Steps to Protect Public Finance From ESG Activism

reason FOUNDATION

Being the largest investment pools funded primarily with taxpayer money, public pension systems and trusts are particularly exposed to the risk associated with activist investing. However, by drawing on best practices from state and local funds around the country, policymakers can ensure important pension dollars are removed from the political table.

What Steps Will You Take?

Step #1 - Take Immediate Action

- ☐ **Clarify Fiduciary Rules and Responsibilities**
  Require pension and state trust fiduciaries only base investment decisions on pecuniary factors like investment performance and risk, not nonpecuniary factors like politics, ESG, etc.
- ☐ **Require Advance Proxy Vote Notice and Annual Reporting**
  Surface activism in proxy voting by allowing the public to view proxy votes well in advance of being cast, as well as requiring a compiled annual report of all proxy votes annually.
- ☐ **Require Limited Partner Status Reporting**
  Help mitigate activism through alternative asset managers like private equity and hedge funds by requiring the annual reporting of limited partners and all committed and allocated capital.
- ☐ **Require Investment Fee Reporting**
  Reporting of investment fees will allow for more transparency around the cost and benefit of generally-higher-risk alternative investments like private equity and hedge funds.
- ☐ **Require Pension/Trust Board Meeting Transparency**
  Ensure taxpayers and stakeholders have access to major planning and investment decisions by requiring materials and meetings are broadcast, published and granted open access to all stakeholders.

Step #2 - Set Up Systemic Oversight

- ☐ **Institute a Pension Oversight Board**
  Creating a dedicated agency or center of excellence to oversee all public retirement systems in your state, both state and local, regarding their actuarial soundness and compliance with state reporting requirements.
- ☐ **Require XBRL Reporting Standards**
  Because government financial reports are mostly published in PDF format and hard to analyze, compare and aggregate, transitioning to more data friendly XBRL format makes government finance more transparent.
- ☐ **Require Public Trustees be Insured**
  Unlike in the private sector, public pension trustees are not required to carry liability insurance. Requiring coverage against claims brought alleging a wrongful act in relation to their role as fiduciaries ensures the appropriate amount of accountability.

Step #3 - Install Protective Policies

- ☐ **Remove Investment and Actuarial Management Privileges**
  Return important fund management duties to taxpayers by suspending management privileges until sound funding policies and metrics are achieved.
- ☐ **Mandate “Excess Value” Consultant Compensation**
  Pioneered by Public Employees Retirement Association of New Mexico, this limited partnership compensation method replaces the widely used carried interest compensation formula with one based on absolute returns, completely removing any consideration of the risk associated with such an asset.

PENSION INTEGRITY PROJECT CONTACTS

- Leonard Gilroy, Senior Managing Director (leonard.gilroy@reason.org)
- Steven Gassenberger, Policy Analyst (steven.gassenberger@reason.org)

Reason Foundation is a national 501(c)(3) public policy research and education organization with expertise across a range of policy areas including public sector pensions, transportation, infrastructure, education, and criminal justice. For more information about the Pension Integrity Project at Reason Foundation, visit reason.org.

reason FOUNDATION