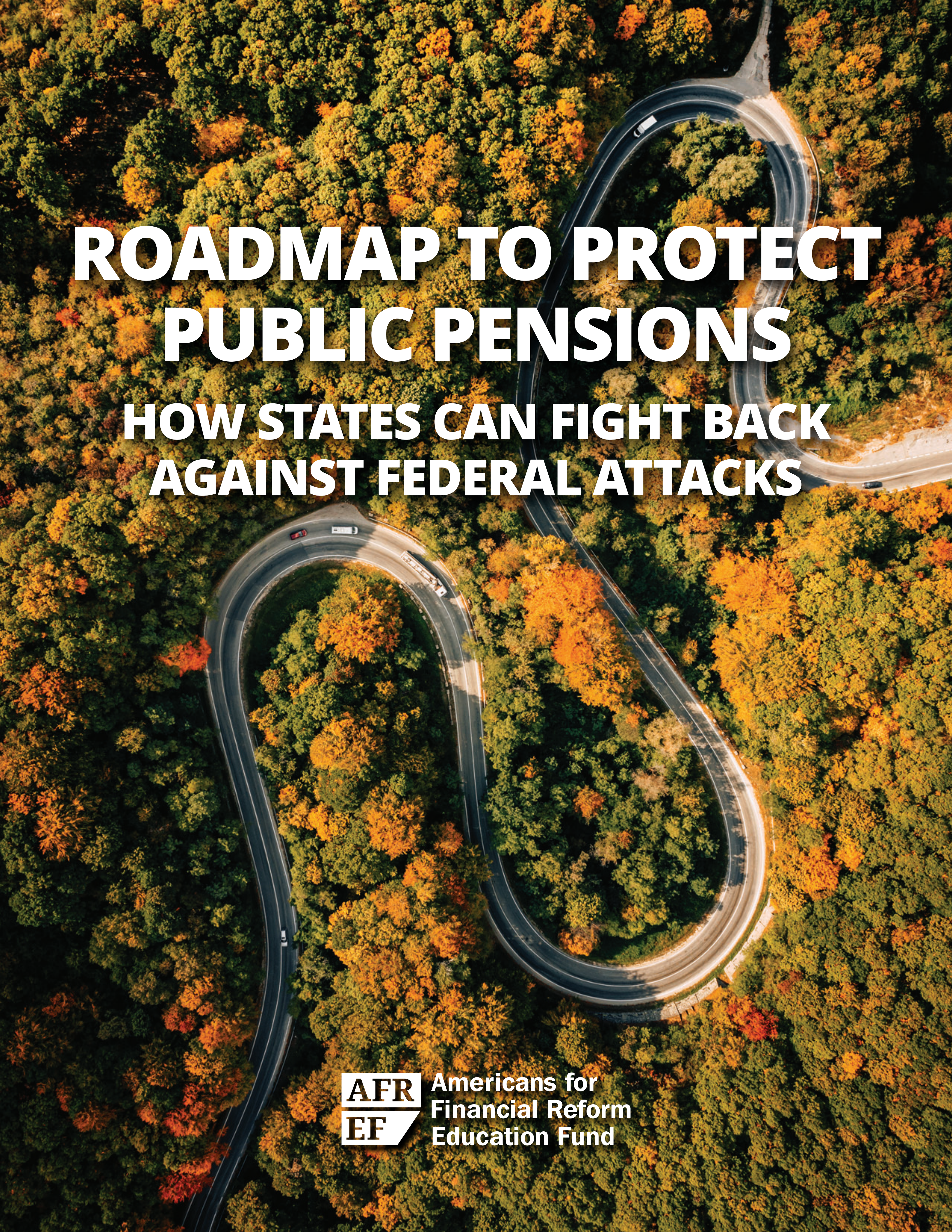
ROADMAP TO PROTECT PUBLIC PENSIONS

HOW STATES CAN FIGHT BACK AGAINST FEDERAL ATTACKS



Americans for Financial Reform Education Fund

About

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Americans for Financial Reform Education Fund (AFREF) is a nonpartisan, nonprofit coalition of more than 200 civil rights, community-based, consumer, labor, business, investor, faith-based and civic groups, along with individual experts. Our mission is to eliminate inequity and systemic racism in the financial system in service of a just and sustainable economy. Follow AFREF at www.ourfinancialsecurity.org and on Twitter @RealBankReform.

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Executive Summary

Public pensions are under attack.[†] Proponents of austerity want to shrink government and government spending, undermine the retirement security of hard-working public employees, and make public sector jobs less attractive. Private financial companies and their ideological allies want to privatize and profit from what should be a public good: a dignified retirement. And in the last few years, there have been escalating attacks targeting not just the availability of pension benefits, but also how pensions invest workers' retirement savings.

These attacks on how pensions invest workers' retirement savings have been escalating in recent years and are expected to be further amplified under the incoming administration and Republican Congress, but state and local stakeholders — public officials, pension trustees, and workers — can fight back to defend the retirement security of public retirees and workers and invest in a just and sustainable future for their communities.

Pensions provide critical retirement security for current and future retirees from state and local government and these retirement payments are vital to the United States economy. Millions of workers, their families, and communities depend on public state and local pensions, and their spending supports jobs and local economies where retirees live.[1] These economic impacts have ripple effects across the country.[2] About 12 million retirees benefit from over 5,000 state and local public sector pension systems, with $334 billion distributed in benefits annually.[3] When these public sector retirees spend their hard-earned pension benefits, the economic activity supports 3.7 million jobs, adds over $400 billion to the gross domestic product, generates $710 billion in economic output, and puts over $86 billion into federal, state, and local tax coffers.[4] An additional 14.9 million workers are currently paying into these systems, which have about $5.3 trillion in assets.[5]

The current wave of attacks against public pensions has been part of a broader "anti-ESG" campaign, an unpopular campaign backed by fossil fuel and other corporate interests that aims to slow the clean energy transition, curtail labor power, and reverse corporate progress on racial justice, workplace diversity, and worker protections.[6] (ESG stands for "environmental, social, and governance," which are factors investors and companies use to assess risks and opportunities.) Because public pensions are large pools of workers' capital with the power to shape our financial system and broader economy through their investment decisions, the "anti-ESG" campaign has sought to curtail public pensions' ability to make investment decisions that benefit workers whose deferred wages make up these funds. State and local officials as well as pension trustees are the stewards of these retirement savings assets and have the authority and responsibility to oversee the investments to pay out retirement benefits but also to direct these investments to benefit retirees, current workers, and their communities.

Pensions rely to a significant extent on their investment returns, and state and local stakeholders must fight back against these anti-ESG attacks on the right and ability for pensions to be vigilant about their investment decisions and be thoughtful about how these investments impact and shape financial markets. This will help protect and grow pension funds, which are ultimately the deferred wages of working people.

The coming year will be critical. State and local pensions face increased threats from the incoming presidential administration and new Congress that are expected to promote misguided pension-related

† This report focuses on state and local public pensions. There are over $10 trillion in assets in private pensions and retirement accounts, which are governed by laws and regulations different from those that govern public pensions. There are both similarities and differences in the tools available to protect these important worker assets. For a breakdown of total assets in U.S. pension plans and retirement accounts, see Topoleski, John J., Elizabeth A. Myers, and John H. Gorman. "U.S. Retirement Assets: Data in Brief." Congressional Review Service. September 20, 2023.

policies, financial deregulation, and actions targeting large asset managers that manage pension money. The anticipated lines of attack have been foreshadowed by the legislative efforts in the House of Representatives in the prior Congress, the Project 2025 regulatory and legislative blueprint for the incoming administration, and past and ongoing state-level legislative and regulatory actions.

State governments can and must withstand these attacks and build robust regulatory and statutory architecture to safeguard public pensions and the ability to determine how and where those pensions are invested to benefit retirees and local communities. State and local pensions are governed by state law, which puts many tools at states' disposal to both protect pensions from federal attacks and wrestle power over workers' money away from Wall Street and corporate interests and towards workers, their families, and communities. State legislatures, governors (who serve as or appoint pension fund trustees in some states), state attorneys general, state and local treasurers and comptrollers, pension fund trustees, and pension fund staff all have important roles to play.

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This paper describes three central anti-ESG threats and the strategies state and local stakeholders can pursue to protect public pensions. The first section describes the expected federal efforts by the incoming Congress and administration to undermine the ability of pensions to consider environmental and social factors in investment decision-making. Federal actors will attempt to create legal uncertainty about when — if ever — pensions can take environmental and social factors into account when pensions make investment decisions, limit the ability of pensions to consider benefits for participants in addition to financial returns, silence pensions' shareholder voice, and create uncertainty about when — if ever — pensions can take diversity, equity, and inclusion factors into account. State stakeholders can respond by providing legal certainty that pensions can consider environmental and social factors, providing greater flexibility in considering non-financial benefits, reclaiming pensions' shareholder voice, and codifying diversity, equity, and inclusion values and goals in state law or regulation.

Second, Congress and the administration are expected to attempt to deregulate the financial sector. Pensions are financial entities invested across the public and private markets that would be negatively affected by deregulatory efforts that would result in less and less reliable disclosures from the public markets and significantly increased risks in the private markets. State actors can respond by mandating reliable company disclosures and making demands of the private fund advisers that work with their pensions.

Third, federal and state efforts to impose anti-ESG directives on large asset managers will create risks for public pensions. These large asset managers, some of which count public pensions as their clients, have outsized influence over how public companies make decisions and are increasingly using their shareholder clout to rubber-stamp risky, short-term-focused corporate practices due to pressure from the anti-ESG campaign. Threats to pensions include cooptation by asset managers of pensions' shareholder voice to endorse short-sighted, risky corporate practices and increased risks to our financial system and broader economy. State stakeholders can reclaim pensions' shareholder voice over public companies and use their client power over asset managers to decrease risks to our financial system and broader economy.

Protecting Pensions from Misguided Anti-ESG Pension-Related Policies and Expanding Their Ability to Make Investment Decisions that Benefit Workers

Congress passed the Employee Retirement Income Security Act (ERISA) in 1974 to protect workers' private sector retirement and health plans. Even though ERISA is a federal law that does not apply to state and local public pensions, the Department of Labor (DOL) regulations as well as caselaw interpreting ERISA have historically influenced how states implement and interpret state pension codes.[7] Many state codes mirror or have similar language as ERISA and some states have limited legal cases interpreting state law at their disposal.[8] Additionally, pension attorneys regularly cite ERISA language as the benchmark for pension best practices and advise their clients to follow ERISA regardless of whether the particular state has the same or similar language.[9]

However, this is likely changing for two reasons. First, the Department of Labor regulations have shifted as different presidential administrations have revised and re-revised federal interpretations of ERISA. These regulations will almost certainly change again during the incoming administration. The most recent Department of Labor regulations on these issues were finalized in late 2022 under the Biden administration in a rule titled "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights."[10] This rule was promulgated after a variety of stakeholders — including those overseeing pension investments — expressed the need for rules to clarify the ability of those managing pensions to make investment decisions that better serve their beneficiaries' interests. This rule replaced two 2020 rules finalized during the Trump administration.[11] The back and forth centered around shaping the extent to which pension managers can make investment decisions that benefit workers whose money is entrusted to them. The Biden-era rule expanded this ability and the Trump-era rules curtailed it.

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At the beginning of 2025, the 2022 rule is in effect, though it is mired in litigation. After the rule was finalized, 27 Republican attorneys general joined a letter urging Congress to nullify the Biden rule[12] and 25 filed a lawsuit challenging its implementation.[13] The new administration and new Congress in 2025 are expected to attempt to revisit and overturn the Biden rule. Project 2025 recommends that the Department of Labor revert back to the 2020 Trump-era rules[14] and the House of Representatives passed bills in September 2024 that would have legislated the reinstatement of the two Trump rules.[15]

Second, states are increasingly passing their own laws to impose versions of the Trump-era rules on public pensions. As of the beginning of 2025, 17 states had passed 19 anti-ESG laws directly targeting pensions, many of which incorporate language from the 2020 Trump-era rules.[16] Additionally, the state attorneys general of Kentucky,[17] Indiana,[18] and Virginia[19] have issued formal legal guidance or opinions interpreting their state laws to align with anti-ESG principles.[20]Notably, a pensioner successfully challenged one of these laws in Oklahoma,[21] and a number of states' budget offices have found these types of laws would result in significant costs to pension funds.[22]

Threat: Creating legal uncertainty about when — if ever — pensions can take environmental and social factors into account

Environmental and social factors are relevant in evaluating investment risk and return and it is entirely appropriate — and in many cases necessary — for public pensions to consider these factors when making investment decisions. The Financial Stability Oversight Council, in its 2021 report on climate-related financial risk, found that physical risks like the "[i]ncreased frequency and severity of acute physical risk events such as hurricanes, wildfires, floods, and heatwaves . . . are expected to lead to increased economic and financial costs."[23] The Human Capital Management Coalition — comprised of 36 institutional investors representing over $10 trillion in assets[24] — has noted that "[t]here is broad consensus that human capital management is important to the bottom line, and a large body of empirical work has shown that skillful management of human capital is associated with better corporate performance, including better risk mitigation."[25]

But the anti-ESG campaign is aimed at preventing pensions from even considering environmental or social factors when making investment decisions. The 2020 Trump administration's DOL rules, a 2024 bill passed by the House of Representatives (but not the full Congress),[26] Project 2025,[27] and state anti-ESG laws have all targeted pensions' ability to make responsible investment decisions by seeking to create legal uncertainty over whether pensions can take these types of considerations into account.

These legislative and regulatory efforts aim to create an ill-defined and deeply flawed distinction between "pecuniary" factors that those managing pension investments can take into account and "non-pecuniary" factors they cannot. Many have criticized this language for creating significant uncertainty and confusion for those overseeing pension investments. Proponents of these policies appear to take the position that environmental and social factors are seldom, if ever, "pecuniary" or relevant to risk and return analysis, when the data shows these factors are often critical to risks and returns. Indeed, a coalition of 40 labor unions, investors, and advocacy organizations opposed a 2024 congressional bill which would have created such a distinction, pointing to the Trump-era rules that they noted "were widely criticized and have since been rescinded because they produced significant confusion about what fiduciaries are allowed to consider when making investment decisions, and had a chilling effect on the consideration of financially relevant information — thereby putting workers' retirement security at risk."[28]

This legal uncertainty has been increasingly replicated at the state level. In 2023 alone, 59 anti-ESG bills related to pensions were considered across the country,[29] most containing provisions that mirrored or directly copied model legislation targeting pensions, such as the State Pension Fiduciary Duty Act from the Heritage Foundation[30] and the State Government Employee Retirement Protection Act created by the American Legislative Exchange Council.[31] For example, Florida enacted a law that narrowly defined pecuniary factors, excluding non-financial goals unless

they materially affect financial risks or returns;[32] Montana's law prohibited any consideration of ESG factors unless they met strict material economic criteria;[33] North Dakota's law explicitly defined pecuniary factors as those tied directly to financial risk, while excluding ESG goals unless prudently assessed as economic risks;[34] and Indiana Attorney General Todd Rokita issued a legal opinion finding that investing "to further general environmental, social, or governance goals" violates state fiduciary duty law.[35] These new laws create significant challenges for fiduciaries who must navigate vague and contradictory definitions. Indeed, an analysis by three legal experts on state-level anti-ESG laws targeting pensions found that distinctions made by some state-level laws are unworkable because they are "so blurry that the bills are self-contradictory."[36]

Opportunity: Provide legal certainty that pensions can consider environmental and social factors

State legislatures, state officials, and state and local pensions can and should clarify that pensions have the authority to consider environmental and social factors when making investment decisions. The Biden Department of Labor rule created legal certainty that environmental and social factors can be taken into account when relevant to a risk and return analysis. This approach and language can be easily incorporated into state measures. States can clarify that their pension laws that are equivalent to ERISA allow pensions to take into account environmental and social factors. This can be done through legislation or through legal opinions issued by state attorneys general. Pensions can also codify their understanding of the state law that governs them in their investment policy statement.

These clarifications should include explicit references to both the impacts of environmental and social factors to individual investments and to a pension's portfolio as a whole. Due to their size and the range of financial and real-world assets they hold, pension funds are sometimes called "universal owners," meaning that their investments are so large and varied that their performance reflects the health of the economy as a whole, and not just a set of individual investments.[37] Therefore, the factors that either lift up or drag down the overall economy are as important to the health of the fund as factors that affect an individual investment or a particular industry.

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For example, the Financial Stability Oversight Council identified climate change as a financial stability risk in 2021 and called on financial regulators to take actions that "both promote the resilience of the financial system and help it support an orderly, economy-wide transition toward the goal of net-zero emissions."[38] Recent research estimates that climate-exacerbated flood risk (which is of course only one part of overall climate-exacerbated disaster risk) has created a $121–$237 billion bubble in residential real estate,[39] and these types of climate risks also apply to commercial real estate and other physical asset classes owned by pensions.

There is also mounting evidence that economic inequality poses financial stability threats of its own, due, in part, to the overextension of predatory and risky consumer debt, and can exacerbate other financial stability risks like those related to climate change.[40] Other compelling analyses identify racial inequity as posing a systemic risk[41] and demonstrate the role it plays in enabling and propagating financial instability.[42]

It is essential that pensions consider both environmental and social risks that affect individual investments and those that affect pensions' portfolio as a whole, especially because pensions owe a fiduciary duty to both retirees and new workers in their early twenties. That means that the long-term sustainability of their investments is significantly more important than short-term, quarterly returns.

Threat: Limiting the ability of pensions to consider benefits for participants in addition to financial returns

Pension investments can affect the real-life economic fortunes of workers and retirees in ways that go beyond the performance of those investments. The scale of pension investments can ameliorate economic burdens (through investments that generate collateral benefits) or exacerbate harms by bolstering sectors or companies that disadvantage customers or communities (like pharmaceutical price gouging or housing unaffordability). It is appropriate for pensions to consider the impact of their investments on the workers and retirees whose wages fund the pensions.

The first Trump administration's rule made it difficult, if not impossible, to consider benefits for participants in addition to financial returns to the funds by instituting a strict condition "that competing investments be economically indistinguishable before fiduciaries could turn to collateral factors to break a tie" and including a burdensome documentation requirement.[43] At the time it was proposed, the AFL-CIO warned the rule would "create unnecessary and burdensome regulations that will discourage fiduciaries from making prudent investments that generate collateral benefits for communities and economic growth for working people."[44] A bill passed by the House in 2024 featured similar language.[45] Project 2025 goes further, calling on the Department of Labor to "prohibit investing in ERISA plans on the basis of any factors that are unrelated to investor risks and returns."[46]

State-level anti-ESG laws mirror these restrictions, further eroding the ability of pensions to consider benefits for participants in addition to financial returns to the funds. For example, a Montana law explicitly prohibits fiduciaries from pursuing non-financial objectives altogether.[47] A Florida law narrowly defines fiduciary responsibilities to focus solely on pecuniary interests, excluding goals that align with community or worker benefits unless they directly impact financial returns.[48] Similarly, Kentucky Attorney General Daniel Cameron issued a formal opinion stating that "investment practices that introduce mixed motivations to investment decisions are inconsistent with Kentucky law."[49]

Turning a blind eye to benefits (and harms) beyond financial returns can result in workers' own money being weaponized against them. For example, a recent Americans for Financial Reform Education Fund & Georgetown University's Kalmanovitz Initiative for Labor and the Working Poor report highlighted that "[a]mong the most troubling aspects of the housing crisis is the extent to which workers' own capital is being used to make it worse" by making investments "that drive the hyperfinancialization of housing and help push prices up."[50] The report notes that this does not have to be the case: pensions can ameliorate the housing crisis faced by many pension beneficiaries by investing in affordable housing instead of exacerbating it by investing in private funds that drive up prices.[51] Laws or regulations that limit fiduciaries to financial returns to the funds alone, discourage investments that both deliver the financial returns needs of pensions and provide additional benefits.

Opportunity: Provide greater flexibility in considering benefits for participants in addition to financial returns

State legislatures, state officials, and state and local pensions can and should clarify that pensions have the authority to consider benefits for participants in addition to financial returns when making investment decisions. The Biden administration's rule provides greater flexibility in considering additional benefits through its tie-breaker test, which allows fiduciaries to consider collateral benefits other than investment returns when "competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon."[52] The collateral benefits that could be taken into account can include things like investing in communities where pension plan participants live and work or stimulating union jobs.[53]

States should adopt similar language so that it is clear that workers' money should benefit workers in ways beyond financial returns to the funds — without sacrificing workers' ability to retire with dignity. As the above-mentioned report on pensions and housing investments noted:

> A pension is money owed to the retirees who earned it. Retirement with dignity is also an important social good. We cannot ask pension funds to put that at risk in order to fund other things, but it is also not the only worker interest on the table. The other interests — affordable housing, good jobs in their communities, clean air, drinkable water, a livable climate, and so on — should be part of any trustee's considerations, not least when they directly involve the welfare of plan members, their families, and communities.[54]

Workers' money should benefit workers in ways beyond financial returns to the funds — without sacrificing workers' ability to retire with dignity.

Codifying the explicit allowance to take into account important beneficiary interests like those listed above would go a long way toward making workers' money work for them instead of undermining their interests. This can be done through legislation or through legal opinions issued by state attorneys general. Pensions can also codify their understanding of the state law that governs them in their investment policy statement.

Threat: Silencing pensions' shareholder voice

Pension funds hold many shares of many public companies. These companies include large corporations with significant power over our economy and our lives, such as Big Tech companies, large retailers, oil companies, banks, health insurance companies, and pharmaceutical companies. Holding shares in these companies gives pensions the right to vote on shareholder ballot items that affect the risks and returns of the companies (and thus of the pensions) and reflect workers' and retirees' interests in corporate governance, including director elections, executive pay packages, and shareholder proposals on issues such as climate, workers' rights, racial equity, political spending, and accessibility of medicine.

Anti-ESG efforts have tried to constrain the ability of pension funds to exercise their shareholder rights to promote the interests of the funds' beneficiaries. The 2020 Trump administration rule, last year's House bill, and state-level anti-ESG laws all attempt to prevent pensions from having their voices heard in corporate decision-making by discouraging voting[55] and prohibiting the

"promot[ion of] non-pecuniary benefits or goals unrelated to those financial interests of the plan's participants and beneficiaries" when exercising shareholder rights.[56] Examples of state laws reflecting this approach include one in West Virginia, which mandates that proxy votes align solely with pecuniary factors and prohibits any consideration of non-financial benefits even when those benefits align with workers' interests,[57] and one in Florida, which requires fiduciaries to adhere to strict financial criteria when casting proxy votes.[58] Similarly, laws in Utah[59] and Montana[60] prohibit fiduciaries from pursuing any objectives beyond maximizing immediate financial returns. These prohibitions can have a chilling effect on fiduciaries casting votes that are in the financial interests of beneficiaries but could be perceived as promoting additional benefits or goals.

Holding shares in these companies gives pensions the right to vote on shareholder ballot items that affect the risks and returns of the companies (and thus of the pensions) and reflect workers' and retirees' interests in corporate governance.

Opportunity: Reclaim pensions' shareholder voice

States should make it clear that pensions have the authority to and should exercise their shareholder rights, including through proxy voting. States can incorporate factors pensions should consider when making decisions on how to vote on ballot items including director elections, executive pay packages, and shareholder proposals on issues such as climate, workers' rights, racial equity, political spending, and accessibility of medicine. Legislatures can clarify these factors in statute or pensions can codify them in their proxy voting guidelines and/or investment policy statement as part of their fiduciary responsibility of stewarding investments to manage risk.

For example, state legislatures or pension funds can adopt language that states that unless extraordinary circumstances exist, pensions should vote in favor of shareholder proposals to set greenhouse gas pollution reduction targets that are consistent with the statewide greenhouse gas pollution reduction goals, reduce the transition risk to the firm, and/or contribute to systemwide physical risk mitigation. As another example, states can codify that pensions must consider a company's practices related to the fundamental labor rights of freedom of association and collective bargaining in deciding whether to vote for, vote against, or withhold votes from directors.

Threat: Creating uncertainty about when — if ever — pensions can take diversity, equity, and inclusion factors into account

There has been a significant backlash against diversity, equity, and inclusion efforts across our economy and pension investments have not been an exception. A bill the House of Representatives passed in 2024 would prohibit the consideration of "race, color, religion, sex, or national origin" in "selecting, monitoring, and retaining any fiduciary, counsel, employee, or service provider" of an ERISA plan.[61] The next administration's Securities and Exchange Commission may seek to implement these legislative goals through regulation. This is but one of many attempts to derail initiatives to address racial inequalities by falsely equating the consideration of race to immoral (and sometimes illegal) discrimination. For example, some Republican Attorneys General recently sent a letter to large companies that threatened that the companies "will be held accountable — sooner rather than later — for [their] decision to continue treating people differently because of the

color of their skin."[62] Some Democratic Attorneys General responded by sending a letter to companies stating that "corporate efforts to recruit diverse workforces and create inclusive work environments are legal and reduce corporate risk for claims of discrimination."[63]

Opportunity: Codify diversity, equity, and inclusion values and goals

Pensions should incorporate diversity, equity, and inclusion values and goals into their core investment approach and vision, along with the fiduciary rationale. This is in line with the recommendations from the Diverse Asset Managers Initiative, which seeks "to increase the absolute number of, and assets under management by, diverse-owned asset management firms for institutional investors."[64]

Pensions should incorporate diversity, equity, and inclusion values and goals into their core investment approach and vision, along with the fiduciary rationale.

Illinois Treasurer Michael Frerichs has commented on these efforts, noting that "[u]sing diverse investment firms is not only about creating growth and opportunity in our communities, but it's integral to increasing our investment returns."[65] Similarly, Steven Meier, New York City's Chief Investment Officer and Deputy Comptroller for Asset Management, noted that "[d]iversity, equity and inclusion are an important component of our fiduciary duty to generate sustainable and superior returns to benefit the nearly 800,000 City employees, retirees and their families who participate in the City's pension funds."[66] New Mexico recently followed suit, announcing a new diversity initiative in December 2024. New Mexico State Treasurer Laura Montoya commented: "New Mexico is a majority minority state with tremendous untapped potential, and [New Mexico State Investment Council's] forward-thinking approach to the makeup of our investments, from the team to the fund managers, sustains and reflects New Mexico's uniquely diverse resource and population landscapes. When our investments remain in lockstep with our state's values and who we serve, we maximize yield, minimize risk, and build a resilient economy that keeps New Mexicans instate and uplifts our communities."[67]

State legislatures can codify diversity values and goals as well. For example, the State Treasurer Act of Illinois states that it is "declared to be the policy of the State Treasurer to promote and encourage the use of businesses owned by or under the control of qualified veterans of the armed forces of the United States, qualified service-disabled veterans, minority persons, women, or persons with a disability in the area of goods and services."[68] It also codified an aspirational goal of directing 25 percent of the total dollar amount of "funds under management, purchases of investment securities, and other contracts, including, but not limited to, the use of broker-dealers" to businesses owned by or under the control of people who meet the above criteria.[69]

Protecting Pensions from Threats Posed by Financial Deregulation

Pensions are financial entities — really, investment firms — that have holdings across the public and private markets. This means they are exposed to risks that emerge from the deregulation of the financial sector — risks that became reality during the 2008 financial crisis for pensions and the broader economy.[70] Financial regulation at its best — coupled with robust enforcement — increases investor protection and decreases financial risks by increasing transparency and accountability and preventing predatory and overly risky practices. Pensions benefit from more robust financial regulatory environments that make financial crises less likely and less severe.

Pensions benefit from more robust financial regulatory environments that make financial crises less likely and less severe.

The incoming Trump administration and new Congress have promoted a deregulatory financial agenda, ignoring the stark lessons of the financial crisis. Project 2025's section on the Securities and Exchange Commission (SEC), the most important regulator of securities markets, makes a fleet of deregulatory policy recommendations.[71] Trump has nominated Paul Atkins to be SEC chair, who is known for his deregulatory stances.[72] Representative French Hill (R-Ark.),[73] the incoming chair of the House Financial Services Committee, and Senator Tim Scott (R-S.C.),[74] the incoming chair of the Senate Banking, Housing, and Urban Affairs Committee, have both supported deregulation of the financial industry.

Besides being exposed to the risks of financial deregulation, pensions are also powerful financial institutions themselves that can play an important role in mitigating these risks to protect and grow those pools of deferred wages of working people.

Threat: Lack of reliable public company disclosures

Project 2025 calls for the dismantling of the SEC climate-risk disclosure rule, which would require public companies to make disclosures about their climate-related risks.[75] It also calls on Congress to "[p]rohibit the SEC from requiring issuer disclosure of social, ideological, political, or 'human capital' information that is not material to investors' financial, economic, or pecuniary risks or returns."[76] This recommendation is consistent with a bill the House of Representatives passed that would allow the SEC to mandate disclosures only to "the extent that the issuer has determined that such information is material."[77] This materiality language allows companies to decide unilaterally what information to disclose to or conceal from shareholders and the public. This undermines the SEC's ability to set standards in the public interest and mandate the disclosure of information investors want that sheds light on financial risks and returns. Pensions — and the public — already lack this basic information from public companies about their climate-related risks and their workforces. The proposed policy changes threaten to make matters worse by weakening corporate disclosures already mandated by the SEC.

State-level executive actions and legal challenges have contributed to these threats. For instance, 21 state attorneys general sent a letter to the SEC opposing the climate-risk disclosure rule.[78] This coordinated effort escalated when 19 state attorneys general filed lawsuits seeking to block the rule entirely in the Eighth and Eleventh Circuits.[79]

In addition to targeting federal rules, state-level actors are also discouraging important company disclosures through indirect methods. For example, Texas Comptroller Glenn Hegar's blacklist of 15 financial companies accused of "boycotting energy companies" pressures these firms to avoid disclosing climate-related risks that could be interpreted as anti-energy.[80] Meanwhile, Oklahoma Treasurer Todd Russ demanded that greenhouse gas reporting not be included in Generally Accepted Accounting Principles (GAAP).[81]

Without reliable disclosures, pensions are forced to rely on incomplete information, potentially exposing beneficiaries to avoidable financial risks.

These efforts are anticipated to escalate with the incoming administration and Congress, which could create a more fragmented disclosure landscape that leaves pensions with inconsistent and incomplete data. This undermines fiduciaries' ability to assess long-term risks associated with climate change, labor practices, and other issues. Without reliable disclosures, pensions are forced to rely on incomplete information, potentially exposing beneficiaries to avoidable financial risks.

Opportunity: Mandate reliable company disclosures

States should require that companies over a certain size doing business in their state make reliable, comparable disclosures. States should codify existing, robust frameworks as much as possible to increase the effectiveness of disclosures for pension fiduciaries. For example, California passed laws requiring companies above a certain size that do business in the state to make a series of climate-risk disclosures. In doing so, it drew on and will allow companies to comply using other rubrics such as the sustainability standards developed by the International Sustainability Standards Board[82] and the greenhouse gas reporting standards in line with the most common methodology, the Greenhouse Gas Protocol.[83]

States should also mandate important disclosures in addition to climate-risk disclosures. For example, the Human Capital Management Coalition calls for the disclosure of four workforce metrics including number of workers, total workforce cost, turnover, and workforce diversity.[84]

In addition to enacting laws or strengthening regulatory requirements to require these disclosures, pensions can also use their shareholder voice to demand companies make important disclosures by requesting more information informally, filing shareholder proposals, or voting in favor of others' proposals. Pensions can adopt policies outlining the minimum disclosures they expect companies to make on environmental and social risks and use it as a guide to allocate pension investments and to determine how to exercise their shareholder rights, including when it comes to director votes.[85]

Threat: Increased risks in the private markets

Pensions invest a significant portion of their capital in private funds,[86] which have grown more rapidly than public markets and represent a growing share of the economy. Private markets are more opaque, riskier, and more illiquid than public market investments, and often come with far higher investment fees. There is a growing body of evidence that private funds are not providing higher returns to counterbalance these problems, [87] and smaller pension funds especially can see lower returns in private funds. William Birdthistle, former Director of the Division of Investment Management at the SEC, notes that the lack of disclosures in private markets "obscures how risky their trading practices might be, how much leverage they are using and what sort of preferential treatment they are giving some investors over others."[88] During his tenure, the SEC promulgated a rule to begin addressing the risks posed to private fund investors — including pensions — from the market's opacity. The SEC pursued enhanced private fund adviser disclosures because its market

oversight actions through the years — including as evidenced in multiple enforcement actions — found that private fund investors are susceptible to fraud, deception, and manipulation.[89] Unfortunately, the industry immediately sued the SEC in the industry-aligned Fifth Circuit Court of Appeals, which struck down the rule.[90]

The incoming administration is unlikely to engage in robust enforcement efforts to address the investor protection issues the derailed private fund advisers' rule would have addressed more systematically. Instead, the next SEC is likely to loosen requirements and reduce the enforcement efforts on private markets based on Project 2025 priorities[91] and Trump's nomination of pro-deregulation Paul Atkins to be chair of the SEC, increasing risks to pensions that invest in private funds.

In addition to the overall risks posed by private funds that the SEC sought to address through its rulemaking, the private equity industry also poses significant labor and climate risks to pensions. A recent American Federation of Teachers report found that there were labor-related issues in companies owned by private equity funds advised by at least nine out of the top ten private equity fund advisers used by their members' pension funds.[92] Additionally, a recent report of the top 21 private equity firms released by the Private Equity Climate Risks consortium found that they play an outsized, opaque role in accelerating the climate crisis — and with it climate-related financial risks to pensions — by financing 1.17 gigatons CO_2 equivalent of annual greenhouse gas emissions.[93]

Opportunity: Make demands of pensions' private fund advisers

States and pensions can confront and reduce the risks that private markets pose to public pensions. These pension funds are major investors of capital in private funds, especially private equity. Public pensions make up almost a third of all private equity investors and represent more than two-thirds (67 percent) of their capital, according to a 2024 University of North Carolina study.[94] Pensions are also increasingly investing in the growing, risky private credit funds market. These funds invest in the largely unregulated and extremely opaque private lending market.[95] This means that pensions have the power to make demands of the advisers who manage these private funds for their own protection.

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First, state legislatures and pensions could use the SEC private fund advisers' rule as a roadmap for what to demand of the advisers who manage the private funds that public pensions invest in. This would put in place standards that the SEC, an agency with a statutory investor protection mission, thought was necessary for investor protection. The main components of the now-defunct rules are:

- Requiring advisers to provide detailed reports on fees, expenses, and performance on a quarterly basis;
- Requiring advisers to obtain an audit of all the private funds they advise on an annual basis and disclose the audited financial statements to investors;
- Requiring advisers to obtain a fairness or valuation opinion when offering existing-fund investors the option between selling their interests and converting or exchanging them for interests in another fund;
- Restricting advisers from engaging in certain activities, like borrowing directly from a private fund client and passing certain expenses on to funds;

- Largely prohibiting giving some investors preferential treatment on redemptions and disclosures about portfolio holdings; and
- Requiring that if advisers provide other preferential treatment, it must be disclosed to existing investors (and, if significant, to prospective investors as well).

State legislatures or pensions themselves could enact comparable requirements by requiring advisers to comply with the strictures of the SEC rule as a condition for pensions to invest in private funds. Intermediary steps can include evaluating current pension private fund advisers to assess their compliance with each element of the SEC rule and demanding that they adjust their practices to comport with what the rule would have required. Pensions could also incorporate the components of the rule into the due diligence process they conduct when choosing advisers and into the monitoring of advisers once invested.

Notably, the Institutional Limited Partners Association, an association of private equity investors, has adopted new and enhanced reporting standards and templates that aim to increase the consistency of disclosures provided by private fund advisers.[96] This is an example of how collective action among pensions and other similarly-situated investors can help provide pension fund trustees with a better understanding of the risks, costs, and opportunities in an opaque market and therefore aid in the fulfillment of their fiduciary duty to their beneficiaries.

Second, pensions should protect themselves from labor-related risks by adopting labor standards as a condition for committing capital to private equity.[97] The American Federation of Teachers[98] and the National Association of Building Trades Unions (NABTU), led by the Laborers International Union of North America (LiUNA),[99] have both recently published suggested labor standards for private equity investments. These include respecting the rights to freedom of association, discouraging privatization and offshoring, and elevating the importance of workplace safety and health. The California Public Employees' Retirement System[100] and the New York State Common Retirement Fund[101] both adopted labor standards. If they have not already done so, pensions should also adopt a responsible contractor policy, which is a policy adopted by many pensions that supports fair market wages and benefits for workers employed by contractors and subcontractors, typically applied to real estate and infrastructure assets.[102] State legislatures could also codify these policies by passing state laws.

Third, pensions should protect themselves from both physical and transition climate-related risks. One way to do so is by adopting a policy against making private fund investments in fossil fuel infrastructure. For example, New York City Comptroller Brad Lander recently announced he will develop a policy to exclude private fund investments in midstream and downstream fossil fuel infrastructure, expanding the existing policy of restricting upstream fossil fuel investments.[103] In making the announcement, Lander stated that the new policy "will help mitigate the systemic risks that climate change poses to the global economy and to New York City's public pension funds."[104] Pensions can also incorporate transition readiness assessments and plans into their due diligence process for selecting private fund managers and track progress and compliance through their monitoring process. State legislatures can weigh in on these issues as well, including by passing legislation like a Maryland law that requires pensions to incorporate climate risk management principles into all their investment policies and conduct a climate risk assessment of all their investments.[105]

Protecting Pensions from Effects of Anti-ESG Campaign on Large Asset Managers

The growth and concentration of the asset management industry has created a few behemoth managers with significant influence over the operation of public companies. These asset managers manage retirement accounts, pension funds, and other savings assets and have significant holdings across most sectors including large corporations with significant power over our economy and our lives, such as Big Tech, large retailers, oil companies, banks, health insurance companies, and pharmaceutical companies.

The growth and concentration of the asset management industry has created a few behemoth managers with significant influence over the operation of public companies.

The relatively recent, outsized influence large asset managers exert over public companies has been driven in large part by the proliferation of low-cost index funds, which allow many people to make low-cost investments across the public markets. Many pensions hire BlackRock, State Street, and other large asset managers to manage their index funds.

At the end of 2021, the three largest asset managers — BlackRock, Vanguard, and State Street — collectively held nearly 22 percent of shares and voted nearly 28 percent of shares voted in the S&P 500.[106] In 2019, academics projected these asset managers would control 34.3 percent of S&P 500 votes within ten years and 40.8 percent of S&P 500 votes within twenty years.[107]

Their influence is most visible through proxy voting, when asset managers cast shareholder votes on behalf of their clients (pension funds, retirement funds, and other invested funds). These asset managers can cast decisive votes on critical issues such as board composition, executive compensation, shareholder rights, and how to address the risks and opportunities related to climate change, human capital management, racial equity, and political spending. This voting power also translates into outsized influence over corporate leadership that asset managers can exercise behind closed doors with little or no transparency. This outsized sway over corporate decision-making makes asset managers de facto regulators of public companies.[108]

Although asset managers have legal obligations to act in the best interest of their investor clients, they are often prioritizing their own private, short-term interests to gain and retain assets under management and avoid government regulation that can conflict with the interest of their clients and the public in mitigating risks to individual companies and risks that affect the financial system. Indeed, asset managers almost always support corporate management proxy voting recommendations, often at the expense of other shareholders' efforts to press companies to address important risks.

In 2023, for example, large asset managers overwhelmingly supported the directors of U.S.-based companies with operations and business models that were most misaligned with decarbonization pathways to limit global warming to 1.5˚C, failing to exercise their power to address the risks posed by climate change to the financial system.[109] They also showed very low support for proposals seeking to enhance labor rights, which decrease inequality,[110] and effectively blocked shareholder action to address important racial equity issues.[111] While the largest asset managers have routinely obstructed investor efforts to compel public companies to address these kinds of risks, the unpopular anti-ESG campaign — backed by fossil fuel and other elite corporate interests — has further discouraged these asset managers from casting proxy votes to confront these known risks.[112]

Threat: Large asset managers coopting pensions' shareholder voice to rubber-stamp short-sighted, risky corporate practices

The incoming administration and Congress are poised to pursue policymaking to either encourage asset managers to vote entirely with management or not vote their shares at all. The House of Representatives passed a bill to this effect in 2024, which includes policies that could be advanced by the SEC through regulation.[113]

If pensions delegate their proxy voting to these asset managers, the pensions risk having their shareholder voice coopted to rubber stamp misguided management practices that prioritize short-term risky returns at all costs. Giving these financial institutions power over pensions' shareholder voice would amplify corporate management's voice and minimize shareholder accountability, as their votes are overwhelmingly in favor of outrageous executive pay packages; against shareholder efforts to get companies to address issues related to climate, labor, racial equity, political spending, and access to medications; and in favor of boards of directors regardless of any shareholder concerns.

Opportunity: Reclaim pensions' shareholder voice over public companies

Pensions, as the beneficial owners of public company shares, can reclaim their voting rights from their asset managers. There are several ways to do this. The most straightforward way is for the pensions to bring the management of index funds in house instead of outsourcing it to asset managers. Pensions can also reclaim their voting rights while maintaining their relationships with their asset managers by taking back proxy voting authority so they can make their own voting decisions and vote their shares without going through the asset manager as an intermediary. This would likely require pensions working with their managers to move their equity holdings into a separately managed account or an account with a smaller number of investors. This would allow pensions to retain the maximum shareholder voice for their investments and would be significantly preferable to some voting choice programs asset managers offer that allow pensions to select a third-party voting policy pre-approved by the asset manager.[114] Although these third-party arrangements may modestly increase pensions' voting options compared to granting the

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asset managers unfettered control over their proxy votes, there is no indication in publicly-available information that asset managers actually give up ultimate control over how the votes are cast under these third-party arrangements.

If a pension is too small to be able to move their holdings into a separately managed account, it could still take a more active role in voting by choosing an asset manager and a third-party voting policy that best meet its needs, closely monitoring their asset manager's implementation of the chosen voting policy, and directing how their asset manager votes the pension's shares on key votes.

Additionally, state legislatures can enact parameters for pensions related to how they hire and work with asset managers so that votes are cast in the best interest of beneficiaries, and state attorneys general can make inquiries of the asset managers managing their state pension funds to ensure they are doing so in compliance with state laws.

Threat: Large asset managers increasing risks to our financial system and broader economy

Large asset managers have outsized influence over large corporations with significant power over the economy and retirees' and workers' lives. These asset managers are increasingly caving under pressure from anti-ESG forces to exert their influence in service of short-term corporate interests instead of long-term sustainability.[115] This trend is poised to get worse with the incoming administration and Congress. Trump's selected SEC chair Paul Atkins has disparaged shareholder concerns about the long-term sustainability of their investments, those who file shareholder proposals, and the companies that negotiate with these investors.[116]

Pensions pay these large asset managers fees for managing their index funds. Even if pensions take the important step of reclaiming their shareholder voice, they are nonetheless contributing to asset managers' ability to rubber stamp the worst short-term impulses of corporate executives that can pose risks to our financial system and broader economy. For example, studies found that financial institutions' pay arrangements that rewarded short-term performance in the years leading up to the 2008 financial crisis incentivized executives to take excessive risks.[117] Additionally, pensions that propose their own shareholder resolutions on important issues could see their efforts undermined by the very asset managers they pay to manage their money.

Several state actions have contributed to increasing pressures on asset managers to ignore important financial risks. In 2022, 19 attorneys general sent a letter to BlackRock accusing it of "unlawful market manipulation" through what they perceive as ESG-aligned voting strategies, falsely alleging that its practices prioritize ideological agendas over fiduciary responsibilities.[118] In 2023, Kentucky Treasurer Allison Ball's blacklisted 11 financial companies, including BlackRock, specifically over concerns about shareholder engagement policies that she alleged diverge from state priorities.[119] In 2024, 16 state attorneys general launched an investigation into BlackRock, focusing on its ESG disclosures and alleging misalignment with fiduciary responsibilities.[120] Later that year, 11 state attorneys general filed suit against BlackRock, Vanguard, and State Street alleging they violated antitrust laws through their engagement with coal companies to decrease climate risk.[121]

Other pressures on BlackRock specifically have come through divestments. Florida announced it would withdraw $2 billion from BlackRock, citing concerns over ESG.[122] Similarly, Louisiana, South Carolina, and Missouri collectively announced almost $1.5 billion in intended withdrawals from BlackRock.[123] In total, state actors from nine states have announced they would withdraw approximately $12.78 billion from BlackRock citing ESG-related concerns.[124]

Opportunity: Use client power over asset managers to decrease risks to our financial system and broader economy

Pensions can decrease risks to their investments by choosing asset managers to manage their index funds that meet criteria related to addressing risks to our financial system and broader economy, including a demonstrated commitment to using their shareholder voice to push public companies to address important risks related to climate change, labor law violations, racial inequity, political spending, and more. Pensions can design a policy with clear enforcement provisions they can operationalize through their requests for proposals, due diligence, and monitoring processes.

Pensions can decrease risks to their investments by choosing asset managers to manage their index funds that meet criteria related to addressing risks to our financial system and broader economy.

Pensions have more options for management of index funds than may be immediately apparent, based on multiple studies that have scrutinized and compared the voting behavior of large asset managers.[125] State legislatures can also weigh in to enact parameters for pensions related to how they hire and work with asset managers so that pensions' relationships with their asset managers are ameliorating rather than exacerbating risks to the financial system and broader economy. State attorneys general can make inquiries of the asset managers managing their state pension funds to ensure they are doing so in compliance with state laws.

Conclusion

States have many tools at their disposal to protect public pensions and safeguard their ability to make investment decisions that promote retirement with dignity and economic security. The incoming presidential administration and Congress are expected to challenge the ability of state and local public pensions to fulfill their fiduciary obligations to consider the risks, returns, and benefits of their investment decisions. State legislatures, governors, state attorneys general, state and local treasurers and comptrollers, pension fund trustees, and pension fund staff all have important roles to play in protecting workers' deferred wages, which are a vital part of states' economies.

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