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Does Terror-Free Investing Help Stop Terrorism?

One of the latest investment trends gaining momentum is the concept of terror-free investing. By choosing to divest in or avoid buying the stock of companies that do business with or in countries that are listed by the U.S. government as state sponsors of terrorism (including Cuba, Iran, North Korea, Sudan, and Syria), shareowners are trying to use their power to exert influence over the management of corporations in an effort to stop the company from doing business in these countries—the goal of these actions being, in effect, to hinder the funding of terrorism. Professional investment advisors to large pension funds are carving out new terrorism guidelines for the funds to follow. And a number of states have passed statutes that require public pension funds to divest from companies having business ties to one or more of these nations, with lobbyists targeting additional state legislatures to pass similar legislation.

An analysis by the National Conference of State Legislatures shows that 16 states had enacted legislation dealing with state divestment by the middle of 2007. All of these laws were the result of growing concerns over the situation in Darfur. The earliest passage of terrorism divestment legislation occurred in Illinois in June 2005. The Illinois statute prohibited the State Treasurer from depositing any funds or transacting any business with any financial institutions doing business with Sudan and barred a retirement system fiduciary from transacting business with any company that engages in activities in Sudan.

Later in 2005, California, Oregon, and New Jersey passed similar divestment laws. Maine and Connecticut's divestment laws were enacted in 2006, with the remaining 11 states passing laws in the first half of 2007. At the time this column was written, 19 additional states had passed or were in the process of passing terrorism divestment legislation. Three states—Missouri, New York, and Ohio—included divestment from Iran as well as from Sudan. Missouri, in fact, requires its public retirement systems to divest all public funds in companies that have a direct financial relationship with all the countries designated by the U.S. Department of State.

But these legislative acts have run into a judicial roadblock. On February 23, 2007, the U.S. District Court for the Northern District of Illinois, Eastern Division, granted the National Foreign Trade Council a permanent injunction barring enforcement of the Illinois Sudan Act. In its ruling, the court noted, "The Illinois legislature acted with laudable motives, but the Act violates federal constitutional provisions that preclude the states from taking actions that interfere with the federal government's authority over foreign affairs and commerce with foreign countries."

In another initiative to help investors identify whether a company has ties to terror-linked countries and the nature of such ties, the Securities & Exchange Commission (SEC) launched a Web tool on June 25, 2007, which took information directly from each company's

10-K annual report. It received more than 150,000 hits in three weeks. The tool was temporarily deactivated July 20 because of criticism that it didn't reflect real-time efforts by public companies to deal with these issues. Noting that the tool attracted "exceptional traffic," the SEC is considering whether formal rule making will be necessary to establish rules, in the form of a public Concept Release, requiring new disclosures that help investors learn about the issue of terrorism.

Notwithstanding constitutional impediments for public investment funds to affect the behavior of foreign governments, certain questions must be asked in regard to terror-free investing: Is terrorism an appropriate addition to the list of issues with which pension fund or mutual fund investors, as well as direct shareowners, should be concerned? Can capital markets really advance the war on terror by trying to dry up some of the private investment flow to nations like Iran?

I believe the answer is a resounding NO! There's no question that responsible share ownership requires investors to encourage the corporations they invest in to practice good citizenship and consider the needs of all stakeholders—and not just those of its shareholders. Dialogue should take place with corporate management to achieve these goals. Divestment should only be a last resort. That state legislatures are becoming more aware of the extent of the global reach of companies in which public funds are invested is certainly a positive development.

Terror divestment, however, isn't trying to influence a company to change its own behavior; rather, it tries to use the company as a lever to change the behavior of a foreign government. It just isn't realistic to expect that divestment by U.S. pension and mutual funds of their stake in Total, S.A., a French oil company, for example, would enable Total to successfully persuade the government of France to influence the terrorist actions of the government of Iran.

Based on market capitalization, Total, S.A. is the world's fourth-largest petroleum exploration, refining, and distribution corporation. Its production in Iran and Syria appears to be declining, but it is still significant to the success of the company. The financial consequences of abandoning its considerable investment in Iran and Syria would be disastrous—to the company and its shareholders. Thus, in answer to the question "Is terrorism an issue where the shareowners of a public corporation can have much influence?" I'm not sure such attempts would be successful in a situation such as this.

Issues selected for shareowner activism should consider three rules of success. The first rule is to clearly outline the objective of the initiative. When Roger Robinson, president and CEO of Conflict Securities Advisory Group, a group formed to develop terror-free investment products, says they will "empower average Americans who have not found a way to join the war on terror and have not been able to find any 'voice' in terms of nonmilitary options," it isn't clear at all what he has in mind

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or what effect this "voice" is expected to have.

The second rule is to ascertain whether the goal will be achieved if the initiative is successful. It seems highly doubtful that shareholders petitioning the board of directors or even total divestment from any corporation doing business in Iran will have any effect on the attitude of the Iranian government toward the U.S. or its citizens or its terrorism activities. This is true for both private and public retirement and mutual funds.

The third rule is to concentrate shareowner activist efforts on the most important issues in which they can be successful. Good governance requires shareowners to actively monitor the actions of the corporations in which they directly or indirectly have an investment. Social issues of employee relations, community, diversity, suppliers, and the environment directly influence a corporation's daily operations. These are issues that management and the board of directors can control and that shareowners should be able to influence.

The benefit of hindsight shows that since 2005 the divestment statutes involving companies involved with Sudan don't appear to have solved or even influenced the problems in Darfur, and the government of Iran appears to be even more intransigent about terrorism and less subject to influence by outsiders.

Corporations can be expected to respond to only a limited number of issues. Shareholders' efforts should be concentrated on the most important issues: those that have a clear objective and where a successful initiative results in the goal being achieved.

BP Promises No Increased Pollution of Lake Michigan

In an August 23, 2007, press release, BP backed down from its plan to use its newly allowable Indiana permit to dump more ammonia and "sludge" solids into Lake Michigan (see "Is BP an Acronym for 'Big Polluter?'" September 2007). The company declined to make the pledge legally binding, however, further tainting its reputation for environmental concern. ■

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