PRI Principles for Responsible Investment

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# PRI ACADEMIC NETWORK
# RI QUARTERLY

## HIGHLIGHTS FROM PRI IN PERSON 2015

## IN THIS ISSUE



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**The PRI Academic Research programme** aims to engage and inform signatories and responsible investment practitioners with academic research that analyses current thinking and future trends, provides practical recommendations and is thought-provoking.

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**The RI Quarterly** extracts the essentials and distils key findings from research in a clear and concise manner for investment professionals.

**EDITOR:** Adam Aljewicz is a communications specialist and a former financial and economic journalist and editor, most recently with Dow Jones and The Wall Street Journal in London and South Africa.

# INTRODUCTION

BACK

The Academic Network Conference was integrated with PRI in Person for the first time this year, with a full stream dedicated to academic research. Over 1,000 delegates from 35 countries attended PRI in Person, making it the largest ever responsible investment conference.

The theme for the academic stream and the Call for Papers was *From awareness to impact: Mechanisms of change in responsible investment.* In the article, *Does ESG pay off financially?* (page 4) distinguished speakers such as Professor Raghavendra Rau, Professor Jean-Pascal Gond and Michael Viehs discuss the need for a new narrative for responsible investment that focuses on a deeper, and more nuanced, understanding of long-term risks and raising the overall standard of markets, rather than a quest for alpha.

In another session, regulators, academics and investors questioned: Is *all investing impact investing?* (page 6)

and considered all investing produces "positive social and economic outcomes, some less so", and examples ranged from tax, to infrastructure and green bonds. This wide-ranging discussion highlighted the communication requirements of investors, communication within companies, as well as the need for identifying and using KPIs more strategically. The development of integrated reporting and decoupling quarterly reporting from quarterly earnings reporting came to the fore, as it did in the session on long-term investment. The debate underlined enhanced corporate disclosure, focusing on organisational culture, clarification of fiduciary duty and nurturing the next generation of leaders.

Understanding barriers, approaches and impacts of engagement is important, and the panel agreed that size does not need to be a barrier. All types of investors can carry out successful engagements. The PRI will be publishing guidance for investors engaging on tax. This will include an overview of recent and potential regulatory changes, example questions for beginning and developing dialogue as well as academic research resources.

The value of education was clear in the roundtable examining the barriers to responsible investment. Bobby Lamy, Head of Curriculum Development at the CFA Institute said: "We will be continuing our assessment of 'ESG Investing' to identify the competencies involved so as to serve as a basis for our credentialing programs. My experiences at the conference provided great insight into the process."

A highlight for me was encapsulated by David Wood who said the RI community is caught wrestling with the fundamental tensions between adopting the conventions of financial practice and critiquing, and trying to change, those same conventions.

We look at comparability, challenge established academic evidence and examine the impact of beneficiaries' attitudes by showcasing the winning papers of the PRI and Sycomore Award for the most outstanding research in responsible investment. The Best Qualitative Paper, *Immature or Impossible: Making Environmental, Social and Corporate Governance Issues Calculable for Investors?* (page 9) details an anonymised global fund manager's frustrations with ESG data and materiality. The research pointed to the need for real ESG integration. The PRI will be publishing a report in the next year providing guidance and case studies on integration, including both quantitative and fundamental approaches, good practice tools and what may be on the horizon.

I hope you enjoy this edition, including the articles on the other winning papers: *The 'Price of Sin' Aversion: Ivory Tower Illusion or Real Investable Alpha?* (Best Quantitative Paper, page 10) and *Red versus Blue: Do Political Dimensions influence the Investment Preferences of State Pension Funds?* (Best Student Paper, page 11). Visit our website to access papers and video highlights from the PRI Academic Workshop.

I would like to thank our sponsors, Sycomore, the PRI Academic Network Committee and Conference Committee, and the many supporters who have made this year such a success.

I look forward to seeing you at PRI in Person 2016 in Singapore!

**Katherine Ng**
*Head of Academic Research, PRI*

# A TRUE SUCCESS

**150+**
SPEAKERS

**40**
SESSIONS

**80%**
of delegates rated their experience at PRI in Person 2015 as either “good” or “excellent”

**558**
**ORGANISATIONS**
REPRESENTED

FROM
**35**
**COUNTRIES**

OVER
**1000**
**PARTICIPANTS**


Tweets #PRIinPerson
**800+**
**in 72 hours**

**643**
APP USERS

**1,503**
LIKES

**344**
STATUS UPDATES

**185,164**
IN-APP ACTIONS

# DOES ESG PAY OFF FINANCIALLY?

BACK

PRI Chair Martin Skancke led a spirited discussion on one of the most commonly asked questions in ESG investing: What effect does responsible investing have on returns?

Michael Viehs said that companies with better ESG practices are more competitive as they are better prepared for external shocks, have reduced credit risk and often benefit from a lower cost of capital. He said that for investors, considering ESG factors can significantly reduce downside risk.

> "Our results show, convincingly, that ESG pays off financially."
>
> Michael Viehs

To overcome the danger of positive ESG effects being priced in at a certain point but then fading, Viehs said that investors should pursue dynamic active ownership strategies rather than just rely on inclusion or exclusion strategies.

> "Sustainability is dynamic because we know that morals, standards, values and investor preferences change, so investors can gain most by backing up their ESG integration strategy with corporate engagement strategies."
>
> Michael Viehs

Martin Skancke questioned whether investors, bidding up the price of companies when they learn they have superior ESG practices, means that the expected return drops, because investors are paying more for the same expected cash-flow. Viehs said that this wasn't necessarily the case, because investors pursuing active ownership strategies might push up ESG standards even more, further boosting financial performance.

Skancke queried whether, as alpha is the difference between actual return and average market return and the sum of all those differences must therefore be zero, if every investor was a responsible investor, would we still see alpha or would average market returns rise overall?

> "Isn't it more about raising the overall standard of markets, which would be captured in the average market return? Wouldn't investors, over the longer-term, be more concerned about how the benchmark developed and not how the deviation from that benchmark developed?"
>
> Martin Skancke

## PAST PERFORMANCE DOESN'T EVEN GUARANTEE PAST PERFORMANCE

Raghavendra Rau, who has studied the behavioural biases of investors and whether investors even understand what performance is, described an unusual pattern created by the US Security and Exchange Commission's mandated holding periods for quoting returns: when a bad quarter no longer has to be included in the performance data, returns are boosted by the addition of a new, better-performing quarter, and although nothing has changed in the fund's management or strategy, investor flows into the fund can be dramatic. Investments also flood in when funds simply rename themselves to reflect the current hot topic.

> "This creates two big problems. One: if you call yourself a responsible investing fund, you have to be careful that people actually understand this. Two: be sure nobody else who's not doing any kind of responsible investing calls himself a responsible investing fund and gets the label."
>
> Raghavendra Rau

**MODERATOR: Martin Skancke, PRI**

**SPEAKERS**

**Jean-Pascal Gond**

Professor of Corporate Social Responsibility, Cass Business School, City University

**Raghavendra Rau**

Sir Evelyn de Rothschild Professor of Finance, Judge Business School, University of Cambridge

*Changing Names with Style: Mutual Fund Name Changes and Their Effects on Fund Flows.*

*Past Performance May Be an Illusion: Performance, Flows, and Fees in Mutual Funds.*

**Michael Viehs**

Visiting Research Associate at the Smith School of Enterprise and the Environment, University of Oxford, and Assistant Manager at Hermes Investment Management

*From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance.*

Rau noted that when returns are poor, funds don't tend to quote numbers in their advertising literature, but when a bad return falls away, that's when advertisements often appear saying "these are actual returns". He said retail investors are unlikely to assess the underlying data, while even institutional investors struggle to justify not investing in stocks showing what he calls a "mechanical" rather than a real return.

"Any investment advert says past performance is no guarantee of future performance, but my research actually shows that past performance is no guarantee of past performance either!"

Raghavendra Rau

## MAYBE LOOKING AND HOPING AFFECTS REALITY

Jean-Pascal Gond said that systematic analysis of previous studies has found a small positive relationship between corporate social responsibility and financial performance, but queried why, if we have the answer already, are we bothering to research it any further?

Surprisingly, the more academics research this topic, the more they tend to show a positive relationship; usually, the mean correlation between two constructs drops the more that academics study it. So Gond suggested making this research bias the object of inquiry, to explore how this bias happens and how practitioners and academics may be fuelling it.

"We're all looking for a relationship and hoping that it's there and maybe that affects reality. It reminds me of the Heisenberg uncertainty principle from physics, that you will change something just by observing it."

Martin Skancke

## IS LONG-TERM RISK THE NARRATIVE?

Skancke asked whether the responsible community's quest for more and more financial data is actually a response to the internal structures within organisations, to try and convince CIOs and CEOs that responsible investment enhances financial returns, and if it is time to propose a different narrative about responsible investing?

Viehs said focus should be centred more on risk management than on adding alpha.

"Maybe we're not making some extra money every month in excess returns, but maybe it gives us a better and richer understanding of some of the long-term risks that we're facing. Maybe that in itself is the narrative?"

Michael Viehs

## NEXT STEPS

In closing, Martin Skancke identified three key issues these findings present to the PRI: the agency problem between owners and managers of capital, the case for improving corporate performance through active ownership and the problem of free-riding because the returns on the efforts of active owners are shared among all investors.

"The challenge for the PRI is to be even more effective and efficient through our engagement platform, in bringing down the cost of engagement and making that a cheaper, more accessible option for investors."

Martin Skancke

He also suggested that, historically, proponents of responsible investing may have focused too much on excess returns and might need to focus on aligning its activities with broader societal objectives, the values of beneficiaries, and risk.

Skancke left the audience with a final idea for future research: a sociological study on the relationship between responsible investing professionals and CIOs, because a lot of the fixation on alpha seems to be driven by responsible investing professionals' need to justify their own ESG activities within larger organisations that do not yet have ESG embedded in their culture.

# IS ALL INVESTING IMPACT INVESTING?

BACK

**MODERATOR: Nathan Fabian, PRI**

**SPEAKERS**

Jessica Fries

Board Member, IIRC and Executive Chairman, The Prince's Accounting for Sustainability Project (A4S)

Marek Grabowski

Board Member, International Auditing and Assurance Standards Board and Director of Audit Policy, Financial Reporting Council

Farha-Joyce Haboucha

Managing Director, Director of Sustainability & Impact Investing, Rockefeller & Co.

Tessa Hebb

Director, Carleton Centre for Community Innovation, Carleton University

David Wood

Director, Initiative for Responsible Investment, Hauser Initiative for Civil Society, Harvard Kennedy School

Mr. Fabian, Director of Policy and Research, PRI kicked-off a discussion on the question: Is all investing impact investing, or is impact investing a special category that needs different reporting tools? Tessa Hebb defined impact investing as the investor acting with the aim of achieving positive social or environmental outcomes as well as a financial return, but Fabian asked how important it is to distinguish between the intention of the investor and the achievability and measurability of that intent. Hebb said a key issue here is what timeframe should be used to measure these impacts, as some benefits could take a lifetime to come through.

> "Results must be measurable and, therefore, must be measured - therein lies the challenge for the sector."
>
> Tessa Hebb

Joyce Haboucha said that all investment has a pronounced effect on society, because all business practices invariably have an impact on society.

> "All investing is impact investing, in that some produce positive social and economic outcomes, some less so."
>
> Joyce Haboucha

## HAVING A GENUINE INTEGRATED STORY

Jessica Fries said that there had been a huge take-up of integrated reporting, with more than 800 companies in the International Integrated Reporting Council (IIRC). However, many firms still need to analyse how they can integrate ESG into their strategy and put numbers to the implications for the business, so are a long way from being able to communicate details effectively to investors.

Fries said that CFOs felt that there wasn't enough demand for ESG information from investors; she said that while investors are doing a lot of detailed research into ESG, it isn't being given enough prominence at quarterly meetings or analyst roadshows.

Fabian said that if we rely on the signals we've always taken for expressing demand, such as company meetings, which are often dysfunctional (from a long term value perspective), there's a chance we're going to miss the demand altogether.

He asked whether the anxiety exhibited by many CEOs in discussing ESG with the market was a generational issue or a confidence issue?

> "The minute sustainability comes up, the mainstream guys get their phones out and start checking emails. SRI analysts want to ask questions but they ask them after the meeting rather than in the main meeting itself. Companies need to take responsibility and raise these issues but they also need confidence in their internal evidence."
>
> Jessica Fries

Fabian said that, surely, companies are responsible for their own narrative to the market? Fries agreed, saying that the A4S research showed that companies must start by improving their own communications: in order to communicate more effectively with their investors, companies need to identify and measure some of the impacts, risks and opportunities that they are facing, and they first have to convince their internal communities.

> "If you're saying something is strategically vital, are you measuring your KPIs based on those issues? Have you actually got some measure that links into remuneration? Is that really over the long term? It's fairly easy to unpick if you haven't genuinely got an integrated story to tell."
>
> Jessica Fries

### THE EMERGENCE OF METRICS

Fabian asked what impact investing can teach us about new metrics for measuring impact.

Hebb said that the metric for impact investment has been too small, and that to roll impact investing out beyond high net worth individuals or foundations to the huge funds, the metrics would need to be more robust.

"As impact investment moves into larger asset classes, we'll see the emergence of some metrics through integrated reporting – understanding the power of the narrative as well as the numbers."

Tessa Hebb

### DEMAND FOR STANDARDISED ASSURANCE?

Hebb noted the beginning of convergence between metrics and assurance, citing the example of green bonds, which have experienced exponential growth over three years. They attracted US$5bn without metrics, and are now estimated at $50 billion, but with investors now wanting comparability, Cicero has introduced both metrics and assurance.

Fabian asked, given investors are looking for comparability, how is the audit and assurance profession addressing emerging trends?

Marek Grabowski said that corporate reporting is currently in a period of disruption created by changing societal expectations about the impact that companies have on society.

"In financial reporting, the world is pretty stable. Audit practitioners know what investors are concerned about and they can test for those things. In non-financial reporting, where there is some disruption now, it's much harder to see a single norm today."

Marek Grabowski

He said that a range of different frameworks, including integrated reporting, are being explored, and that investors definitely want comparability, which is primarily established in the reporting framework and tested through assurance.

"The demand for assurance in the non-financial reporting space will likely evolve as non-financial reporting matures, but there are still a number of issues to be worked out."

David Wood asked if previous studies' findings were true that the demand for assurance is not from investors but from corporate social responsibility representatives within companies, to give themselves credibility with their peers.

Grabowski said that even if the demand is coming from within the company to back up external reporting, there must be a focus on communication to the end user in delivering assurance.

"If the assurance doesn't meet the expectation of those end users, just like if the audit of financial statements doesn't, then it won't be of much use to anybody."

Marek Grabowski

David Wood said that the responsible investment community is caught wrestling with the fundamental tensions between adopting the conventions of financial practice and critiquing and trying to change those same conventions.

### NEXT STEPS

Wood said that there are many systemic issues remaining, citing tax avoidance as an example.

"At a portfolio level, saving money on taxes in your corporations is probably not a terrible idea if what you're trying to do is make money, but at a systemic level, depriving the public sector of the resources it needs to make a just and sustainable world is odious."

David Wood

When asked how the panel saw the development of the impact investment market, Hebb said that government policy will have to be involved, as the impact is often the generation of good for all of society, and government is the way of capturing that return.

Fries said that at a roundtable of CIOs and asset management heads, all participants said that they wanted to get rid of quarterly reporting, and the European Commission is moving in that direction. However, analysts still demand quarterly reports.

> "From a company's perspective, it's hard to move alone, without your peers moving. And it's all well and good if you're performing well, but if you're not, how do you make sure you're aligning market expectations? And if the market is moving in one direction and reality in another, how can you align the two? It is possible to move away from quarterly reporting, but not quite as easy as it might seem."
>
> Jessica Fries

# CASE STUDY: CAN ESG FACTORS REALLY BE CAPTURED LIKE FINANCIAL DATA?

BACK

AUTHORS

John Roberts

Professor at The University of Sydney Business School

Anna Young-Ferris

Lecturer at The University of Sydney Business School

*Immature or impossible: making environmental, social and corporate governance issues calculable for investors?*

Roberts and Young-Ferris's paper details the frustrations that a large global fund manager (InvestCo) encountered trying to quantify and systematise ESG analysis within an investment process reliant upon a traditional financial accounting framework.

These frustrations included:

- a head fund manager's concerns about the quality and usefulness of ESG data;
- a data provider's attempts to overcome these concerns by developing a comprehensive ESG database;
- disagreement between the ESG integration team and the investment team's data managers about whose responsibility it was to distil the data and find the most material ESG issues.

The authors then explore whether ESG issues can be made calculable for investors and whether ESG accounting data can be viewed as an immature form of accounting that, over time, will be as robust as financial accounting, or whether that is an impossibility.

The study draws on observations from 60 interviews and 67 meetings conducted by Young-Ferris over three and a half years.

## ISSUE 1: FUND MANAGERS DON'T TRUST THE DATA

As head of an investment team that believes in the power of numbers, the fund manager's view was that ESG data is poor, incomplete, lacks standards to govern its production and is inconsistent, so doesn't allow comparison between companies.
A key criticism was that ESG questions are answered with words not numbers and that even when good ESG data was available, it was ambiguous and "unlikely to be material". For example, a low number of work days lost to strikes could be read either as a sign of good labour relations, or of a management who yield too easily to employee demands at the expense of shareholders returns.

## ISSUE 2: THE IDIOSYNCRASIES OF DATA PROVIDERS' METHODOLOGIES

To appease the frustrations of the investment teams, InvestCo changed ESG data provider.

They believed the new provider offered more timely, comprehensive, comparable and factual data. It produced an ESG rating for 3,000 listed companies, ranking 750 equal-weighted data points about each company, gleaned from CSR reports, news feeds and NGO websites, which then fed into 250 key performance indicators (KPIs).

However, the use of equal weighting, as it admitted, created perverse effects. For example, the Deepwater Horizon incident in 2010 scarcely dented BP's overall ESG rating because "oil spills" affect just one of those 250 equally weighted indicators. Thus, the data provider's process of scaling to structure ESG data like financial data only served to obscure what was meaningful.

The methodology also produced a reporting bias – strong reporters would automatically score more strongly – thus favouring large cap companies that "have the money and do the big reports".

## ISSUE 3: RESPONSIBILITY FALLING BETWEEN THE CRACKS

The ESG integration team proposed that the investment analysts reduce the 250 KPIs down to the 30 or so most relevant and material to the company and industry sectors that they were interested in. However, the investment team had expected to be handed a single E, S and G score to include in their valuation model template for each stock.

InvestCo's aim had been to introduce an ESG metric in the valuation model – albeit as an optional risk weighting – but this was not accomplished in the three-and-a-half year research period. The only integration that actually happened was when the ESG integration team member joined the team stock reviews and meetings with senior company executives, where ESG-related discussions appeared to be an afterthought to the financially-focused discussions.

## LESSONS

At InvestCo, the ESG data failed to resonate with the investment analysts, so remained tangential to their core activity. If the analysts couldn't translate the impact of these ESG indicators into dollars, they were of little or no use.

ESG accounting has tended to use the structure of financial accounting as its model, and investors have played a key role in making ESG data more robust via standards and assurance. However, due to the difficulty in translating the sheer volume and diversity of the qualities the ESG data captures into an aggregated measure, the data lacks the essential characteristics that would enable it to be meaningfully integrated with financial accounting data.

The authors conclude: "Rather than seek to further subordinate ESG accounting to the demands of investor relevance, we should, perhaps, recall the founding, political inspiration of early social and environmental accounting researchers and insist that the purpose and function of such reporting is to create a public visibility for what financial accounting refuses to see. After all, even what is not judged material for the investor may nevertheless prove material for the environment and for society".

# IS THE "SIN STOCK PREMIUM" AN ILLUSION?

BACK

AUTHORS

Hampus Adamsson

Research Fellow, ICMA Centre, Henley Business School, University of Reading

Andreas Hoepner

Associate Professor in Finance at the ICMA Centre, Henley Business School, University of Reading

*The 'Price of Sin' Aversion: Ivory Tower Illusion or Real Investable Alpha?*

Adamsson and Hoepner's paper *The 'Price of Sin' Aversion: Ivory Tower Illusion or Real Investable Alpha?* argues that the apparent "return on vice" found by an influential 2009 study is an illusion.

Hong & Kacperczyk's (H&K) pioneering 2009 work examined US "publicly-traded companies involved in producing alcohol, tobacco and gaming" between 1965 and 2006. The authors found that these stocks significantly outperformed the market – a so-called "sin stock premium" – which they explained by institutional investors deserting sin stocks on ethical grounds.

Adamsson and Hoepner re-examined H&K's methodology and find that this apparent "return on vice" is likely to be an illusion created by a research design that contains statistical inaccuracies and would not apply to the real investment world. The study provides a useful example of how claims about the market effects of exclusionary screening can and should be interrogated.

## CHALLENGING THE RESEARCH DESIGN

Adamsson and Hoepner identified several weaknesses in H&K's research:

- The sample was predominantly US sin stocks, hence largely ignoring cultural differences across different geographical markets
- Many stocks included in the sample would not have been investable in the real world because they ignore common investment criteria, such as market capitalisation, liquidity and trading volume
- An equal-weighted portfolio of sin stocks was compared against a value-weighted market benchmark
- No sub-sample analysis between 1965 and 2006 was conducted, so any outperformance could have stemmed from decades ago.

## RE-EXAMINING THE DATA

The authors included in their analysis sin stocks listed on the FTSE All-World index, examining returns data between 2002 and 2013. They developed a methodology to address the weaknesses in H&K's research by studying:

- how cultural differences affect sin stock performance across different countries
- sin stocks listed on a major international index
- value-weighted as well as equal-weighted sin portfolios, to test if the out-performance found by H&K could simply be due to an over-weighting of small cap stocks and under-weighting of large cap stocks
- additional statistical controls for the known outperformance of small cap stocks (H&K only apply these controls market-wide – Adamsson and Hoepner also apply them within sectors).

## RESULTS

By interrogating previous claims, Adamsson and Hoepner show that the investment premium associated with sin stocks is likely to be an illusion produced by various manifestations of size bias created by the weighting given to small-cap and large-cap stocks within a given sin stock portfolio. Careful correction of this bias results in the "return on vice" disappearing.

The small-cap heavy, equal-weighted portfolios all generated higher returns than their market capitalisation weighted counterparts. However, using a value-weighted portfolio led to a significant decline in performance, implying that any outperformance is driven by small-cap bias, as small stocks outperform large stocks. For gambling, the sin premium disappeared and when controls for industry-specific factors were then added, any outperformance by the other value-weighted portfolios was wiped out too.

Using just US data, the equal-weighted portfolios outperformed in line with H&K's results. However, the value-weighted alcohol and tobacco portfolios no longer showed any significant outperformance and the gambling portfolio underperformed by 42 basis points.

# DO BENEFICIARIES' BELIEFS AFFECT FUNDS' DECISIONS?

BACK



Lisa Schopohl's paper *Red versus Blue: Do Political Dimensions influence the Investment Preferences of State Pension Funds?* finds that US state pension funds with Democratic-leaning members favour companies that perform well on ESG issues to a greater extent than funds with Republican-leaning counterparts do.

That the investment decisions of such a large group of investors with enormous market power might be affected by the political attitudes of their members could have wide effects on financial markets: considering the largest of these funds have assets under management of US$200bn-US$300bn, changes in a state's political climate could lead to a great channelling of money in or out of ESG investing, affecting firms' cost of capital and the prominence of ESG investing itself.

## RESULTS

Schopohl found that pension funds with Democratic-leaning members tilt their portfolios more strongly toward companies that perform well on ESG issues, and this effect is even more marked when the state government is predominantly affiliated to the Democratic Party. The political leaning of funds' members, rather than potential pressures by state politicians, appears the dominant force behind the preferences: funds from states with Republican-leaning members seem to engage less strongly in ESG investing, even if the state government is predominantly composed of Democrats.

The author also found that funds dynamically adjust their ESG investment approach in response to changes in their members' political leanings. When changing from Republican to Democrat, funds systematically increased ESG investment and vice versa.

Schopohl concludes that at this institutional level, ESG investment preferences may be driven strongly by investors' attitudes towards the social aims of firms, as opposed to pure financial considerations of risk and return. The funds studied tended to slightly overweight underperforming stocks and underweight outperforming stocks, but these tendencies do not seem to be consistently related to their ESG preferences and/or the political climate.

The study suggests that these ESG practices are not financially detrimental to beneficiaries and might provide them with indirect value as their pensions are invested in accordance with their own political beliefs.

## METHODOLOGY

Schopohl studied the funds' full public equity holdings, where available, from 1997 to 2013. The sample consists of 31 pension funds based across 23 states, whose holdings were internally managed.

She connected funds' portfolio holdings to the ESG performance of the companies being held, in particular, relating a company's weight in a fund's portfolio to the ESG performance of the company. She then analyses whether this relation changes, depending on the political leaning of fund members.

Without direct information on the political affiliations of individual fund members, Schopohl defines the political interests of pension fund members as the political leaning of the state the fund is located in (based on the percentage of the state's votes received for either the Democrats or Republicans in the most recent presidential election). She judges this a viable proxy for the members' political values as members of state pension funds represent a considerable share of the state's population and even taxpayers that are not employed in the public sector have a stake in how these pension plans are managed because the responsibility for funding these plans ultimately lies with the sponsoring government.

The study also tests whether the likelihood for pension funds to engage in ESG investing depends on the degree of pressures on the fund by state politicians. Their proxy for such political pressures is based on the proportion of Democrats and Republicans in the state government. As state pension funds' ESG investment preferences might be subject to a variety of other factors, Schopohl controls for company characteristics, fund and state characteristics and the overall market conditions in her analyses.

To check whether a change in political leaning affects the level of ESG investing, Schopohl identifies pension funds that experienced a change in the political leaning of the state population after the four elections that took place over the sample period.

A set of robustness tests control for alternative explanations of the observed associations, including industry effects, effects of indexing, and alternative specifications of the main variables.

## AUTHOR

Lisa Schopohl
PhD student at the ICMA Centre of Henley Business School, Reading

*Red versus Blue: Do Political Dimensions influence the Investment Preferences of State Pension Funds?*

# PRI ACADEMIC WORKSHOP 2015

BACK

Financial markets continue to function in ways that do not always serve investors – or society – over the longer term. The misalignment of interests and incentives, a general loss of trust in financial institutions and the ongoing allocation of capital to businesses that may prove unsustainable over the longer term continues to undermine value creation for asset owners and their ultimate beneficiaries... These market failures and inefficiencies cannot be addressed by investors or institutions acting alone.

Martin Skancke Chair, PRI Board

The Academic Workshop was kindly hosted on 11th September at The Systemic Risk Centre based at the London School of Economics and Political Science (LSE). The overall theme examined moving from awareness to impact, focusing on mechanisms that affect change and exert influence within organisations and in financial markets.

The event attracted PRI signatories, other responsible investment professionals and academics, with the top three reasons for attending being:

1. To engage with academic research and gain evidence and insights
2. To see how academic research relates to practitioners' work
3. To develop research ideas

24 original research papers were presented covering issues such as:

- Long-term investing and investing behaviour
- Responsible investment and fixed income
- ESG integration and impact
- Regional and cultural perspectives
- Corporate finance, management and sustainability
- Responsible investment and banking
- The importance of institutional investors

Visit our website to access the papers and watch videos from the event in which the authors outline the key findings and actions for investors.

CFO GENDER AND BANK LOAN PRICING: A CROSS-CULTURAL PERSPECTIVE

SUSTAINABLE RESPONSIBLE INVESTMENT IN SOUTHERN AFRICAN PRIVATE EQUITY: PRACTITIONER PERCEPTIONS AND PRACTICES

THE INTEGRATION OF ESG CRITERIA INTO INVESTMENT PROCESSES CONSIDERING INVESTORS' PREFERENCES

THE IMPORTANCE OF SUSTAINABILITY AND TRANSPARENCY LABELS IN INVESTMENT DECISIONS BETWEEN CONVENTIONAL AND SUSTAINABLE MUTUAL FUNDS

SRI RESEARCH: FOUR COMPETING AGENDAS

CORPORATE RESPONSES TO EXTERNAL METRICS: A DYNAMIC PERSPECTIVE ON DECOUPLING

PRI in Person

Next stop

# Singapore 2016

6-8 September, Marina Bay Sands

www.unpri.org/Singapore2016

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### The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance issues and to support signatories in integrating these issues into investment and ownership decisions.

The six Principles were developed by investors and are supported by the UN. They are voluntary and aspirational, offering a menu of possible actions for incorporating ESG issues into investment practices. In implementing the Principles, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

## The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

### United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

### UN Global Compact

Launched in 2000, the United Nations Global Compact is a both a policy platform and a practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact