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# Social Investing

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## The Implementation of a Social Investment Policy—as Exemplified by a State Retirement System

by Madelon DeVoe Tailey\*



The first time that I ever heard the term *social investing* was back in the early 1970s, when the Dreyfus Corporation, where I then worked, launched a new fund called the "Third Century Fund." Quite frankly, I was horrified at the thought of using any criteria other than possible investment gain in choosing an investment. The rating of a corporation's policies, either environmental or employment standards in a Bo Derek manner seemed totally subjective and then using them to preselect a portfolio, destructive.

The next time I was confronted with the term was on arriving at Albany to assume management of one of the largest public pension funds in the country. My boss, Comptroller Regan received a letter that he read at the weekly staff meeting requesting information on our policy towards investment in South Africa. Everyone looked around the room—and one member from the past administration stated that letters like this were never answered and just thrown away. Well, in the 80s its hard for any politician to throw these letters away. Soon the Comptroller's Retirement Advisory Council started complaining that they wanted to be included in the investment decision process and

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asking him assorted questions about policies. This committee, made up of nine members representing the pensioners, is an interested group that quite frankly has a right to know. They include:

- The Professional Firefighters Association.
- Counsel 82 (AFSCME).
- Conference of Mayors.
- Assembly representatives.
- CSEA.
- NYS Senate representatives.
- Police Conference of NY.
- Retired Public Employees Association.
- Private-sector representative.

On the advice of the Common Retirement Fund's Investment Advisory Board, we created a subcommittee on proxy voting, made up of these nine members. This committee reviews shareholders proposals and other proxy questions relating to economic and social issues. Business issues are reviewed by the comptroller's staff. In the first year 221 proposals had been considered and the subcommittee voted 48 percent in support of shareholders, 47 percent against.

The original procedure became cumbersome, so now each year the committee develops a series of policy attitudes on the main topics raised by shareholders at corporate annual meetings. Some of these I will share with you:

## Consideration of Shareholders Resolutions

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### Corporate Giving

A number of resolutions dealt with corporate contributions to charitable and educational institutions. A proposal to increase philanthropic contributions to a specified percentage of pretax earnings failed to find any support. It was the subcommittee's opinion that philanthropic contributions were gifts and that corporations should not be subject to any mandated level of giving.

The subcommittee, on the other hand, normally favored proposals to halt contributions to schools which knowingly employ avowed Communists or which restrict, or attempt to restrict,

contact between intelligence agencies of the United States and members of the educational communities.

The subcommittee considered several proposals to restrict or eliminate philanthropic contributions. The general opinion was that contributions to charitable and educational institutions were in the general interest and, as such, deserved corporation consideration.

### Directors and Annual Meetings

On the question of reporting the attendance of directors at meetings, the subcommittee felt that, since a minimum attendance report is already required by law, an actual report of attendance beyond that point was certainly no hardship and should be included in the annual reports.

In regard to cumulative voting for directors, the subcommittee underwent a change of opinion in midterm. Initially, these proposals were supported in the belief that such voting would give more power to the small shareholder. As time went on, however, the subcommittee became concerned that fragmentation of the board of directors might be a result of cumulative voting and, on this ground, changed its opinion.

The subcommittee felt that the annual election of directors was contrary to the continuity which is an important element in the efficient operation of the board. The subcommittee, therefore, did not support such proposals.

The subcommittee was of the basic opinion that a variety of outside directors was essential to effective board operation and, therefore, favored proposals calling for the presence of employee or outside directors on the board.

To date, the subcommittee has not supported any of the proposals which would mandate the conduct, location, or date of annual meetings since it believes that, given a level of reasonable behavior, management was best accorded a free hand in such matters.

On the question of secret balloting, on the other hand, the committee has consistently supported shareholder proposals.

### Shareholder Prerogatives

The subcommittee was sympathetic to most proposals supporting shareholder rights. The subcommittee, for example,

consistently supported proposals to restore limited preemptive rights. It was generally felt that the large shareholder's control of the corporation would be increased by the removal of preemptive rights and that requiring a corporation to offer shares to its current stockholders would enable lesser power centers to maintain their position vis-a-vis the larger shareholder or management.

The subcommittee dealt with the numerous requests for reports to shareholders by asking the following questions:

- a. Was the information already available?
- b. Was the proposal worded in such a way that it provided for reasonable distribution of information to those who wanted it, without subjecting the corporation to extensive costs in providing bulks of material to an uninterested audience?

Using these criteria, the subcommittee supported proposals requesting reports on the retention of outside law firms, governmental service of employees who might be selected as lobbyists, and pricing and diversification information. On such matters as recruitment policy and EEOC information, it was the subcommittee's opinion that such information was already available and consequently need not be provided in annual or other reports.

Proposals requiring disclosure of the basis for selecting proxy counters and judges, and the operation of proxy counts, were not supported by the subcommittee because it was believed that such information was of little interest and too extensive in its nature. The subcommittee did, however, support all proposals requesting publication of the number of unmarked proxies since, in the subcommittee's opinion, this was a good gauge of management's influence in a corporation.

## Policy Statements

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The following are the specific policy attitudes developed, to date, by the Proxy subcommittee.

### Management Incentive Programs

The committee supports the right of management to provide such special compensation programs as are deemed necessary to

retain experienced and talented personnel. Therefore, unless a shareholder proposal is designed to correct an egregious abuse of this management prerogative, the subcommittee will not support proposals which would restrict, limit, or terminate such plans.

### South African Proposals

The subcommittee, having devoted time and attention to the study of historical processes which have produced the current state of affairs in South Africa, finds that it disapproves strongly of the apartheid policy of the South African government, and, at the same time, disapproves of any course of action which could lead to a violent or anarchic states of affairs. With these attitudes as background, the committee has determined the following:

1. The subcommittee will recommend that the comptroller not support shareholder proposals requesting withdrawal from South Africa if the corporation in question has either signed (and received satisfactory ratings as a signatory of) the Sullivan Principles or has demonstrated that it is incorporating social reform principles in its operations in South Africa. Where a company has neither adopted the principles, nor demonstrated any activity to ameliorate the position of the South African black, the subcommittee will recommend to the Comptroller that he support withdrawal proposals with the understanding that the company is being warned about its failure to respond positively in a critical social environment.

2. The subcommittee will recommend that the comptroller oppose the shareholder proposals calling for nonexpansion in South Africa if the company is actively carrying out its commitment to the Sullivan Principles or is actively promoting training programs and other equal rights opportunities in its operations. If the company is doing nothing along these lines, the subcommittee will recommend that the comptroller support the proposal as a warning to management.

3. The subcommittee is of the opinion that South African Review Committees are a desirable and necessary adjunct to the board of any corporation doing business in South Africa and, consequently, will recommend to the comptroller that he support all such shareholder proposals.

4. The subcommittee's recommendations listed above are so ordered as to encourage the comptroller to convey a strong and clear message to the management and boards of the companies involved. The subcommittee also wishes to recommend to the comptroller that he use related proposals to convey a strong and clear, albeit indirect, message to the South African government. Consequently, the subcommittee will recommend to the comptroller that he support all proposals to stop sales to the South African government, stop private-sector loans to the South African government, and stop dealings in the Krugerrand.

## Nuclear Energy and Nuclear Weapons Proposals

The subcommittee has not yet developed a policy on the prohibition of use of nuclear energy, or on prohibitions against nuclear weapons production.

The committee is, however, deeply concerned with the economic, health, and safety problems associated with the generation and storage of nuclear and nuclear-related materials. It is the opinion of the subcommittee that the burden is on the industry to show that these risks or hazards can be overcome. It is, furthermore, the opinion of the subcommittee that any company involved in the nuclear energy or nuclear weapons arena should be open and public about the risk elements of such undertakings. In this light, the subcommittee will recommend that the comptroller support all proposals encouraging corporations to develop alternate energy sources or energy conservation programs and will recommend that the comptroller also support all requests for reports on nuclear energy plants, nuclear weapons production, safety conditions, accident costs, insurance costs, and related informational items.

## Corporate Political Activity

It is the opinion of the subcommittee that since political action committees (PACs) comprise individual contributions made by employees of the corporation, information about these contributions and their utilization are not a direct right of the shareholder. Where requests for information about corporate expenditures on PACs are lodged, the subcommittee will recommend to the comptroller that he support such proposals.

The subcommittee is of the opinion that corporations should affirm political nonpartisanship and avoid any activities which would lead shareholders or the public to believe that political pressure is being applied by the corporation to its employees. The subcommittee, therefore, recommends that shareholder proposals calling for such an affirmation be supported by the comptroller.

The creation of this subcommittee has thus turned out to be very helpful in the Retirement Advisory Council's Participation in decision making in our pension fund. Overnight the council changed from an adversary relationship to a constructive one, and I think you can tell from their deliberations how thoughtful

they became. One union representative remarked that after working on this committee, he realized that there were no easy decisions, and issues that had seemed obvious before he served, no longer were.

## Legislature and Commerce Commissioner

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The next pressure group turned out to be members of the legislature and the State Commissioner of Commerce. Their practice is to issue a critique via a press release stating that our fund the New York State—Common Retirement Fund has not done enough for New York State's economy and that we are funding economic growth in the South and West via commercial mortgage commitments. No matter how many times we answer that 50 percent of our mortgage portfolio is in New York State and that it is a heavy concentration, the attack continues. It is interesting also that our sister funds in the state are ignored.

In spite of this pressure to red line the United States, our investment policy in commercial projects has continued to be to pick the best investment projects in the country that are available to us and invest in them. This market is a very competitive one, and real estate submissions cannot even be controlled.

The members of the Legislature most active in this attack would then submit bills restructuring the management of the Common Retirement Fund, forming a board of trustees guaranteed to stimulate the economy.

Most public pension funds trustee system boards were created in the 1950s and 1960s and were structured to represent the participants as well as contributors. Over the years, as their pension assets grew and thus there was more money to manage at a time when the financial markets grew complicated, it became harder and harder for this system to be effective. With the comptroller as sole trustee, New York State has an original arrangement, which helps to explain why there is so much conversation in New York on this subject.

The broad issue today is control and management of pension plan assets, and that is where we moved next. When we reviewed some of the legislators' proposals, we decided that it was far better if we came up with our own plan for the future. Roy Schotland of Georgetown Law School helped to come up with a

structure that was introduced last year into the legislature. This three-pronged program included:

1. A five person board of trustees for the Common Retirement Fund.

- a. Appointed by the comptroller with traditional legislative confirmation by the New York State Senate;
- b. For staggered five-year terms.
- c. With experience requirements of at least 10 years managing major pension assets in a firm or corporation authorized to do business in New York.

2. Replacement of obsolete statutory investment restrictions with a prudent investment standard. Our statutory restrictions largely parallel the "legal list" for savings banks. Although sound a few decades ago, such restrictions have lagged behind general investment practices over the past 20 years, behind Federal law for private pension funds for almost 10 years, and behind a growing number of states. For example, the Common Retirement Fund cannot invest in:

- a. Any company, however attractive, unless it has paid dividends for five years consecutively.
- b. Any investment pool or commingled venture, such as participation in real estate equity joint ventures.
- c. Any equity investments in real estate.

Nor can the Common Retirement Fund lend stocks. This extremely low-risk method for providing incremental earnings is simply barred for our \$3.7 billion stock portfolio.

3. A new state investment opportunity council. Because of the size of funds like the Common Retirement Fund, some officials and members of the public suggest that these funds be tapped for a wide array of public needs, such as housing, in-state business, small business, etc. But a pension fund's size must always be viewed in the light of its huge, fixed, legal liabilities and its ability to honor its obligations to participants in the pension system.

The Common Retirement Fund has one of the finest records in the nation for responsive and prudent investments designed to strengthen local economic conditions. There are worthy New York investment opportunities that, because of their size, loca-

tion, or unsophistication, lack adequate access to investment capital. The state can and should help such opportunities find capital.

The Common Retirement Fund is only one of seven public pension funds in New York State. There are \$160 billion in other public pension funds nationwide, much of it in states that normally turn to New York City investment firms for advice. There are \$450 billion in private pension funds, which also customarily turn to New York City. And, of course there are major nonpension institutional investors, such as insurance companies. The state can help all such investors find more New York opportunities.

The state can promote new New York investment vehicles, such as state-guaranteed, mortgage-related securities that are free of the administrative impediments that currently inhibit major institutional investors from purchasing federal government and federal agency mortgage-related securities. The state can promote new New York investments by assembling joint ventures attractive to the CRF and other public pension funds so long as they can take a part rather than all of the venture. The state can take steps to assure that New York's role as financial capital encourages our great private financial institutions not to overlook opportunities right here at home.

As an investment manager during this period, I considered the investment advice of Randy Barber and could not find many investments that met our permissible investment criteria. When they did, we found them impossible to purchase. Such ideas as buying New York State Small Business Guaranteed Certificates or New York State pools of GNMA's are impossible to purchase in size. A few million can be purchased but that's it. This reversal to thinking of what is possible for us to invest that is both prudent from a fiduciary standard and that has a basic public purpose led us two years ago to start investing in New York State conventional mortgage pass-through securities. These are pools made up of single-family homes, underwritten by banks and then pooled into a private placement for us. By law, we had been prohibited from making loans under \$250,000 until special legislation had been cleared. We were the first state to get involved in the purchase of in-state conventional mortgage pools but many others have invested in them now, and most others are reviewing the idea.

The key issue in any social investing debate on this subject is the setting of the rate and what it should be geared to. What most people who are evaluating these investments do not realize is the difficulty of setting a rate that is attractive while closing the pools in the shifting rate environment we have experienced over the last two years.

Our intention was never to subsidize this program but to find a market rate that we could live with. In our first endeavor we stumbled around, not having any in-house experts in the housing field. But our second-year rate improved and was above the GNMA rate on the day of commitment, and this year in our discussions we are gearing the pools to the GNMA future rate. Since rates are coming down it would be impossible to create a pool; all we would have is our commitment fee.

Are we going to continue each year investing in these pools? That I cannot say. The last few years have been extreme pressure points in the housing industry with the historical suppliers of mortgage money literally unable to participate. Part of the decision depends on the pension fund's total fixed-income commitment from our net cash flow.

I have tried to trace my stream of consciousness on this issue of social investing and what policies we have implemented that we thought were reasonable. What we have not done:

1. We never bought MAC Bonds to prevent New York City from going bankrupt; we did buy federal guaranteed bonds at a rate 50 basis points over the equivalent Treasury bonds.
2. We did not refinance a Chrysler plant in Syracuse with mortgage money in spite of pressure, or the fact that other states committed monies to Chrysler's survival.
3. We have not financed housing projects or bought old mortgages from Sunny Mae, nor have we bailed out the savings banks.
4. We have not bought tax-exempt paper from New York State or its localities, although its spread from Treasuries is now so narrow that such an investment is not as unthinkable as it once was.
5. We do not screen corporations' activities before we invest in them.

The biggest conflict arose this spring when the state budget was stalled in Albany. There would be enough money to make

either a state payment to New York City or the contribution to the pension fund but not both unless the budget was passed and the short-term state spring borrowing could go forward. Luckily we never had to make the choice since most politicians would have lobbied for the payment to New York City. Pensioners unfortunately are not active lobbyists.

In summary, what we have done is to try to respond to responsible requests without relinquishing our own objective fiduciary duty.

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