

# ADVISORY COMMITTEE ON INVESTMENT RESPONSIBILITY

---

Open Forum

October 25, 2023

Emma Rasiel, PhD

David T. Robinson, PhD

# The ACIR Committee

<https://acir.duke.edu>

## The Advisory Committee on Investment Responsibility

The Board of Trustees recognizes that Duke University's ability to meet its educational mission and financial goals requires enhancing the value of the endowment over the long term by investing in companies that achieve real growth. It also recognizes the importance of ethical practices. The Advisory Committee on Investment Responsibility (ACIR) assists the President in making recommendations to the Board of Trustees in keeping with the Board's Guideline on Investment Responsibility.

The ACIR provides advice and recommendations about responsible investing, but it does not manage Duke's Foundation or its investments in any way. The company that does is [DUMAC](#). Viewers should review DUMAC's website to familiarize themselves with how Duke's investments are managed

### ACIR OPEN FORUM

Duke community members are encouraged to attend the annual forum hosted by the ACIR to learn more about the committee's work and to share suggestions.

FORUM INFORMATION

### DOCUMENTS

Find reports and other documents released by the committee and learn more about its mission and goals.

DOCUMENTS

### ABOUT THE COMMITTEE

Learn more about the committee, its mission and the members that provide guidance for socially responsible investing.

ABOUT THE COMMITTEE

# Leading today's discussion

## Emma Rasiel

- Richard Y Li Professor of the Practice of Economics
- Teaching Director of Duke Financial Economics Center
- Chair, Advisory Committee on Investment Responsibility

## David T. Robinson

- James and Gail Vander Weide Distinguished Professor of Finance
- Member, Advisory Committee on Investment Responsibility

# Two Matters Before ACIR

## Proposal to Divest from Fossil Fuels

- *we are formally requesting that the Advisory Committee on Investment Responsibility (ACIR) conduct a detailed reevaluation of the benefits and drawbacks of Duke divesting its full endowment from fossil fuel companies. We acknowledge that the ACIR has already addressed the issue of fossil fuel divestment on two occasions previously, in 2014 and 2019, and, at both times, declined to recommend divestment. However, given the worsening state of the climate crisis, the instability of fossil fuels as shown by the pandemic and the Russian invasion of Ukraine, the recent Climate Commitment, and the moves toward divestment by other universities around the globe, we believe that the issue of divestment must be reevaluated.*

## Proposal to Increase Transparency Surrounding Climate Impact

- *we are formally requesting that the Advisory Committee on Investment Responsibility (ACIR) make a case to the Duke University Management Advisory Council (DUMAC) for more transparency with Duke's \$12.1 billion endowment. In light of the university's recent Climate Commitment, which aims to direct efforts and resources across Duke towards environmental sustainability, we believe it is necessary to include Duke's financial activities in this undertaking.*

# PROPOSAL TO DIVEST FROM FOSSIL FUELS

---

Conducting a detailed re-evaluation

# Re-evaluating fossil fuel divestment

- ¶ Anthropogenic climate change creates enormous uncertainties and risks for developing and developed economies alike, and has far reaching implications for food systems, biodiversity, political stability, financial markets, health and safety.
  
- ¶ Important to reconsider Duke's position on fossil fuel divestment considering Duke's commitment to climate leadership.
  
- ¶ ACIR's task is to evaluate efficacy and appropriateness of divestment as a response:
  - ¶ Growing popularity of investment strategies that favor pro-ESG and CSR-oriented investment
    - ¶ What does the scientific evidence say about the fiscal and environmental tradeoffs between risk and return?
  
  - ¶ The case for divestment from a financial economics standpoint
    - ¶ Is there empirical evidence that divestment alters corporate decision-making?
    - ¶ Does divestment tilt the investment landscape in favor of responsible environmental stewardship?

# Conflicting evidence on performance of pro-ESG stocks

## Edmans (2011)

- From 1980-2009, companies that scored higher on employee satisfaction surveys generated positive abnormal returns
- They “beat their benchmark” by around 3% per year.
- Although restricted to employee satisfaction, and not environmental stewardship, study is widely cited as evidence that firms embracing “multi-stakeholder” perspective outperform.
- Suggests something similar might hold for climate friendly stocks.

## Hong and Kacperczyk (2009)

- From 1962-2006, “sin” stocks outperformed comparable stocks in other industries
- Suggests that risk associated with sin stocks commands a premium in the market
- Study limited to alcohol, tobacco and gaming; fossil fuels were not part of analysis
- Nevertheless, points to the idea that “out-of-favor” stocks must generate a return premium over other stocks to offset investor distaste

## Incorporating values into an asset pricing framework

Can asset pricing models that are used to guide investment portfolio formation tell us about the risk/return tradeoffs associated with “green” investing?

Pastor, Stambaugh and Taylor (2021) “Sustainable investing in equilibrium,” *Journal of Financial Economics*.

- Suppose stocks can be divided into “green” and “brown” based on whether they generate favorable or unfavorable social externalities regarding climate
- Green stocks outperform in the short term as investors’ tastes shift toward green investing
- Green stocks earn lower returns over the long run
  - Investor taste—because these stocks are in favor, investors require a lower return to hold them
  - They hedge against climate risk

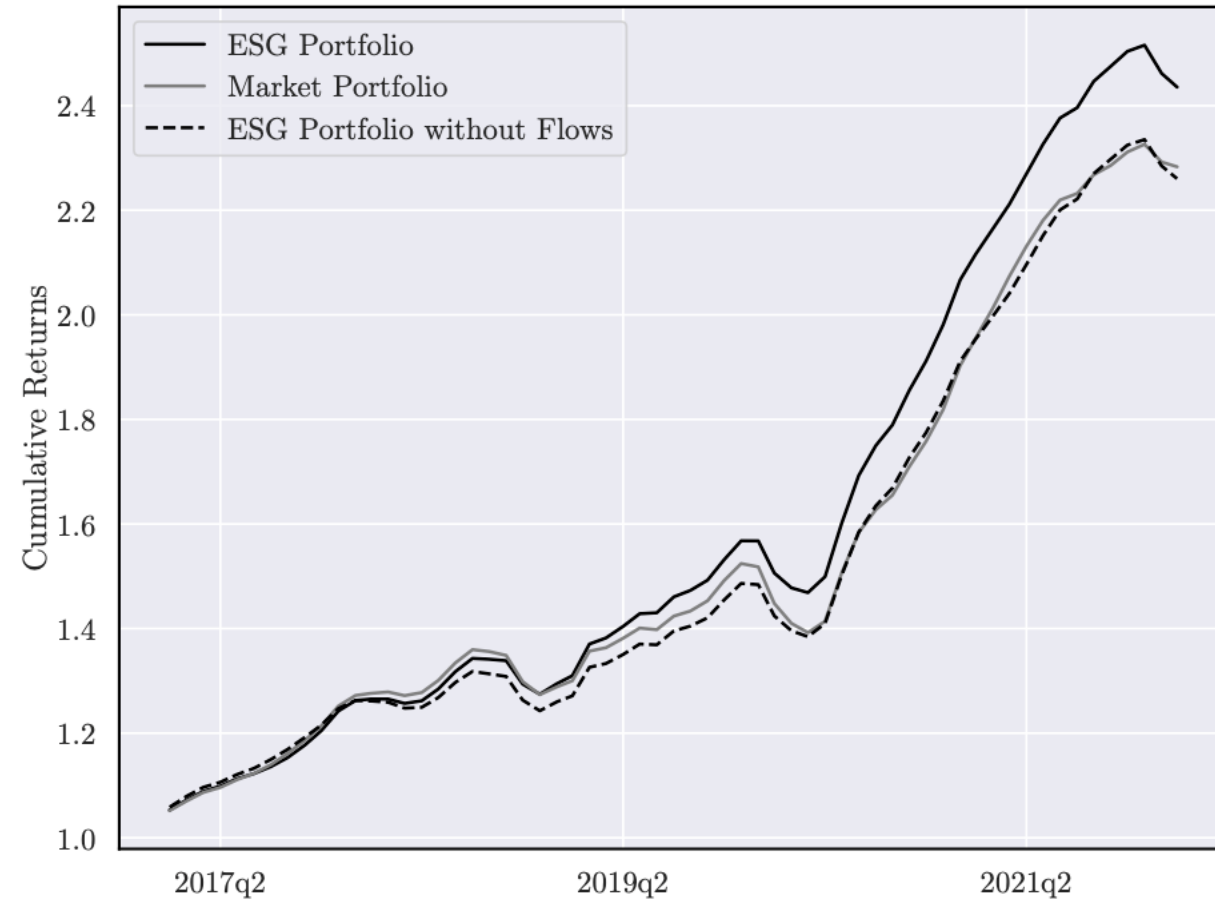


## Historical and Expected Returns to ESG Investing

Philippe van der Bek, “Flow-driven ESG Returns”

“The returns to sustainable investing are strongly driven by price pressure from flows towards sustainable funds, causing high realized returns that do not reflect high expected returns. In the absence of flows, sustainable funds would have underperformed the market from 2016 to 2021.”

Thus: the recent performance of ESG-tilted portfolios appears to come from short-term price pressure, not long-term expected returns differences. These stocks would have underperformed in the absence of investor tastes shifting towards pro-ESG investment.



# Summarizing market-level evidence

- ¶ Divestment can be seen as part of a larger trend towards favoring pro-ESG stocks and holding anti-ESG stocks out of favor.
- ¶ The evidence suggests that shifts in investor values impact returns in the aggregate.
- ¶ Important to contrast between:
  - ¶ **Resetting effect:** As tastes shift, this moves prices in a manner that helps in-favor stocks and hurts out-of-favor stocks
  - ¶ **Expected returns effect:** Once shift is over, out-of-favor stocks must generate higher performance *because* they are out-of-favor
- ¶ Open questions:
  - ¶ How large is the impact of divestment on stock performance?
    - ¶ Berk and van Binsbergen (2023): provide calibrations suggesting that price impact of divestment is small; key factor is the high correlation between environmentally friendly and unfriendly portfolios.
  - ¶ Does divestment cause brown firms to shrink and green firms to grow?
    - ¶ Hartzmark and Shue (2023) provide evidence that raising the cost of investment capital makes it more difficult for polluting firms to adopt green transition

# IF NOT DIVESTMENT, THEN WHAT?

---

How do we lead on climate in the face of mixed evidence on the impact of divestment?

# Divestment vs. Engagement

## ESG framework based on "Clearing the Air" by Dunn, Hernandez, and Palazzolo (2019)

### Responsible Asset Selection



### Responsible Ownership

Screening			ESG Integration	
<b>Norms-Based (static)</b>	<b>ESG (dynamic)</b>	<b>Thematic</b>	<b>Valuation</b>	<b>Risk</b>
e.g.:	- Environmental	e.g.:	- Environmental	- Environmental
- Coal	- Social	- Green	- Social	- Social
- Tobacco	- Governance	- Impact	- Governance	- Governance

Voting	Engagement	Activism	Direct Management
e.g.:	e.g.:	e.g.:	e.g.:
- ESG-focused	- Campaign	- Board seat	- Private equity
- ESG-aware	- Disclose	- Acquire shares	- Other illiquids

# Divestment vs. Engagement

## Flammer (2023)

- References previous studies suggesting that active sustainable investing strategies are more effective than passive in shaping the ESG practices of portfolio companies.
- Offers intuition:
  - When investors divest, they lose their seat at the table (i.e., the potential to shape their portfolio companies' business practices).
  - In contrast, investors' active engagement may serve as a more effective governance mechanism
- Studies growing importance of shareholder activism regarding:
  - ESG practices
  - Corporate short-termism
  - Shareholders' demand for greater disclosure of firms' climate risk exposure.
- Argues that shareholder activism can serve as an important private governance tool:
  - Improves ESG practices & their disclosure
  - Contributes to shareholder value.

## Pless (2023)

- Observes that “continuing to invest in dirty industries could drive green innovation conditional on investors being socially conscious and governing through ‘voice’”
- Provides caveats:
  - Depends on understanding which strategies foster green innovation
  - Commonly-used ESG indicators have limitations
- Shows that alternative environmental performance measures can improve:
  - investment, strategy, and management decision making
  - Policy design
- Evaluates whether large firms in 16 pollution-intensive sectors are on track for Paris Agreement emissions targets (“carbon performance”)
  - Finds no correlation between carbon performance and basic practices such as emissions disclosure
  - Finds positive correlation for five more explicit strategies:
    - Setting long term quantitative emissions targets
    - Having a third party verify emissions data
    - incorporating environmental performance into executive remuneration policies
    - supporting governmental climate change efforts
    - setting an internal price of carbon.

# Divestment vs. Engagement

¶ Recent empirical examination by Kahn, Matsusaka and Shu (2023):

¶ What happens to a firm's carbon emissions when investors with environmental priorities increase or decrease their direct stock ownership?

¶ Focus on state pension funds and use changing state level politics to proxy for shifts in environmental priorities

¶ Party controlling the fund is characterized as "green" or "not green"

¶ Observe impact of increases and decreases in equity component of fund as a result of portfolio rebalancing for portfolio allocation requirements across asset classes

¶ Provides data on changing equity investment because of asset re-allocation, *not* as a result of changing return expectations

¶ Result:

¶ When green investors increase their ownership, companies reduce their greenhouse gas emissions

¶ When green investors decrease their ownership (which means non-environmentally focused investors own more) no change occurs in emissions.

¶ Authors conclude:

¶ "Overall, our findings suggest that (a) corporate managers respond to the environmental preferences of their investors; (b) divestment in polluting companies may be counterproductive, leading to greater emissions; and (c) private markets may be able to address environmental challenges without explicit government regulation."

# CONCLUSION

---

## In sum

- ¶ In response to the Duke Climate Coalition and the Graduate and Professional Student Government Crisis Committee, ACIR is conducting a detailed re-evaluation of the question of divesting from fossil fuels
  
- ¶ An enormous amount of academic work in financial economics has been conducted over the last five years on a range of topics that bear directly on this question:
  - ¶ What drives the returns to sustainable investing
  - ¶ Measuring corporate social responsibility and environmental stewardship
  - ¶ Understanding how divestment and engagement impact corporate behavior
  
- ¶ ACIR has not yet reached a consensus recommendation
  
- ¶ Our recommendations will hinge in part on a deeper understanding of:
  - ¶ whether divestment increases the cost of investment capital for firms whose investments generate undesirable environmental consequences
  - ¶ whether increasing the cost of capital for such firms impacts their investment behavior in the appropriate manner
  - ¶ Conditions under which divestment constitutes the most effective form of leadership on climate issues



# References

- ¶ Flammer (2023) “ESG and Sustainable Investing,” NBER Reporter vol. 3
- ¶ Edmans (2011) “Does the stock market fully value intangibles? Employee satisfaction and equity prices,” Journal of Financial Economics
- ¶ Hong and Kacperczyk (2009) “The price of sin: the effects of social norms on markets”, Journal of Financial Economics
- ¶ Pastor, Stambaugh and Taylor (2021) “Sustainable investing in equilibrium,” Journal of Financial Economics.
- ¶ Pless (2023) “To starve or to stoke? Understanding whether divestment vs. investment can steer green innovation” NBER Entrepreneurship and Innovation Policy and the Economy, vol. 2
- ¶ Philippe van der Berk (2021) “Flow-driven ESG Returns” Swiss Finance Institute research paper
- ¶ Berk and van Binsbergen (2023) “The impact of impact investing” NBER Working Paper.
- ¶ Hartzmark and Shue (2023) “Counterproductive Sustainable Investing: The Impact Elasticity of Brown and Green Firms,” Yale School of Management Working Paper.
- ¶ UN PRI, “Top Academic Resources on Responsible Investment.” <https://www.unpri.org/research/top-academic-resources-on-responsible-investment/4417.article>
- ¶ AQR Alternative Thinking (2019) “Responsible Asset Selection: ESG in Portfolio Decisions”
- ¶ Dunn, Hernandez and Palazzolo (2020) “Clearing the Air: Responsible Investment” Journal of Portfolio Management.
- ¶ Kahn, Matsusaka and Shu (2023) “Divestment and Engagement: The Effect of Green Investors on Corporate Carbon Emissions” NBER Working Paper