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Public Pension Funds—the Next Battleground for Human Rights

As the fight in Oregon to divest from the Israeli manufacturer of Pegasus spyware shows, pension funds can use tools like proxy votes and responsible contractor policies to hold private equity firms accountable.

By Sravya Tadepalli

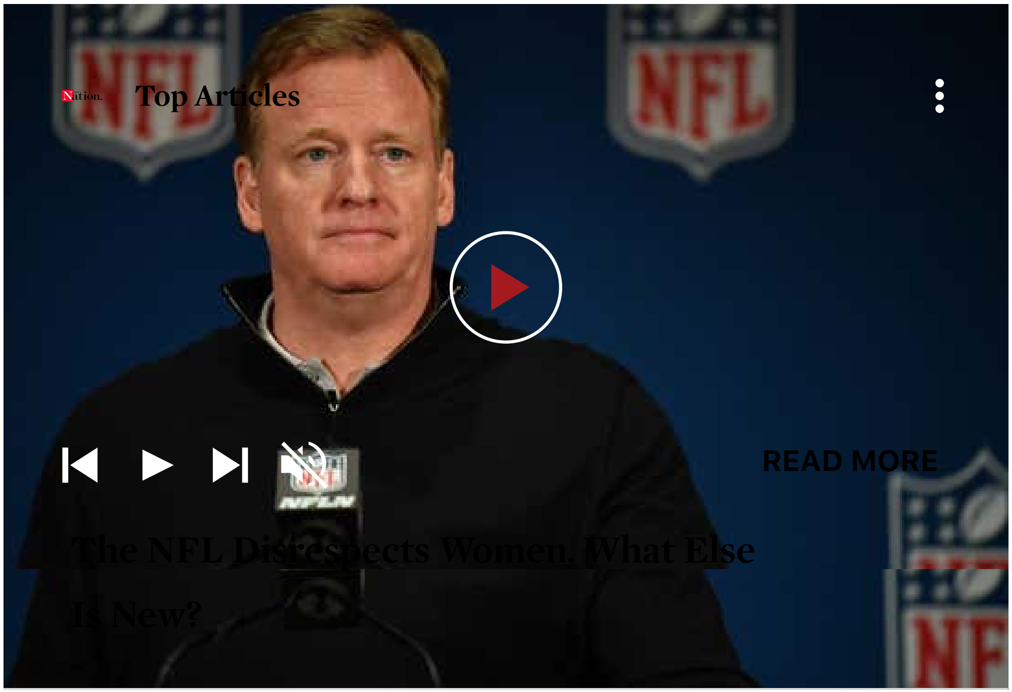
AUGUST 3, 2022

The NSO Group company logo is displayed on a wall of a building next to one of their branches in the southern Israeli Arava valley near Sapir community center on February 8, 2022. *(Photo by Menahem Kahana / AFP via Getty Images)*

In the past few months, officials in at least 25 states have issued orders to divest public pension funds from Russian assets or examine Russian investments. While these states should be applauded, it is troubling—given that Russia's seizure of Crimea dates back to 2014—that so many public pension funds were investing in Russia in the first place. At the end of 2021, state and local government pension funds held assets of approximately $5.85 trillion, and several of these pension funds have investments in entities complicit in gross human rights violations.

The Oregon public pension fund is the largest indirect investor in NSO Group, the Israeli company whose Pegasus spyware has been used by several authoritarian governments to surveil and arrest activists, journalists, and union members. The California State Teachers' Retirement System owns millions of shares in Hangzhou Hikvision Digital Technology Co., whose cameras have helped Xinjiang police track and detain Uyghurs in China. Eight US public pension funds are currently invested in KKR Asian Fund III, a private equity firm that has a large investment in Cue Group, another company that developed surveillance technology in coordination with the Chinese government.

Public pension funds are legally obligated to maximize returns on their investments to ensure that public-sector retirees receive consistent payments from the system they paid into as employees. In the midst of a perpetual crisis of underfunding, public pension funds will generally invest in the companies they see as giving the best possible financial returns regardless of potential human rights or environmental concerns. While some states have adopted requirements to account for environmental, social, and corporate governance (ESG) standards, most have not. Some GOP-led states are even banning pension plans from dealing with firms that adopt ESG practices.



Public pension funds are also increasingly investing in private equity, an industry with a reputation for high returns but low transparency. Pension managers are often limited partners in the firms that choose which companies to invest in, and this passive investment allows external fund managers to maximize returns however they want, while absolving investors of any moral responsibility for a company's behavior.

Implementing a human rights impact assessment for future investments is a simple step public pension funds can take to better align financial commitments with a fund's "social" goals. Investors can use these assessments to make value-based choices about where to invest and where they should try to use their leverage as shareholders to mitigate harm or provide remedy for abuses that have already occurred. Pension funds can use tools like proxy votes and responsible contractor policies to hold private equity firms accountable for incorporating human rights into their investment decisions.

“All businesses are responsible for respecting human rights under the UN Guiding Principles on Business and Human Rights and UN Social Development Goals,” said James Roth, cochair of the Minnesota Alliance for Sustainable Investment. “Addressing human rights risks is essential to financially responsible and sustainable investment strategies for state and local pension funds.”

Also, investors face reputational, financial, and legal risks when companies they have invested in gain attention for violating human rights. US investments in oil and gas companies have fueled a war that has caused millions of Ukrainians to flee and thousands of civilian deaths. In turn, the global sanctions in response to that war have caused the value of Russian assets to plummet. States that invested in Russia contributed to the harm in Eastern Europe while failing to reap any financial benefit. When the Oregon public pension fund invested in NSO Group, it contributed to the continuation of surveillance, while global disrepute and sanctions sunk the company’s value.

Public pension fund managers often argue that choosing investments in accordance with environmental and social factors politicizes decisions that should be based solely on the prospects for financial returns. But high-return investments and social responsibility are not mutually exclusive. They go hand in hand—and thinking about investment in the context of environmental and social risk factors can help pension funds improve their gains and curb their losses.

“It’s not politicizing [pension funds] to think that something in a portfolio that violates sensibilities is likely to come under scrutiny that will cause it to underperform,” said David Wood, the director of the Initiative for Responsible Investment at the Harvard Kennedy School. “You can’t just have some kind of apolitical financial evaluation.”

Public pension funds should also seriously consider divesting in clear cases where a company or country has committed gross abuses and where investor attempts to change behavior have failed. State governments have done this before, most notably divesting from South Africa in the 1980s and Sudan in the 2000s. While the financial impact of divestiture on human rights abroad is contested, the political pressure divestment and even just the threat of divestment brings—particularly when used in concert with other policy tools such as sanctions—can make it harder for entities to continue bad behavior, as in South Africa and with the Dakota Access Pipeline. In cases where the US federal government has sanctioned human rights violators, state governments are well-placed to make powerful choices to support these actions through divestment.

The NSO Group is one example of an entity ripe for state divestment. The company has suffered a considerable financial hit from US blacklisting and reputational damage from public scrutiny over use of its Pegasus spyware by authoritarian governments. The Oregon public pension fund is the largest investor in the private equity fund that holds the majority stake in NSO. While the Oregon state treasurer and investment council has argued that the treasury must make decisions based solely on performance and not "political or personal" reasons, Oregon has chosen to divest from Russian investments, a political decision that might lower the value of its assets. Still, divestment from Russia and NSO would not be enough to negatively affect returns,

A large number of labor organizations, representing thousands of public sector workers, including the Oregon chapter of the AFL-CIO, the American Federation of State, County, and Municipal Employees, and the Oregon Education Association, have passed resolutions supporting divestment from NSO as long as the retirement system remains stable. If legislators are willing to supplant divestment-related losses with other funding sources, the state will meet its fiduciary responsibility to retirees while taking a stand against atrocities.

American workers care about human rights and want to take action to stand in solidarity with workers abroad facing the brunt of oppression. While making human rights an investment priority will not stop countries from going to war or spying on civilians, it reduces our complicity and lets us stand shoulder to shoulder with people fighting authoritarianism abroad.

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COMMENT (1)