York are unpopular and would put already-underfunded pensions at further risk with no real chance of changing the behavior of energy companies. Instead, NYC and the state must focus on growing their investments for their retirees. A pension is a promise for a secure retirement after years of service.

Colorado

The stakes of fossil fuel divestment for Colorado’s Public Employees’ Retirement Association (PERA) are even higher than those in New York. Within the last year, PERA fund managers have faced increasing political pressure to completely eliminate its investments in fossil fuel companies. In response to these pleas and others, former Dean and Professor Daniel Fischel of the University of Chicago Law School conducted an in-depth analysis to determine the impact of fossil fuel divestment.

“Colorado’s cost of divestment ranges from $36 million to $50 million per year. As this compounds, the scholar determined that over 50 years, fossil fuel divestment could lead to a 10-12% fund shortfall, or a net loss of a whopping $646 billion dollars.”

¹⁸ https://www.reclaimnewyork.org/2018/01/12/state-comptroller-just-not-radical-divestment-proposal/
The results were not favorable. According to Fischel, Colorado’s cost of divestment ranges from $36 million to $50 million per year.20 As this compounds, the scholar determined that over 50 years, fossil fuel divestment could lead to a 10-12% fund shortfall, or a net loss of a whopping $646 billion dollars.21 Perhaps most startling, the costs that Fischel determines are only “those attributable to lost diversification benefits,” meaning his analysis does not even cover the entire picture.22 While Colorado has not moved forward with divestment as of yet, this astronomical cost clearly shows how damaging divestment can be for pension funds.

**California**

California has a long history of considering divestment. The California Public Employees’ Retirement System (CalPERS) states in their policy on divestment that, “divesting appears to almost invariably harm investment performance, such as by causing transaction costs (e.g., the cost of selling assets and reinvesting the proceeds) and compromising investment strategies.” However, that has not stopped CalPERS and the California State Teachers’ Retirement System (CalSTRS) from moving forward with various divestment schemes.

In October 2015, a report found that CalPERS missed approximately $8 billion in investment earnings due to its various divestments. Tobacco divestments alone cost the pension fund nearly $3 billion over the 14-year period examined.23 Even though these estimates have come from CalPERS’ own investment team, this has not stopped the fund from continuing to divest its assets from other industries. A 2017 memo revealed that CalPERS had divested from 14 coal companies without providing any financial analyses of the firms.24 Further, over the past couple of years, the fund has actively considered proposals to divest its assets from gun manufacturers, the Dakota Access Pipeline, and car manufacturers that do not meet emissions standards.

CalPERS is not the only California pension fund that has pursued divestment for political purposes. On November 7, 2018, the investment committee of CalSTRS approved a measure instructing the fund to divest its assets from two companies engaged in the operation of private prisons, CoreCivic and GEO Group. When CalSTRS made the move to withdraw its investments, the pension fund held over $12 million dollars in the two companies.25

21 Ibid
22 Ibid
The CalSTRS investment committee narrowly voted 6-5 to divest from the private prison companies, based on the false belief that the private prison companies affect and participate in setting national immigration policy, especially as it relates to issues on the Southern border. However, the committee actually concluded that it is “the contracting agency, such as the US Government, that creates and carries the risk” [of violating CalSTRS’ ESG policy]. One committee member voted to divest despite recognizing that “no matter what we do, I shouldn’t say that, but if we divest, those conditions are still going to exist, the policies will still be the same.” It seemed that instead CalSTRS was responding to the demands of protestors who appeared at an investment meeting in July.26 Thus in lieu of fulfilling its duties as a fiduciary and ensuring the strong financial performance of its fund, CalSTRS decided to give into political pressure and remove its funds from the two companies, with the only effect likely to be reduced returns for Californian teachers.

Both CalPERS and CalSTRS continue putting the retirement of their beneficiaries at risk through various politically-motivated divestment decisions. Recognizing this, Corona police officer Jason Perez was recently elected to the CalPERS board on a platform of wanting to rein in the politicization of the fund and instead focus on generating maximum returns with a reasonable amount of risk. While individuals may want to make specific statements with their investment dollars, public pensions, including CalPERS and CalSTRS, should instead focus on meeting the needs of their retirees and adhere to their fiduciary responsibility to generate optimal return.

CONCLUSION

Pension funds should resist calls to divest holdings to pursue a social cause or political goal. Divestment lacks the fundamental efficacy of influencing target companies as a strategy of change. Beyond its innate ineffectiveness, the costs and practical barriers are considerable and violate the fiduciary responsibility held by fund managers. The politicization of public pension funds, which are driven by elected or appointed officials, is irresponsible and financially unsound. Divestment moves the conversation away from responsible investment to strengthen the overall fund portfolio, and instead attempts to use the pension fund as a tool to achieve political goals.

Furthermore, many pension funds understand that divestment is costly, ineffective, and not in the interest of their beneficiaries. As outlined above, some funds in New York City have begun pushing back against the social movements calling for divestment across industries and repeatedly votes on divestment have increasingly failed to pass. It’s time that pension fund managers refocus their efforts on growing the funds, not furthering other objectives. As two law professors at Harvard and Northwestern recently authored in a Wall Street Journal op-ed, “the fiduciary may not use other people’s money to pursue collateral benefits to third parties, no matter how well-intentioned.”

It should always be the goal of the fund manager, in line with his/her fiduciary responsibility, to manage the fund with reasonable risk and the greatest possible return. Divestment renounces that responsibility to the detriment of millions of hardworking American public service retirees.
