William Michael Cunningham
Economist and Social Investing Advisor
April 22, 2015

Elias Koufou
DWP Consultation Coordinator
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London
SW1H 9NA

Via Email: elias.koufou@dwp.gsi.gov.uk

Re: Consultation on Changes to Investment Regulations

Dear Mr. Koufou:

We understand that "the Government (of the United Kingdom) wants to ensure that trustees of pension schemes understand the extent of their investment powers and duties, and that the law supports them in meeting these."

While not a citizen of the UK, I believe I have expertise borne of education and experience that may be helpful. Further, we respectfully remind the Department for Work and Pensions and the Law Commission that *"All men are caught in an inescapable network of mutuality, tied in a single garment of destiny. Whatever affects one directly, affects all indirectly."* This is certainly true with respect to the subject matter at issue here.

These comments, submitted by William Michael Cunningham and Creative Investment Research, Inc., reference certain information and text from the response authored by the Network for Sustainable Financial Markets (NSFM). I do not speak for this group. I am, however, a NSFM Participant.

Summary answers to Consultation questions

Question 1. How could regulation 2(3)(b) of the Investment Regulations be amended so that it more clearly reflects the distinction between financial and non-financial factors?

According to the Public Consultation document, "Regulation 2(3) of the Investment Regulations requires (a pension scheme have) a Statement of Investment Principles to cover amongst other things 'the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of Investments'".

This seems entirely reasonable and there are limits to the ability of any regulator, using the English language as I know it, to make regulations clearer, short of listing each and every financial and non-financial factor. While this is impractical, as we discuss below, a generalized framework for outlining these factors *(Effective Investing)* may be helpful.

Question 2 - Do you agree that amending the Investment Regulations to require trustees to comply with the current requirements in the Stewardship Code or explain why they have not done so, is the most appropriate way to implement the Law Commission's recommendation? Yes.

If not, what approach would be more appropriate to encourage trustees to consider their approach to stewardship? N/A.

Question 3 - What steps would trustees need to take to comply with any amendments to the Investment Regulations, as set out in Chapter 2? What, if any, costs would be involved in meeting any new requirements?

Prior to the creation and adoption of high speed, massively networked public computer systems, "complying with..amendments to the Investment Regulations, as set out in Chapter 2" providing a method for revealing "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of Investments" was a costly proposition, unfair to public companies and corporate management. This is, however, no longer the case.

Many investors and shareholders currently use websites like www.google.com/finance/ to obtain corporate information. Internet technology was specifically designed for this type of problem. We have addressed these issues in detail over the years.

I appreciate the on-going ESG investing activities of the UK Government and understand that the "Government (of the United Kingdom) is keen to encourage the growth of new markets that allow investments to be made on the basis of both financial and social returns. The Cabinet Office is currently working on a number of initiatives designed to grow the supply of and the demand for social investments and create an enabling environment for investors and enterprises. We know that trustees in a number of pension schemes have been seeking to understand to what extent such investments may be consistent with their duties to the scheme."

I am in general agreement with the recommendations of the Network for Sustainable Financial Markets (NSFM) regarding how active ownership can be consistent with trustee's duties to the pension scheme. My comments cite proprietary research we have conducted over the years, however, and references our activities in support of strong marketplace ethics.

Background

William Michael Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services.

Creative Investment Research, Incorporated is an independent investment research and management firm, founded in 1989. For clients, our services save millions, if not billions: on December 22, 2003 and February 6, 2006, we warned the S.E.C. and other regulators that statistical models using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure (see below). Clients who heeded our warning adjusted their investment portfolios in a manner that allowed them to escape much of the damage caused by the crisis. The firm was formerly in the pool of Corporate Governance Advisors and Diversity Investing Advisors to CalPERS.

Mr. Cunningham is a Global Member of the Internet Society (ISOC), a Public Member of the World Wide Web Consortium (W3C), and an Invited Expert Member in the eGovernment Group of the W3C. On November 16, 1995, he launched one of the first investment advisor websites at www.ari.net/cirm (now www.creativeinvest.com).

Track Record

On July 3, 1993, Mr. Cunningham wrote to US Securities and Exchange Commissioner (SEC) Mary Schapiro to notify the Commission about a specific investing scam, the "Nigerian letter scam." A timely warning was not issued to the investing public, members of the public were damaged, and the SEC launched retaliatory regulatory actions *against* Mr. Cunningham.

He designed the first mortgage security backed by home mortgage loans to low and moderate income persons and originated by minority-owned institutions. (See: Security Backed Exclusively by Minority Loans, *The American Banker Newspaper*. Friday, December 2, 1994.)

Mr. Cunningham opposed the application, approved by the Federal Reserve Board on September 23, 1998, by Travelers Group Inc., New York, New York, to become a bank holding company (http://www.creativeinvest.com/FRBtrav.pdf). In October 1998, in a petition to the United States Court of Appeals (Case Number 98-1459) concerning the Travelers Group Inc./Citicorp merger (http://www.creativeinvest.com/USAppealsCourt.pdf), Mr. Cunningham cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions.

From October 1999 to March 2002, Mr. Cunningham was responsible for proxy voting activity for the Board of Pensions of the Evangelical Lutheran Church in America. In 2001, he voted on 1395 issues impacting 401 companies. In 2000, he voted on 1903 issues impacting 422 companies. We managed fund efforts and corporate governance matters related to Talisman Energy and its' operations in the Sudan. We researched the issue, contacting various groups involved in the process. For the fund, our efforts also included researching fund policies and procedures. Our collaborative, risk controlled strategy helped lead the firm out of the Sudan. On February 1, 2000, Mr. Cunningham wrote to the office of U.S. Senator Samuel Brownback (http://www.creativeinvest.com/SudanSenateLtr.pdf) urging him to encourage pension funds to divest from the Sudan.

On June 15, 2000, Mr. Cunningham testified before the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE) of the U.S. House of Representatives and suggested that GSE Fannie Mae and Freddie Mac be subject to a *Social Audit.* A social audit is an examination of the performance of an enterprise relative to certain social return objectives. It includes a review of ethical practices. Had the GSE been subject to this audit, certain flaws in their operation, including ethical shortcomings, would have been revealed earlier, **prior to the GSEs entering bankruptcy. (See: http://www.creativeinvest.com/fnma/fnmapr16.html)**

In 2001, Mr. Cunningham participated in the first wide scale home mortgage loan modification project. The Minneapolis-based effort helped 50 families victimized by predatory lending practices. See: Property Flipping Remediation Yields Investment-grade Security. (http://www.socialfunds.com/news/article.cgi/article682.html)

On December 22, 2003, we warned US regulators that statistical models created by the firm using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure See Page 6. (http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf)

In 2005, Mr. Cunningham served as an expert witness in a case that sought to hold Credit Suisse First Boston, Fairbanks/SPS, Moody's and Standard and Poor's, US National Bank Association, and other parties legally responsible for supporting and facilitating fraudulent subprime lending market activities. ***Had this single case been successful, we believe the credit crisis would have been less severe.***

On December 22, 2005, he issued a strongly worded warning that system-wide economic and market failure was a growing possibility in a meeting at the SEC with Ms. Elaine M. Hartmann of the Division of Market Regulation.

On February 6, 2006, we again warned regulators that statistical models we created using the proprietary Fully Adjusted Return® Methodology confirmed that system-wide economic and market failure was a growing possibility. We stated that: *Without meaningful reform there is a small, but significant and growing, risk that our (market) system will simply cease functioning.* This is, of course, exactly what happened. See pages 2 and 8.
http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf

We created the first consistent methodology for measuring the social impact of banking activities, which we discussed on August 3, 2006 at a seminar sponsored by Fannie Mae and the Federal Reserve: http://www.knowledgeplex.org/showdoc.html?id=188307

On June 18, 2009, he testified before the House Ways and Means Select Revenue Measures Subcommittee at a joint hearing with the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee: Testimony on the New Markets Tax Credit Program. He suggested ways to improve the program. See:
http://www.novoco.com/new_markets/resource_files/advocacy/cunningham_testimony_061809.pdf

On Wednesday, January 13, 2010 and Monday, June 14, 2010, Mr. Cunningham wrote to Mr. Phil Angelides, Chairman, Financial Crisis Inquiry Commission, to submit testimony and comments to the Commission. In addition, he noted that he was “disappointed that FCIC has not sought out or recognized a broader set of opinions and viewpoints and are further disappointed by FCIC’s lack of ethnic diversity at both the Board and Staff level.”

On July 19, 2010, Mr. Cunningham testified on behalf of the public at the Joint Interagency Public CRA hearings: “The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency jointly held public hearings on modernizing the regulations that implement the Community Reinvestment Act (CRA).” See: http://www.fdic.gov/CRAhearings/Individual_Presentations.pdf

On August 13, 2012, Mr. Cunningham filed a "Friend of the Court" brief in United States Securities & Exchange Commission vs. Citigroup Global Markets Inc. (Second Circuit Court of Appeals Case Number 11-5227). The case concerned the rejection, by a Federal Judge, of a settlement agreed to by the United States Securities & Exchange Commission (SEC) and Citigroup Global Markets Inc. (Citigroup), the latter accused of securities fraud. http://www.prlog.org/11948760-william-michael-cunningham-files-revised-brief-in-sec-vs-citigroup-2nd-cir-ct-of-ap.html

On December 9, 2013, Mr. Cunningham filed a "Friend of the Court" brief in the United States District Court, Central District of California in a case concerning an action that the U.S. Department of Justice, acting on behalf of the United States of America (Plaintiff), brought against McGraw-Hill Companies, Inc., and Standard & Poor’s Financial Services LLC, et. al., (Defendants) under 12 U.S.C. § 1833a; 18 U.S.C. §§ 1341, 1343 & 1344. Our comments led to a significant change in enforcement strategy, including the first ever, albeit temporary, rating firm suspension. See: http://www.prlog.org/12256590-william-michael-cunningham-files-amicus-brief-in-us-vs-sp-us-district-court-central-district-ca.html

On February 3, 2015, we commented on an effort by Apple Computer, one of the largest holdings in the fund, to utilize women and minority-owned brokerage firms:
http://www.usatoday.com/story/tech/2015/02/03/apple-debt-offering-minority-firms-jesse-jackson-diversity-silicon-valley/22805673/

Detailed comments on the proposal

We agree with NSFM that "We see the need for better balance between short- and long-term investing as providing the foundation for responses to all three of the consultation questions. "

This is particularly important. As the market value of environmental, social and governance factors continues to grow, companies and investment managers will engage in fraudulent practices related to these factors. These practices will range from simple falsification of environmental, social and governance records to more sophisticated, but no less fraudulent methods related to environmental, social and governance ratings. We note that unethical practices have flourished in capital market institutions, propelling ethical standards of behavior downward. Thus, unethical behavior has become standard in the financial services marketplace. We incorporate the following comments by reference:

Comments on Proposed Rule:
Executive Compensation and Related Party Disclosure
[Release Nos. 33-8655; 34-53185; IC-27218; File No. S7-03-06]
http://www.sec.gov/rules/proposed/s70306/wcunningham6601.pdf

Comments on Proposed Rule:
Internet Availability of Proxy Materials
[Release Nos. 34-52926; IC-27182; File No. S7-10-05]
http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf

Comments on Proposed Rule:
Security Holder Director Nominations
[Release Nos. 34-48626; IC-26206; File No. S7-19-03]
http://www.sec.gov/rules/proposed/s71903/wmccir122203.pdf

Comments on Proposed Rule:
Definition of Nationally Recognized Statistical Rating Organization
[Release Nos. 33-8570; 34-51572; IC-26834; File No. S7-04-05]
http://www.sec.gov/rules/proposed/s70405/wcunningham9442.pdf

Comments on Proposed Rule:
Securities Offering Reform
[RELEASE NOS. 33-8501; 34-50624; IC-26649 International Series Release No. 1282 File No. S7-38-04]
http://www.sec.gov/rules/proposed/s73804/cunningham013105.pdf

Effective Investing

Our research supports the contention that there is no contradiction between financial goals and an objective of influencing environmental, social and governance factors.

We coined the term "*Effective Investing*" to reflect a style of investing that minimizes costs while maximizing financial AND social return. There are only two ways to accomplish this, stock investing and bond investing. Pension scheme funds should go toward participants' future, not, to an unreasonable degree, to a broker or investment management/mutual fund company fees.

Pension scheme money should be safe and effective investing means being able to sleep at night. This means managing and minimizing risk. There are a limited number of ways to accomplish this, too. Risk is a feature of investing: it is how you get to return. Still, pension schemes can rationally minimize risk by taking a few constructive steps.

In the bond or fixed income world, investing in Government securities is the only way to accomplish this. In the stock market, the strategy is the polar opposite and can be summarized as "don't put all of your eggs in one basket." This means investing in an Index Fund. But, as we have seen with the LIBOR scandal, even this style of stock investing is not free from ethical risk imposed by brokers and other financial institutions.

Finally, *effective investing* means being at peace. This means not investing in companies that are, or that may do "bad" things. This means looking for and investing in responsible companies.

In summary, *Effective Investing*:

Minimizes fees.
Minimizes risk.
Maximizes potential financial AND social return.

See: http://twisri.blogspot.com/2015/04/effective-investing-how-to-minimize.html

Environmental Issues and Stock Returns

Using data from both old and new sources, Creative Investment Research, Inc. explored and quantified the impact environmental factors have on stock prices using several statistical techniques.

Our research is structured into two parts. In the first, we specify three standard market models and test the hypothesis that environmental factors do, in fact, impact equity prices. In the second part, we examine the impact of a major environmental incident on stock prices, using new data sources and with the assistance of the equity market models specified in phase one.

We created three portfolios based on a ranking of environmental impact forecasts and preparations, as outlined below. The first portfolio returned -21.974% from March 10, 2011 to August 10, 2011. This portfolio consisted of firms with an environmental impact forecast who were well prepared for an environmental incident. The second portfolio consisted of firms with an environmental impact forecast who were marginally prepared for an environmental incident. Returns were +30.686% from March 10, 2011 to August 10, 2011. The final portfolio consisted of firms without an environmental impact forecast who were not prepared for an environmental incident. Returns were -24.036% from March 10, 2011 to August 10, 2011.

Our analysis strongly suggests that investors and publicly traded companies must recognize the impact environmental incidents and issues have on a given firm's ability to use company assets and therefore generate revenue and profits.

We look forward to reviewing your continuing efforts to carry out your mission. We appreciate the time and effort devoted to this task. Thank you for your leadership. Please contact me with any questions or comments.

Sincerely,

/William Michael Cunningham/

William Michael Cunningham
Social Investing Adviser for William Michael Cunningham and Creative Investment Research, Inc.