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How State Pension Funds--And 401k Managers--Prioritize Politics Over Returns

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While Congressional elections are an entire year away, a different election season is almost upon us that could also impact public policy. These elections are driven by large public pension funds and asset managers advocating for increasingly political agendas during the annual meetings of publicly-held companies. For the majority of U.S. households who hold a portion of their retirement assets in the stock market in some form, it could mean that some of their money will be used to support a political agenda that hurts their investment returns.

A majority of U.S. publicly listed companies hold their annual shareholder meetings--which the Securities and Exchange Commission requires them to conduct--between March and July. Shareholders holding as little as $2,000 worth of stock have the right to put proposals on the company ballot, along with a 500 word supportive statement. In years past, these proposals tended to be about improving corporate governance, with a simple agenda: improving returns for shareholders.

Regrettably, politics has entered the shareholder proposal space, and these days the typical proposal has less to do with improving the long-term value of the company and, instead, increasingly focuses on political agendas that are often irrelevant to the company's mission--but not its bottom line.

Many of these proposals constitute little more than harmless exercises, and stand little chance of passing. However, to blithely assume that any proposal that might actually harm a company's bottom line would invariably be voted down by the shareholders would be mistaken.
The sponsors of such proposals are often able to skillfully craft their proxies so as to make it exceedingly difficult for investors to reject them. Company boards usually must at least make an effort to comply with these non-binding proposals, regardless of the negative impact to underlying shareholder value.

While some proposals still aim to push companies towards the best practices for corporate governance, social and environmental proposals rule the roost these days. According to Proxy Monitor and the National Association of Corporate Directors, the largest 250 companies faced more environmental, political and social proposals in 2017 than all corporate governance proposals combined, and a report in the Harvard Law Forum found that over 40% of shareholder proposals in 2017 dealt with environmental and social issues.

The content of these proposals is not what should alarm shareholders but rather that these decisions are being sponsored, placed, paid for and voted on by large financial entities whose real responsibility ought to be to manage money.

The politicization of the proxy proposal process has been led by institutions that represent millions of public workers and retirees -- including the New York City Pension Funds and State Common Retirement Fund and the California Public Employee Retirement System (CalPERS) and State Teachers' Retirement System -- in an effort to promote a political agenda that has failed to achieve results through the political process. Between 2006 and 2015, these funds alone put forward 235 shareholder proposals, and they submitted 127 more in 2016. NYC Comptroller Scott Stringer has already jump-started the 2018 season with letters to 151 public companies that will no doubt result in a new wave of proposals shortly.

It's worth noting that these four public pensions are a combined $338 billion underfunded, based on their own (conservative) calculations, which puts their state's taxpayers at risk of needing to make up future shortfalls. Pursuing a political agenda that could potentially depress their funds' returns seems counterproductive, to say the least.

The top asset managers – BlackRock, State Street Global, and Vanguard – also work closely with (and for) public pension funds, and together they control over $9 trillion. After years of voting against value-destroying proposals, they are increasingly likely to acquiesce as they derive increasing fees from pension funds, which provides them a non-fiduciary motivation to vote for the pet causes of their clients. Reports that CalPERS may outsource management of its $26 billion private equity business to BlackRock reinforces the new reality driving so much of the activism today: the pension funds are calling the shots.

Many shareholder proposals today ask companies to take actions that can harm them competitively, particularly when they compete against foreign or private companies unaffected by such strictures. Requiring a fossil fuel company to write yet another crystal-ball report about how it might fare in decades into the future owing to climate change--to cite one common proxy proposal--will not increase its value or come close to achieving any broader public policy goal. As we enter the season of shareholder meetings it is worth pondering, for every proxy vote taken, whether money managers are more interested in growing their political influence than in growing the value of their investments.

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