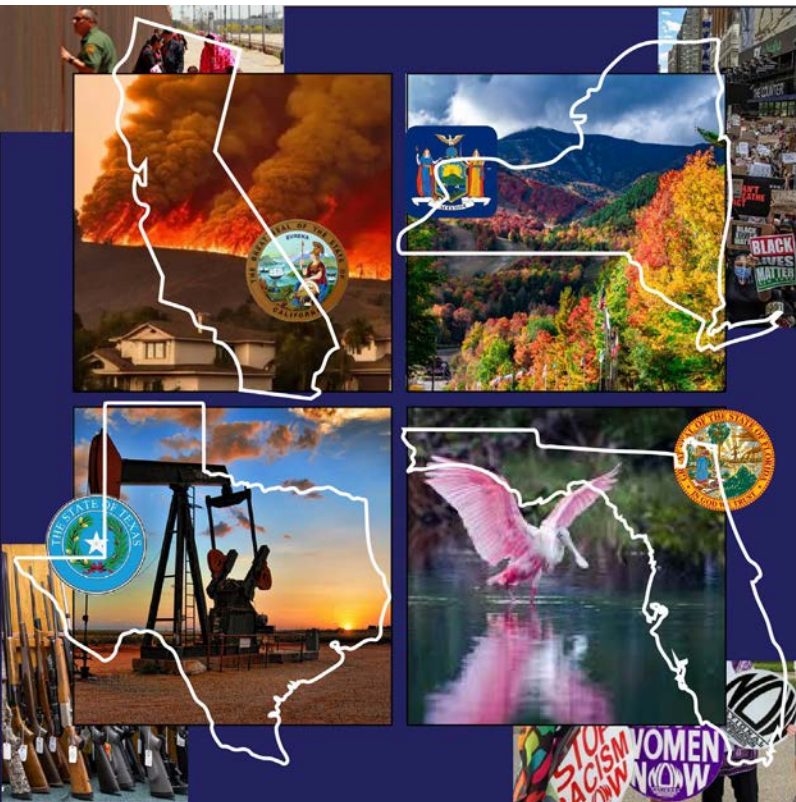


# BEYOND THE BOTTOM LINE

## How ESG Engagement Reshapes Pension Fund Strategy



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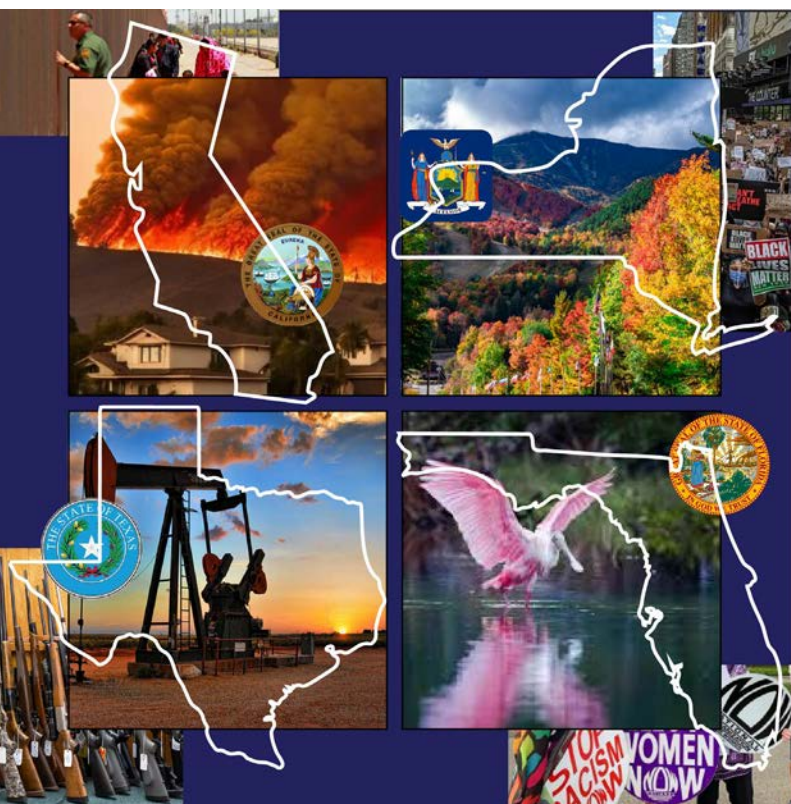
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## EXECUTIVE SUMMARY

### Overview

Environmental, Social, and Governance (ESG) initiatives call for transforming investing and corporate governance by turning businesses into agents of progressive social change. Several state public pension systems are well-known for promoting ESG principles. This study scrutinizes ESG activity by seven of the largest public pension plans in California, New York, Texas, and Florida from 2013 to 2023 to determine whether activism impairs the systems' duty to safeguard members' retirement funds. The examination reveals that ESG activity falls into three distinct categories: divestment, financial withdrawal from disfavored industries; acceleration, targeted investment in approved causes; and engagement, use of fund investment to alter business practices. The research finds that these pension funds primarily employ ESG engagement tactics rather than divestment strategies to influence corporate behavior.

### Key Findings

- **Engagement Over Divestment:** Contrary to expectations, these pension funds have engaged in minimal divestment from companies based on ESG considerations. Instead, they have focused on corporate engagement through proxy voting and shareholder resolutions.
- **Maintained Investments:** Despite making public ESG commitments, these pension funds have largely maintained investments in sectors such as fossil fuels while simultaneously applying pressure on these industries through shareholder activism.
- **California and New York Activism:** Pension funds in California and New York have been especially active in ESG efforts, voting on tens of thousands of proxy ballots annually and engaging with thousands of companies.
- **ESG Resolution Support:** All the examined pension systems overwhelmingly supported ESG shareholder resolutions in 2021. This coordinated action suggests a problematic alignment of government pension funds working to impose non-financial agendas on corporations.

### **Strategic Implications**

The study suggests that pension funds have developed methods to advance ESG objectives without significantly changing their investment portfolios. This approach enables them to influence corporate behavior while maintaining financial positions. However, all pensions and investors may suffer reduced returns when activism undermines value-creating investment. Pension systems that merely engage, rather than divest, may not underperform compared to other funds, but their tactics allow government-backed entities to exert extraordinary influence without sufficient accountability or transparency.

### **Financial Impact**

The research found limited evidence that ESG activism has reduced the investment returns of the California and New York pension systems relative to those in Florida and Texas. However, this finding does not mean that ESG initiatives are cost-free. Instead, the costs are borne by the targeted companies and their investors, who absorb the operational changes and related expenses prompted by ESG demands. This arrangement effectively weaponizes pension fund capital to coerce corporate America into compliance with politically driven objectives, often at the expense of shareholders.

### **Conclusion**

Public pension systems increasingly influence corporate America through shareholder engagement rather than divestment. This approach may generate diffuse but substantial costs for publicly traded companies that are difficult to quantify or trace directly. The trend represents a troubling expansion of state power into private-sector governance and undermines free market principles and corporate autonomy in ways that may damage long-term economic growth.

## INTRODUCTION

ESG was once a niche term buried in financial reports, but it has morphed into a political lightning rod, igniting fierce clashes from executive suites to legislative chambers. Never has a trio of letters stirred such intense controversy at the volatile crossroads of corporate finance and public policy.

ESG operates on two distinct but interconnected planes. At the micro level, it serves as an internal corporate framework that guides allegedly sustainable business practices; at the macro level, it constitutes a constellation of non-financial standards that asset managers, financial institutions, and institutional investors use when allocating capital or assessing risk.<sup>1</sup>

This dual nature—corporate strategy versus investment criterion—helps explain why ESG has become both a rallying cry for progressive finance and a target for those who see it as a “mission drift” away from financial returns. As public pension funds increasingly enter this ideological fray, the quest to measure ESG’s impact on retirement security has never been more urgent.

In 2022, New York City Comptroller Brad Lander directly challenged BlackRock, critiquing what he perceived as inconsistencies in the firm’s climate commitments.<sup>2</sup> Lander’s intervention came at a critical juncture for BlackRock, which faced scrutiny from opposing political factions. Nineteen Republican-led states had recently accused the firm of prioritizing environmental objectives over fiduciary duty, while Lander, from the opposite perspective, urged BlackRock to take more decisive action on climate-related investments.

The timing of Lander’s critique was particularly significant because it coincided with BlackRock’s efforts to counter allegations from state attorneys general asserting that the firm’s ESG policies were overly interventionist. In response to these claims, BlackRock’s Head of External Affairs, Dalia Blass, emphasized that the firm neither boycotted energy companies nor imposed specific emissions standards.<sup>3</sup> However, Lander’s demands underscored the firm’s complex position as it navigated competing pressures from policymakers advocating for greater ESG integration and those resisting its influence in investment decisions.

This conflict highlights the significant influence that ESG considerations have on the management of public pension funds. The involvement of a key municipal comptroller and multiple state attorneys general in high-profile debates over BlackRock’s ESG policies proves the significant impact these



investment strategies can have on the financial security of millions of public-sector retirees. The intensity of the rhetoric suggests that ESG investing extends beyond the scope of corporate social responsibility discourse, representing a contested arena where political and financial imperatives intersect with momentous implications for institutional asset management.

Our study examines a decade of activity (2013–2023) across public sector retirement systems in the four largest states: California, Texas, New York, and Florida. It analyzes seven major pension plans (see Box 1) chosen for their significant influence on the public sector workforce and financial markets. California and New York’s pension systems are recognized as leading proponents of ESG, while Texas and Florida, often referred to as “Red States,” have spearheaded the anti-ESG movement. Therefore, these four states are ideal for identifying disparities in ESG activities.

### Box 1: Abbreviations for the State Pension Systems

Abbreviation	Full Name
CalPERS	California Public Employees Retirement System
CalSTRS	California State Teachers Retirement System
FRS	Florida Retirement System
NYSLRS	New York State and Local Retirement System
NYSTRS	New York State Teachers Retirement System
TXERS	Texas Employees Retirement System
TXTRS	Texas Teachers Retirement System

Our initial objective was to assess whether ESG investing impacted public pension fund returns and to quantify any financial cost associated with ESG strategies. We anticipated finding notable differences in returns between the ESG-heavy states, commonly referred to as the “Blue States” (California and New York), and the anti-ESG states (Texas and Florida). However, our findings were unexpected. After reviewing annual reports and related documents, we discovered that the California and New York pension funds did not widely divest from companies based on ESG considerations. Instead, their ESG commitment was primarily reflected in corporate engagement rather than broad divestment strategies. This revelation shifted the focus of our analysis.

Rather than comparing returns across states, we redirected our attention to examining the nature and financial impact of engagement strategies.



Suppose pension funds are not significantly altering their portfolios but are instead attempting to influence corporate behavior through shareholder activism. In that case, the financial consequences may be more subtle and pervasive than initially anticipated. This realization prompted us to develop a more nuanced framework for understanding how ESG influences pension fund management and its broader economic effects.

We categorize ESG activities into three primary approaches: (1) divestment, (2) acceleration, and (3) engagement. While divestment and acceleration can lead to direct financial consequences—potentially lowering returns for the affected pensions—the impact of engagement is more diffuse, influencing returns across all investors holding the relevant stocks or bonds.

To accurately assess the financial impact of ESG investing, it is essential to document specific pension fund actions rather than rely solely on their public statements. For instance, pensions may make headlines by announcing divestment from particular industries, such as CalPERS's and CalSTRS's divestment from gun manufacturers following the Sandy Hook Elementary School Massacre. However, divestment does not necessarily occur immediately; it may only apply to directly managed assets and exclude index or bond funds that track broad market indices. As a result, the financial impact of divestment may not be realized until the actual divestment occurs.

Pension systems could also take offsetting measures to mask any negative returns caused by divestment or acceleration. For example, they may shift funds into higher-risk, higher-return assets—such as the riskiest tranches of mortgage-backed securities or private equity—to compensate for lost returns. In the short term, these riskier investments could offset the financial drag of ESG activities, creating the appearance that ESG strategies have no impact on returns. However, the elevated risk could lead to greater volatility and potential losses over time, negating short-term gains. This practice makes it more challenging to isolate the actual financial impact of ESG investing on pension performance.

These findings also underscore the potential for greenwashing. Both ESG proponents and critics have accused corporations and financial institutions of committing to social and environmental goals while engaging in merely symbolic actions. Although public sector pensions are generally viewed as genuine advocates for driving change through finance, the potential for greenwashing makes it crucial to document their ESG implementation efforts.

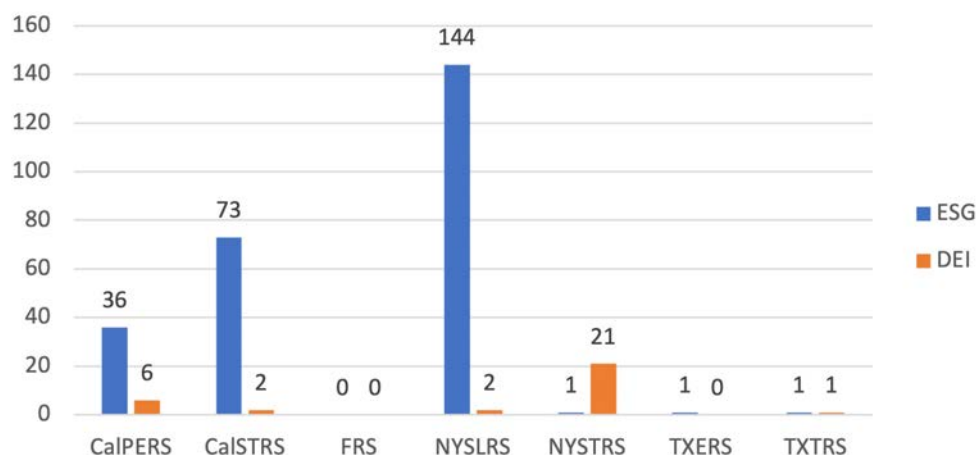
Accurately evaluating the financial effects of ESG investments by public pension funds requires a sharp focus on concrete actions, such as the precise timing of divestment or acceleration decisions and thorough documentation of engagement initiatives. Only by scrutinizing these specific activities can the real influence of ESG on pension fund performance—and, consequently, the retirement stability of public-sector employees—be adequately measured.

### **Tracking ESG References in Pension Reports: Frequency and Variability**

We begin by tracking the use of the term ESG in the annual reports of the pension systems analyzed. Figure 2 displays the total references to ESG made by the seven pension systems over the ten years. The frequency of ESG mentions varied significantly across the systems: four of the seven made zero or only one reference throughout the decade, indicating minimal public emphasis on ESG. However, several systems frequently cited ESG, led by NYSLRS, which made 144 references over the past ten years, including more than 20 annually in recent years. CalSTRS followed with 73 total references, while CalPERS made 36 references. For comparison, Figure 2 also reports references to the term “Diversity, Equity, and Inclusion” (DEI), even though DEI initiatives might be subsumed under the Governance element of ESG.

**Figure 2: ESG and DEI Mentions**

Mentions of ESG and DEI in Annual Reports,  
2014-2023



The stark difference between the two New York systems highlights the peculiarity that pension funds within the same state can engage in ESG at different levels. While the total number of references is only a rough indicator, it suggests that specific systems strongly emphasize ESG in their public communications.

We must examine the content of these discussions to understand the specific ESG activities that pension systems are undertaking. For instance, in his 2023 NYSLRS annual report letter, the New York State Comptroller offered the following remarks:

I am deeply concerned about climate change. Around the world, we are witnessing the impact of record temperatures, floods, rising sea levels, droughts, and wildfires; however, climate change is not just an environmental issue. It poses significant financial risks to the Fund's investments, to the economy, and our entire society. One of the Fund's biggest challenges is investing in opportunities while mitigating the risks that climate change poses to its long-term value.<sup>4</sup>

The ESG journey of NYSLRS reveals a steady trajectory of sustainable investing marked by incremental yet strategic developments between 2009 and 2023. The fund's initial Green Strategic Investment Program, launched in 2009, committed \$500 million to environmentally focused investments when ESG was still a relatively new concept in institutional investing.<sup>5</sup>

By 2014-2015, the fund had expanded its ESG footprint substantively, investing in specialized index funds such as the HSBC Climate Change Index Fund and the FTSE Environmental Technology 50.<sup>6</sup> During this period, a significant \$300 million commitment to the Rockefeller Global Sustainability & Impact Strategy signaled a more structured approach to sustainable investing.<sup>7</sup> The timing is noteworthy: This expansion occurred only a few years after the 2008 financial crisis, suggesting the fund may have sought alternative investment strategies for reputational management purposes.

A critical turning point occurred in March 2017, when NYSLRS published its inaugural ESG Report outlining a systematic ESG integration strategy across asset classes. This report introduced the identification of material ESG factors and a risk management framework. This development coincided with increasing global momentum around climate change discussions and growing investor discussions of non-financial risk factors.

By 2017-2018, the fund had dramatically scaled its commitment, announcing a \$7 billion sustainable investment program.<sup>8</sup> The breakdown was telling: \$4 billion in a low-emissions index that reduced carbon emissions intensity by over 75 percent and \$3 billion in additional global sustainable investments.<sup>9</sup> Within a few years, NYSLRS implemented a Sustainable Investments and Climate Solutions (SICS) Program to provide a comprehensive roadmap for addressing climate risks across various asset classes.<sup>10</sup>

In 2019, NYSLRS introduced a Climate Action Plan, pledging to achieve net-zero greenhouse gas emissions by 2040. The fund leveraged SICS to “position its portfolio for a low-carbon economy.”<sup>11</sup> By 2023, the fund had allocated \$18 billion to this initiative.<sup>12</sup> Additionally, more than \$31 billion in fund assets were managed by state-certified Minority- and Women-Owned Business Enterprises.<sup>13</sup>

The 2020-2021 fiscal year marked another significant milestone with the release of a comprehensive ESG Strategy.<sup>14</sup> This document was particularly timely, coming at a moment of heightened political polarization surrounding ESG investing and emerging legislative challenges in states such as Texas and Florida.

The chronology also reveals a deliberate response to emerging challenges. In early 2021, the fund updated its ESG scorecards to incorporate climate-specific criteria, including governance, risk assessments, and proxy voting.<sup>15</sup> This development came amid increasing scrutiny of ESG investing, suggesting a proactive approach to potential criticism.

By 2022-2023, NYSLRS had refined its approach to include engagement with existing managers about climate risks, net-zero alignments, and investment opportunities. The continued use of the Global Real Estate Sustainability Benchmark (GRESB) demonstrated a commitment to sustainability metrics.

The fund's engagement metrics are astounding—nearly 30,000 proxy ballot items annually and interactions with over 1,700 portfolio companies in 2020-2021—but the actual impact of these engagements remains challenging to quantify definitively.<sup>16</sup>

CalSTRS demonstrated a similar trajectory during this period, beginning with its recognition of ESG factors as potentially significant influences on company performance, mainly through its partnership with the Sustainability Accounting Standards Board (SASB), of which it was a founding board member. In May 2015, CalSTRS released its inaugural sustainability report, marking a first among U.S. public pension plans. Its ESG strategy evolved from initial recognition to active implementation across multiple dimensions.

By 2016-2017, CalSTRS had taken concrete steps, such as divesting \$9.8 million from thermal coal companies worldwide, to demonstrate its willingness to align with its stated ESG principles.<sup>17</sup> Its Sustainable Investment and Stewardship Strategies (SISS) unit, which evolved from the previous Corporate Governance portfolio, became a key driver of its ESG approach. By 2022, the SISS unit oversaw approximately \$8.8 billion in assets, including activist managers, sustainability-focused funds, and low-carbon index strategies.<sup>18</sup>

A significant milestone occurred in July 2017 with the implementation of the CalSTRS Low-Carbon Index Portfolio, which initially invested \$1.3 billion in the U.S. market and plans to expand to \$2.5 billion across developed and emerging markets.<sup>19</sup> By 2021-2022, the CalSTRS ESG commitment had become so integral that it was one of three strategic goals in the CalSTRS organizational blueprint, with the explicit aim of “fully integrating a unified environmental, social, and governance ethos in all we do.”<sup>20</sup>

The CalSTRS approach to ESG encompassed not only divestment but also active engagement. It consistently emphasized engaging with companies on governance matters, voting on over 91,000 proxies at more than 9,000 companies in a fiscal year.<sup>21</sup>

By 2022-2023, CalSTRS had further refined its approach. The SISS unit now oversees approximately \$9.8 billion in public equity strategies and leads the

implementation of a net-zero portfolio emissions pledge.<sup>22</sup> This progression illustrates CalSTRS's transformation from a passive observer of ESG trends to an active, influential leader in sustainable investing.

CalPERS demonstrated a consistent but comparatively understated approach to ESG integration over the decade from 2014 to 2023. Its ESG activity began earlier than the analyzed period, as evidenced by the 2013-2014 report, which referenced its "second report" on sustainable investing, indicating prior initiatives in this area.<sup>23</sup> CalPERS maintained a gradual and evolving structural ESG framework throughout this period rather than undergoing dramatic shifts.

From 2014 to 2015, CalPERS established its strategic themes—"Alignment of Interest, Human Capital, and Climate Change"—to guide its ESG integration work for years.<sup>24</sup> During this period, CalPERS made significant strides in proxy voting, supporting proxy access proposals at 92 companies and signing the Montreal Carbon Pledge to map the carbon footprint of its equity investments.<sup>25</sup> This foundation established CalPERS's approach as one focused on integration and engagement.

By 2016-2017, CalPERS introduced a more formal 5-year sustainable investment strategy with an "enterprise-wide view" on integrating ESG factors.<sup>26</sup> This strategy included specific key performance indicators (KPIs) and focused on data and corporate reporting standards, diversity and inclusion, manager expectations, and research. The pension fund's core ESG work continued to center on proxy voting, corporate engagement, and carbon footprinting, voting on more than 75,300 individual ballot items in 2016.<sup>27</sup>

A notable development occurred in 2017-2018 when ESG was formally integrated into CalPERS's strategic plan as part of its "Fund Sustainability" goal. This elevation of ESG considerations to a top-level organizational goal demonstrated an increased institutional commitment, although it was still primarily framed in terms of risk management and long-term returns. During this period, CalPERS cast votes at over 11,000 meetings, representing more than 105,000 individual ballot items.<sup>28</sup>

The reporting on ESG activities remained relatively consistent from 2018 through 2021, with nearly identical language appearing in successive annual reports. This period showed limited evolution in the CalPERS strategy or reporting framework, suggesting a steady-state approach to ESG rather than continuous innovation.

The 2021-2022 report marked a shift in focus toward data standardization with the establishment of the ESG Data Convergence Project (EDCP), which aimed to create standard ESG metrics for private equity portfolios. This initiative demonstrated CalPERS's interest in addressing the fundamental challenge of ESG measurement and standardization in private markets.

Finally, in 2022-2023, CalPERS took a significant organizational step by hiring Peter Cashion as Managing Investment Director for Sustainable Investments. This appointment signaled a potential new phase in the CalPERS ESG pursuit, with Cashion tasked with setting "the vision, strategy, and governance for CalPERS' sustainability work" and developing an "economics-based research and data framework" for ESG integration.<sup>29</sup>

While these three pension funds trumpet commitments to ESG—allocating billions to low-carbon strategies and sustainability programs—their actual impact remains frustratingly nebulous. Their chronological progression reads like a carefully staged narrative: initial recognition, strategic investments, dramatic announcements of net-zero pledges, and extensive proxy voting, all wrapped in the language of transformation and leadership. Yet their annual reports provide little concrete evidence of meaningful systemic change beyond financial reallocation.

These funds' self-congratulatory tone masks a fundamental question: Are these ESG initiatives genuine attempts at addressing global challenges or merely sophisticated financial marketing designed to appease increasingly environmentally conscious stakeholders? Is the proliferation of sustainability reports, strategic plans, and investment programs merely an elaborate corporate responsibility performance whereby declaring commitment matters more than the substantive outcomes?

### **Examining the Mechanics of ESG Strategies: Divestment, Acceleration, and Engagement**

Having tracked ESG references in pension reports, we now examine each ESG strategy—divestment, acceleration, and engagement—more closely, peeling back the layers to reveal their distinct mechanics. First in our crosshairs is divestment, perhaps the most visible yet ironically limited weapon in the arsenal of socially conscious investing. While it makes headlines and satisfies moral imperatives, its financial fingerprints tell a more complex story.



**Divestment** refers to ending support for disfavored activities or companies. The modern form of ESG emerged from the tradition of socially responsible investing. Divestment attained widespread attention during the efforts to end South Africa's apartheid regime and, more recently, with calls to divest from fossil fuels. Virtually every business operates on credit; therefore, a coordinated effort to prevent disfavored activities from securing financing would dramatically reduce the scale of economic activity. Divestment entails withdrawing investments from the stocks and bonds of disfavored companies, including avoiding index funds that contain these holdings.

Excluding specific options from a portfolio of investments would be expected to, on average, reduce the returns earned by a pension on these asset components. Furthermore, only the pensions actively divesting would incur the loss. The impact of divestment would be readily apparent when comparing returns earned by different pension funds. Worse performance would not necessarily be expected each quarter or year. Companies excluded from investment may perform poorly in each period or underperform when analysts expect strong results. If the divested companies represent a small portion of total assets, detecting the impact on returns may be difficult. Nevertheless, divestment would ultimately result in weaker performance for the pensions that adopt it, with returns on specific asset classes, such as equities or bonds, potentially revealing the effect.

**Acceleration** refers to investments made in favored activities or companies that are not strictly justified by expected returns. Investments in renewable energy, battery storage, and electric vehicles are often considered essential for achieving a net-zero energy transition. Despite modest financial returns to investors, expanding the capital directed toward these ventures reflects an ESG strategy that prioritizes societal benefits over immediate profits. Investors may also be encouraged to fund businesses aligned with the social and governance dimensions of ESG, such as minority- or female-owned companies or firms with diverse boards. These investments qualify as acceleration when they occur or are scaled up beyond what would be justified by expected financial returns alone.

The impact of this form of ESG on pension investment returns would depend on the earnings of favored businesses. At the time of investment, the expected returns must be lower or carry greater risk than comparable alternatives; otherwise, these ESG-focused investments would be defensible under fiduciary duty requirements. While some socially driven ventures may deliver competitive returns—just as occasional risky bets can pay off—the

general expectation is that investments to accelerate social change will yield lower returns, affecting only pension plans that choose to pursue them.

**Engagement** encompasses various efforts to influence the behavior of companies or institutions that receive investment dollars, promoting ESG objectives. Pension funds can influence the financial institutions managing their assets—whether through passively managed index funds or actively managed portfolios—and the companies in which they invest directly. Under Albert Hirschman’s well-known framework<sup>30</sup>, one might say that engagement represents using **voice** to sway the entities with which pensions do business. For instance, pensions might pressure financial giants such as BlackRock, State Street, and Vanguard to create ESG-themed investment funds and leverage their voting power in index funds to advance ESG priorities. Passive index funds, increasingly popular among investors, are held in trusts controlled by the issuing institutions, which not only have the right but, following an SEC mandate, also must vote the shares they hold.

Despite management’s wishes, voting these shares in support of ESG causes has become a significant element of ESG. A key aspect of engagement involves proxy voting on shareholder resolutions related to ESG. Many corporations have been burdened with costly shareholder proposals that were approved despite the board of directors’ recommendations. In some cases, board candidates have been voted out by dissenting shareholders for not sufficiently supporting ESG initiatives.

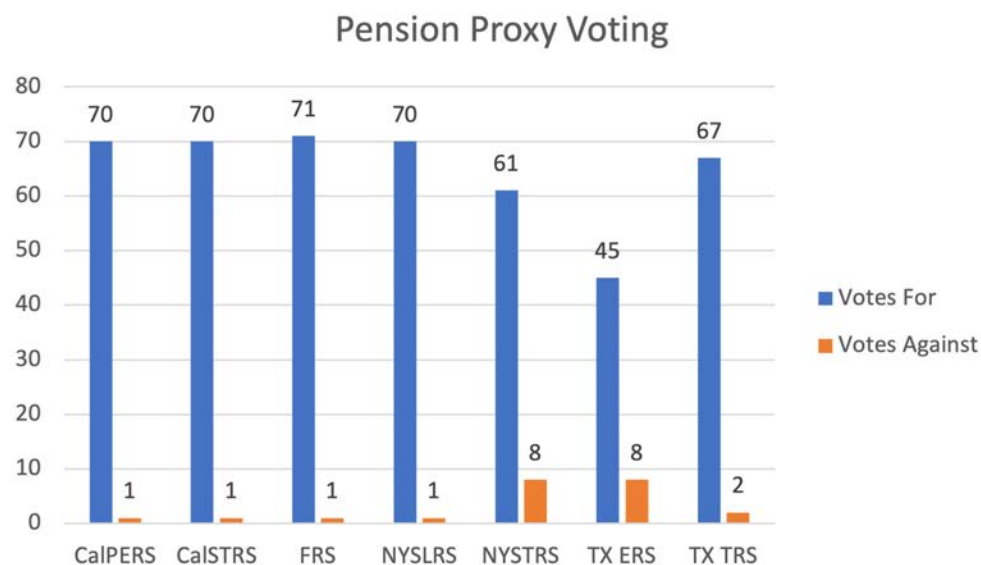
Shareholder engagement also involves voting on ESG-related resolutions. An increasing number of corporations have incurred substantial financial costs from proposals introduced by activist groups with minimal equity stakes. These measures have frequently passed despite board opposition, driven partly by the growing support for ESG from proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass Lewis. The resolutions have pursued various objectives, including removing board members, mandatory emissions disclosures or reduction targets for oil giants such as ExxonMobil and Chevron, and adopting costly initiatives, such as Apple’s mandated racial equity audit.<sup>31</sup>

Morningstar has created annual scorecards tracking votes on ESG-related shareholder proposals by state and local pension funds. For the 2021 proxy season, Morningstar compiled a list of 72 significant ESG proposals,

which included proposals like a racial equity audit for J.P. Morgan, Net Zero 2050 reports for ExxonMobil and Chevron, and a pay equity report for Oracle.<sup>32</sup> Morningstar then reviewed how pension systems voted on these 72 resolutions, compiling results for 20 of the largest public pension systems, including all seven systems analyzed in this report.

The voting results are presented in Figure 3. As expected, the two California systems and NYSLRS supported nearly all key ESG resolutions, with only one vote against each. Surprisingly, FRS and TXTRS also overwhelmingly backed these resolutions, opposing only three measures between them. In contrast, NYSTRS and TXERS voted against eight resolutions, with TXERS abstaining on more than a quarter of the measures. Overall, all the public pensions examined here consistently supported ESG shareholder resolutions in 2021.

**Figure 3: Proxy Voting on ESG Resolutions by Pension Systems**



Many of these shareholder proposals were costly for the affected corporations. Equity audits and climate change reports incur significant expenses, while advancing DEI often conflicts with merit-based considerations. These measures reduce corporate America's performance. Pensions invested in these major companies ultimately bear the cost through reduced returns for their members. Even pension systems in "Red States," such as Texas and Florida, overwhelmingly supported ESG shareholder resolutions.

While these shareholder proposals may impose significant costs on corporations, a broader question remains: How do these engagements affect the long-term financial outcomes for pension funds? The impact of engagement on investment returns differs significantly from strategies such as divestment or acceleration because it often directly influences corporate practices that can affect profitability. For instance, though well-meaning, shareholder resolutions focusing on diversity audits or climate change initiatives may have unintended financial consequences. Understanding these dynamics is crucial in assessing the actual cost of ESG engagement for pension funds, especially when evaluating the balance between ethical goals and economic performance.

The impact of engagement on investment returns differs significantly from divestment and acceleration. Some of the most notorious ESG shareholder resolutions appear likely to reduce the profitability of the affected companies. Apple's DEI audit is expected to cost millions of dollars and may undermine merit-based hiring for numerous positions within the company. ExxonMobil has halted and sold off oilfield development projects at a loss. These engagement efforts will reduce profitability and expected returns for these companies' stocks and bonds. However, the loss will be borne by all investors holding these stocks and bonds. Researchers will never be able to identify perfectly a difference in investment returns for pensions based on ESG engagement activity. To the extent that all invest broadly in leading corporations, all will suffer from ESG engagement.

CalPERS openly acknowledges, "We engage our portfolio companies to encourage them to consider how environmental, social, and governance (ESG) risks and opportunities affect their ability to create value over the long-term."<sup>33</sup> How so? Raymond Venner, a portfolio manager at CalSTRs, explains that "CalPERS addresses environmental policies through divestments, regulatory lobbying, shareholder activism, public relations, and investment policies."<sup>34</sup>

CalPERS acknowledges that it advances DEI initiatives through multifaceted approaches spanning leadership roles, partnerships, outreach, and advocacy. For instance, the organization joins entities such as Out Leadership and contributes to the CFA Institute's DEI efforts, while its Chief DEI Officer chairs industry committees and presents at major conferences.<sup>35</sup> Regarding collaboration and policy engagement, CalPERS participates in state-sponsored working groups addressing so-called healthcare equity, cultural competency, and quality standards, providing recommendations on policy

and accountability measures for healthcare providers.<sup>36</sup> Its workforce and career outreach includes participation in job fairs, conferences, and advisory meetings to promote DEI in hiring and professional development.<sup>37</sup>

CalPERS aims to establish thought leadership and public recognition through its presence in reports and media articles highlighting its governance, board diversity, and DEI initiatives while contributing to discussions on “inclusive capitalism” and investment strategies.<sup>38</sup> Additionally, the organization shares alleged best practices for DEI programs and employee resource groups with other state agencies, reinforcing its position as a model for purportedly inclusive workplace policies.<sup>39</sup> Through this comprehensive approach, CalPERS aims to advance DEI principles internally and throughout the broader financial and policy landscape.

Venner states, “CalPERS seeks to influence financial regulations by actively participating on regulatory advisory boards.”<sup>40</sup> Moreover, he says, “CalPERS leveraged its access to the SEC chair and staff to lobby for mandated corporate environmental disclosures.”<sup>41</sup> He reveals that CalPERS utilizes its shareholder influence to encourage companies to take climate action by submitting proposals, voting on boards, and collaborating with other investors. It also works closely with Climate Action 100+ to pressure major corporate polluters to meet strict climate targets, though success is often limited. On this point, we quote him at length:

CalPERS exercises its shareholder rights by filing and voting on shareholder proposals, nominating and voting on company board members, filing proxy solicitations, negotiating with company representatives, engaging in public relations, and coordinating with other shareholders. CalPERS cofounded and has remained a leading member of several organizations dedicated to shareholder environmental activism. Joining these organizations and coordinating with other members can strengthen shareholder bargaining positions. CalPERS closely collaborates with Climate Action 100+ (CA100), ‘an investor-led initiative to ensure the world’s largest corporate greenhouse emitters take necessary action on climate change.’ CA100 scores companies on a benchmark of ten climate indicators: emissions reductions over various time periods to net zero by 2050, decreased fossil fuel exploration and no ‘unsanctioned’ investments, lobbying and memberships that promote the Paris Climate Agreement, the

board's climate focus and expertise, executive compensation being contingent on company climate measures, disclosures of numerous climate measures, and 'Just Transition.' A CalPERS goal of such collaboration is that 'by 2050 all of these companies need to have reduced emissions by an order of 80 to 90 percent.' CA100 members press companies, often unsuccessfully, to take actions that increase their climate scores. CA100 coordinated a campaign by government pensions in California and New York to hold the board of a Texas energy company 'accountable on climate change.'<sup>42</sup>

Venner describes how, in 2022, CalPERS led climate negotiations with more companies than any other Climate Action 100+ member, pressuring them to align with emissions targets and climate policies.<sup>43</sup> If companies fail to meet these standards, CalPERS votes against their board members to push for more substantial commitments.<sup>44</sup> Although CalPERS has different financial responsibilities than other state agencies, it still supports California's climate policies, pushes companies like Ford and GM to disclose lobbying efforts, and invests heavily in sustainable projects.<sup>45</sup> CalPERS has been a leading force in shareholder environmental activism, but its investment performance has been relatively poor.<sup>46</sup> Over multiple periods, its returns have ranked among the worst compared to other pension funds.<sup>47</sup> In some cases, it has significantly underperformed benchmarks, raising concerns about whether its environmental focus conflicts with its duty to maximize returns for members.<sup>48</sup>

CalSTRS initiated its environmental engagement strategy in 2014 with a bold declaration about climate risk management in its investment approach. The organization's annual report emphasized the need to address "underlying risks of climate change."<sup>50</sup> Under the banner of risk mitigation, CalSTRS engaged in dialogues with 44 U.S. companies about fossil fuel reserve valuations—a process more complex than a straightforward financial assessment.<sup>51</sup>

The CalSTRS fund's subsequent investment trajectory demonstrated a significant expansion of clean energy investments, from \$1.4 billion to \$3.7 billion by 2019.<sup>52</sup> This investment aligned conveniently with the rhetoric of the 2014 UN Climate Summit, where CalSTRS positioned itself as a key player in global climate discussions. CalSTRS framed its approach as a strategic response to emerging market opportunities, arguing that low-carbon solutions represented a promising investment landscape.

However, the underlying logic of prioritizing environmental considerations over traditional financial metrics is contested. The fund seemed to be transforming what should be a purely financial management exercise into a platform for broader policy objectives.

Like CalPERS and CalSTRS, NYSTRS openly engages companies in which it holds equity positions. According to its 2023 Annual report, “NYSTRS engages with the companies in which the System invests, votes our proxies, and seeks opportunities to invest in companies and areas that can help mitigate the risks we have identified.”<sup>53</sup> Put differently, NYSTRS inappropriately pressures companies in which the System invests and uses retirees’ proxy votes to advance political agendas; it also diverts funds toward ideologically driven investments, allegedly to “mitigate risks,” potentially compromising financial returns for pensioners.

In a recent “Stewardship Update,” NYSTRS announced it had ramped up stewardship efforts by divesting from thermal coal, restricting investments in high-risk companies, revising its proxy voting policies, and engaging in investor coalitions.<sup>55</sup> Additionally, it stated it had reduced the carbon intensity of its portfolio, explored renewable energy investments, and developed policies to guide future stewardship and divestment decisions.

Given the predictable corporate engagement strategies of CalPERS and NYSTRS, it is reasonable to consider whether pension funds in traditionally more conservative states, such as Texas and Florida, adopt similar practices with their investment portfolios. Although the terminology and specific goals may vary, the core question remains whether these funds also aim to influence the companies in which they invest, how they exercise their shareholder voting rights, and what principles guide their investment decisions. This comparison provides insight into whether corporate engagement is a partisan strategy or a standard practice in pension fund management across the political spectrum.

A systematic examination of the annual reports from three prominent “Red State” public pension systems—FRS, TXERS, and TXTRS—spanning the decade from 2013 to 2023 revealed a notable absence of discourse related to corporate engagement strategies. Through a comprehensive textual analysis, we conducted a targeted search utilizing the keywords “engage,” “engagement,” and “engages” alongside “corporate” within these institutional documents. This analysis demonstrated a consistent and significant omission of substantive discussions regarding the deployment of pension assets for corporate engagement purposes.



When the term “corporate” emerged within these reports, it was predominantly used in contexts related to fixed-income instruments or financial performance metrics. While this methodological finding does not definitively preclude the existence of corporate engagement activities, it strongly suggests a minimal prioritization of such initiatives. The lack of explicit reporting implies deliberately minimizing ESG-related strategic interventions within these institutional investment frameworks.

However, as evidenced by the Morningstar report, even pension funds in traditionally ESG-resistant states, such as Texas and Florida, have pursued corporate engagement strategies incorporating ESG considerations. The deliberate downplaying or strategic communication of such activities may stem from multiple strategic imperatives, not least the anticipation of anti-ESG legislation. For instance, in 2021, Texas codified Senate Bill 13, a legislative measure prohibiting state institutions from investing in companies deemed to be boycotting energy companies, mandating complete divestment from any entities on the designated list. Following suit, Florida Governor Ron DeSantis signed House Bill 3 in 2023, which categorically prevents the incorporation of ESG factors in state and local investment decisions and procurement processes. While these legislative actions postdate much of the activity detailed in the annual reports under examination, political rhetoric may have suggested an emerging regulatory trajectory that astute institutional managers could have reasonably anticipated. The increasingly polarized stance toward ESG considerations could have signaled potential regulatory interventions that would fundamentally reshape institutional investment strategies.

Similar motivations for omitting language regarding corporate engagement may include aligning public messaging with legislative expectations, mitigating potential political backlash, minimizing exposure to legal challenges, adhering to a strict interpretation of fiduciary responsibility, or strategically navigating potential reputational risks. Alternatively, such funds may have pursued a more nuanced and targeted approach to ESG engagement, prioritizing confidentiality as a mechanism for effective institutional intervention.

The opacity of these engagement strategies suggests a sophisticated interplay between institutional investment practices, political landscapes, and strategic communication approaches. Funds may carefully calibrate ESG interactions to balance financial prudence, regulatory compliance, and nuanced stakeholder expectations.

The contrasting approaches to corporate engagement between the pension systems of California and New York, on one side, and those of Florida and Texas, on the other, reflect a significant divergence in investment philosophies. Whereas CalPERS and NYSTRS actively promote ESG-related objectives through shareholder activism, proxy voting, and targeted investments, the pension systems in Texas and Florida appear to encourage a more traditional, returns-driven model. This disparity indicates that corporate engagement is not a universally applied strategy but a practice shaped by political and regional factors, resulting in considerable variation across state pension systems.

### **Pension Fund Divestment and Acceleration**

An examination of pension system investment portfolios is warranted to identify potential divestment targets and acceleration investment opportunities to quantify their impact on annualized returns. Such an analysis safeguards against errors from greenwashing claims or discrepancies between publicly stated ESG commitments and actual investment practices.

Our analysis centers on equity investments in publicly traded corporations, as disclosed by the individual pension systems. We primarily relied on reported investments from the 2022-23 fiscal year; however, in certain instances, only current holdings were publicly accessible. Detailed equity investment data was obtained for four pension systems—CalPERS, CalSTRS, NYSLRS, and NYSTRS—while only limited return information was available for TXERS.

ESG strategies often involve divestment from industries deemed undesirable. Gun manufacturers and tobacco companies, long targeted for exclusion, are included in our analysis. More recently, the environmental component of ESG has prioritized fossil fuel divestment and the broader push for net-zero emissions. As noted earlier, several contentious shareholder resolutions have called for net-zero commitments and sought to restrict the operations of oil companies.

Our review encompasses multiple segments of the fossil fuel industry, including coal, oil and gasoline, natural gas, and public utilities. The status of utilities concerning climate objectives is somewhat ambiguous. On one hand, electric utilities could play a pivotal role in replacing oil and gas, particularly by integrating wind, solar, and battery storage. On the other

hand, natural gas utilities have increasingly faced disfavor from climate activists. We include all these energy sector segments in our examination to identify potential divestments that could impact returns.

Renewable fuels and electric vehicles are the most notable categories of potential acceleration investments. The capital required to transition to carbon-free energy will reach trillions of dollars. ESG advocates justify such investments as essential to facilitating or expediting this transition. Our analysis identifies investments in four key areas: solar power, wind power, electric vehicles, and electric vehicle batteries.

Our review of pension system portfolios revealed significant allocations to passive investment vehicles, predominantly those replicating the S&P 500 index or other major market benchmarks. To evaluate divestment patterns, our analysis begins with the constituent companies of the S&P 1500 composite index, which encompasses corporations across large, mid, and small capitalization segments. We employ S&P industry classifications to identify relevant entities within the tobacco, coal, and utilities sectors. However, where these classifications yielded insufficient sample sizes for particular categories, we supplemented our dataset with industry-leading firms identified through alternative financial information sources like Yahoo Finance, specifically targeting global leaders in firearms manufacturing and distribution, coal production, wind and solar energy, electric vehicle manufacturing (largely corresponding with major automotive producers), and electric vehicle battery technologies.

Having identified companies within each industry segment, we analyzed equity holdings (both domestic and international) across the available systems to determine current investments in these entities. Table 4 presents these findings, detailing absolute investment amounts and their relative proportions as percentages of total equity allocations. We begin our examination with longstanding controversial sectors—firearms and tobacco—displayed in the upper section of the table.

**Table 4: Potential Divestment and Acceleration Stock Investments**

	CalPERS		CalSTRS		NYSLRS		NYSTRS	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Gun Manufacturer	0	0%	\$2	33%	\$2	33%	\$0.3	33%
Tobacco	\$0	0%	\$0	0%	\$0	0%	\$271	100%
Gun Retailer	\$1,238	100%	\$586	100%	\$414	100%	\$421	100%
Guns & Tobacco Totals	\$1,238	0.63%	\$588	0.43%	\$416	0.44%	\$692	0.99%
Coal	\$300	32%	\$78	20%	\$73	32%	\$14	8%
Oil Exploration & Drilling	\$299	37%	\$269	73%	\$450	95%	\$151	95%
Oil and Gas	\$2,507	67%	\$2,264	100%	\$2,265	74%	\$1,247	100%
Natural Gas	\$219	44%	\$349	78%	\$153	89%	\$191	100%
Fossil Fuels Total	\$3,325	1.69%	\$2,960	2.14%	\$2,941	3.16%	\$1,604	2.29%
Electric Utilities	\$2,579	82%	\$906	100%	\$681	100%	\$558	95%
Gas Utilities	\$205	78%	\$86	89%	\$65	100%	\$52	100%
Multi-Utilities	\$2,188	88%	\$654	94%	\$648	100%	\$468	94%
Utilities Total	\$4,972	2.54%	\$1,647	1.19%	\$1,394	1.50%	\$1,078	1.54%
Solar	\$60	50%	\$34	40%	\$1	50%	\$11	30%
Wind	\$67	50%	\$70	30%	\$79	50%	\$12	40%
Electric Vehicles	\$2,972	93%	\$1,887	100%	\$1,186	93%	\$1,325	93%
EV Batteries	\$246	80%	\$164	60%	\$51	80%	\$37	80%
Alternative Energy Total	\$3,245	1.66%	\$2,156	1.56%	\$1,316	1.41%	\$1,385	1.98%

(a) – Amount of investments, in millions of dollars

(b) – Percent of companies in the category owned by the pension system; in the category total, this is the percentage of pension equity investments invested in this category.

The pension systems have predominantly divested from tobacco manufacturers and firearms producers, with NYSTRS constituting the sole exception in the tobacco sector.

NYSTRS maintains positions in all three tobacco companies listed on the S&P 1500, representing a cumulative investment exceeding \$250 million. Regarding firearms manufacturing, only one of the three leading producers (Sturm, Ruger) appears on the S&P 1500, and no pension system holds positions in more than a single manufacturer, with aggregate investments amounting to less than \$4 million.

However, divestment practices have not extended to firearms retailers. All four systems maintain investments in the three largest firearms retailers, each represented on the S&P 1500.

Following the 2012 Sandy Hook Elementary School Massacre, CalPERS and CalSTRS publicly declared their intentions to divest from the firearms industry.<sup>56</sup> Our analysis underscores the importance of scrutinizing the specific parameters of such divestment declarations. Upon closer examination, the California divestment mandate specifically required withdrawal from investments in manufacturers producing illegal firearms for sale within California rather than encompassing all firearms retailers. When evaluated against these criteria, the pension systems appear to have adhered to their stated commitments.<sup>57</sup>

Have the pension systems divested from fossil fuels and the broader energy sector? To date, none of the four progressive state systems have done so. The fossil fuel market segment is presented in Section 2 of Table 4. Though there is some indication of divestment from coal, most of the top 25 coal companies in our sample are international and not listed on the S&P 1500. In contrast, the companies in the other three energy segments are all S&P-listed and widely held by the four systems. Collectively, the systems maintain over \$10 billion in fossil fuel investments, although only a tiny fraction—approximately \$464 million—is allocated to coal companies. The limited coal holdings may reflect fiduciary considerations rather than ESG-driven divestment, as U.S. coal companies suffered significant financial losses during the Obama administration, and many countries have pledged to phase out coal plants as part of their commitments under the 2015 Paris Climate Agreement.

The third section of Table 4 details investments in utility companies. As noted, utilities—particularly electric utilities—are likely to play a key role in the energy transition, making divestment from this sector unlikely, even under stringent net-zero mandates. Indeed, no such divestment has occurred, as evidenced by the more than \$8 billion in utility stock holdings

spread across all four systems. This broad ownership is likely driven by the fact that these companies are listed on the S&P 1500. Notably, the pension systems also maintain significant holdings in natural gas utilities, despite recent campaigns by climate activists advocating for the elimination of natural gas—a factor that could render such investments increasingly contentious.

This analysis reveals the practical challenge of quantifying the impact of divestment on pension system returns, primarily due to the modest scale of potentially divested holdings. Consider NYSTRS's tobacco company investments—a sector from which other systems have withdrawn—representing less than 0.5 percent of its total equity portfolio. Assuming CalPERS and CalSTRS would have maintained comparable allocations, the financial consequence of forgoing even exceptional returns on such a minimal portfolio component would be negligible in terms of overall system performance.

Even the more substantial fossil fuel sector investments, ranging from 1.7 to 3.2 percent of total equity holdings (typically approximately half of total investment assets), present similar measurement challenges. While excluding fiduciarily justified investments solely to pursue ESG objectives remains problematic in principle, the practical financial impact of missing potentially attractive returns on approximately two percent of equity investments—roughly one percent of total assets—would likely be modest and potentially statistically indiscernible in performance evaluations.

We also consider acceleration investments in alternative energy, detailed in the lower section of the table. These investments are predominantly focused on the electric vehicle sector, which, apart from Tesla and Rivian, mainly includes large traditional automotive manufacturers. As a result, it is difficult to determine whether these investments were intended to advance electric vehicle development or support conventional combustion engine production. Investments specifically in wind, solar, and electric vehicle battery technologies amount to only \$730 million, representing no more than 0.2 percent of any individual system's equity portfolio. Moreover, even if these investments underperform, dedicating a small portion of a portfolio to higher-risk, growth-oriented assets aligns with fiduciary responsibilities.

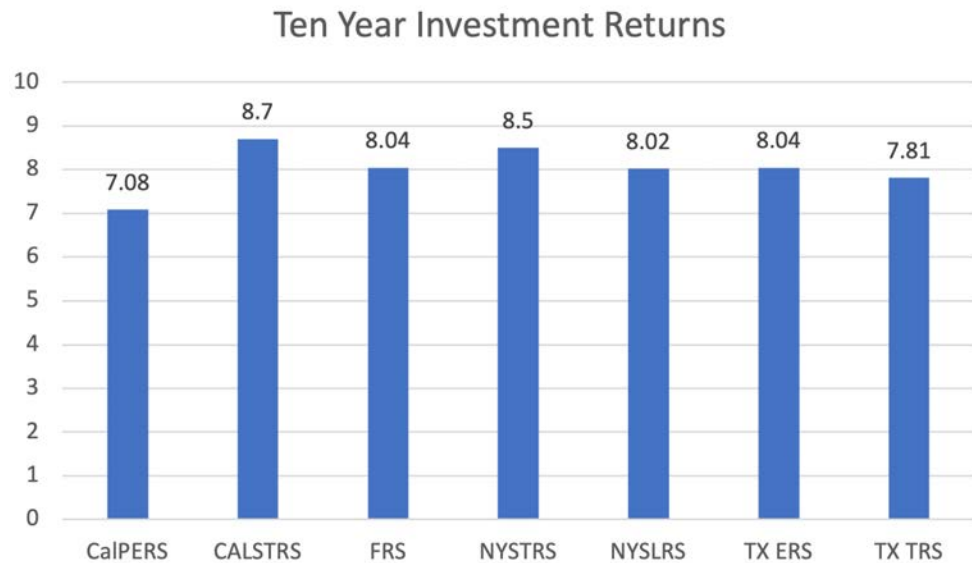
However, the risk is not negligible and should not be overlooked, particularly if system managers fail to address warning signs related to these investments. For instance, consider the equity holdings in electric vehicle

manufacturer Rivian and wind turbine producer Vestas Wind Systems. The four pension systems collectively had \$36 million and \$200 million invested in these companies, respectively, carrying considerable risk. In 2024, Elon Musk predicted that Rivian might go bankrupt (although his perspective is not impartial), and technical analysis suggested a 30 percent likelihood of bankruptcy. CalPERS's book value for its investment in Rivian was \$41 million; by late March, these holdings had lost approximately 70 percent of their value. Additionally, several major wind projects were canceled in 2024, resulting in significant write-offs for wind energy companies. Rising interest rates have also impacted the profitability of these capital-intensive, long-term investments, while opposition to wind and solar projects has been growing. Considering the past failures of alternative energy companies like Solyndra, a key question arises: Are alternative energy investments truly high-risk ventures, or are they inherently flawed?

The next focus is on the rate of return for these pension systems. Given the previously noted lack of significant divestment from fossil fuels, notable variations in returns are not expected. As such, returns are not analyzed yearly to assess any potential reduction linked to divestment. Figure 5 presents the annualized rate of return over ten years. Three pension systems show nearly identical returns, ranging from 8.02 to 8.04 percent, while two systems perform lower, with CalPERS at 7.08 percent and TX TRS at 7.81 percent. Conversely, two systems outperform: NYSTRS at 8.5 percent and CalSTRS at 8.7 percent.

CalPERS's extensive engagement with ESG initiatives may lead some to attribute its relatively low rate of return to these efforts. However, CalSTRS, which included more references to ESG in its annual reports, achieved the highest ten-year return of the seven systems analyzed. Similarly, NYSLRS, which placed the most emphasis on ESG, performed near the median in terms of returns. The average ten-year return for the three most ESG-active systems, as shown in Box 1, was 7.93 percent, while the four systems with the least ESG involvement averaged 8.10 percent. While it is possible that ESG activism could account for this difference, one would expect such engagement to lower returns across the board. The equity investments reviewed here do not conclusively indicate that ESG is the primary factor responsible for the lower returns observed.



**Figure 5: Ten Year Annualized Investment Returns**


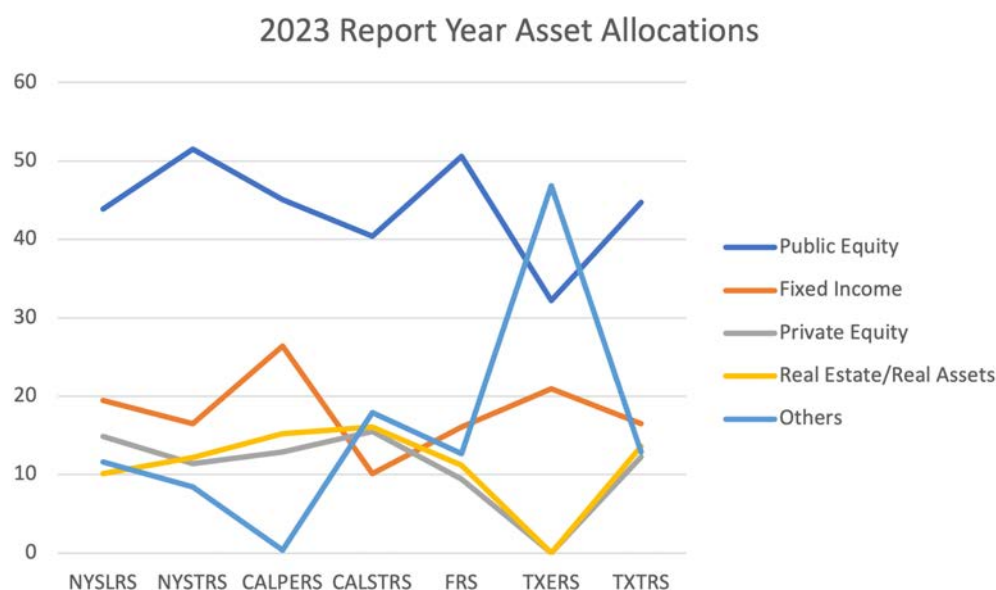
Although the differences in annual rates of return shown in Figure 5 may seem small, compounding over a ten-year period results in a substantial gap in accumulated asset values. The 1.6 percentage point difference between CalPERS and CalSTRS translates to a disparity of more than thirty percentage points in total accumulation after ten years.

Previous literature has suggested a correlation between ESG investing and lower returns. How, then, can we explain our findings? Most of the academic discourse centers on investments made by ESG-themed funds or in companies that score highly on ESG metrics. Such specialized ESG funds generally underperform relative to broader stock market indices.<sup>58</sup> Few studies have specifically addressed the impact of ESG activities by pension systems on investment returns; accordingly, a definitive link between the two remains unexplored. Venner argues that CalPERS's subpar returns are a direct consequence of its ESG strategy, although this assertion is based on comparing its annual returns to those of other pension systems. Although similar evidence is presented in Figure 5, establishing a causal relationship between these returns and ESG engagement remains highly speculative.

Finally, we consider the allocation of pension system assets across various investment categories. As noted earlier, a pension system's decision to divest from certain assets for ESG reasons may be counterbalanced by reallocating funds into riskier, potentially higher-yielding investments. Critics have long argued that public pensions have been overexposed to risk, given the predictable nature of the benefits they must pay out. The seven pension

systems examined here employ differing asset categories, so we consolidated the reported categories for each system into five groups, as illustrated in Figure 6. These groups include public equity, fixed income (bonds), private equity, real estate and tangible assets, and an “Other” category. The asset allocations are based on actual amounts (rather than target ranges) reported at the close of the 2022-23 fiscal year.

**Figure 6: Asset Allocations in 2023**



Public equity is, as expected, the largest category across all pension systems, with the “Other” category for TXERS encompassing multiple subcategories, each smaller than its public equity investment. Stocks constituted between 32 percent and 52 percent of total assets. Bonds, on the other hand, accounted for 10 percent to 26 percent of assets. Private equity has increasingly captured a larger portion of pension investments in recent years, driven by the potential for substantial returns. This category ranged from 9.4 percent to 15.5 percent, except for TXERS, which did not report a directly comparable category.

The asset allocations for 2023 may offer some insight into CalPERS’s reported returns. CalPERS allocated the highest proportion of its assets—71.5 percent—to public equity and fixed income, opting not to invest in alternative assets that promise higher returns. In contrast, CalSTRS, which demonstrated the strongest ten-year performance, allocated just over 50 percent of its assets to these two traditional categories.

Our analysis of pension system investment portfolios highlights several important considerations regarding ESG strategies, divestment practices, and their potential impact on returns. While divestment from industries such as firearms and tobacco has been more widely adopted, investments in fossil fuels and utilities remain prevalent, complicating the assessment of ESG's financial impact. The relatively modest scale of potentially divested holdings and the minimal effect on overall system performance suggest that divestment from specific sectors may not significantly affect long-term returns. Similarly, investments in renewable energy, including electric vehicles and alternative energy technologies, though high-risk, account for only a small fraction of pension systems' portfolios, making their effect on returns difficult to measure conclusively. Furthermore, our findings suggest that ESG engagement, although potentially influencing investment decisions, does not establish a clear, causal link to the lower returns observed in certain systems. The allocation of assets across traditional and alternative categories plays a more significant role in shaping the financial outcomes of these pension systems, with the highest returns associated with systems maintaining a balanced, diversified approach to investment.

## Conclusion

This study of ESG investing across several public pension systems reveals a landscape more complex—and perhaps more politically calculated—than either proponents or critics might acknowledge. The stark contrast between rhetoric and reality suggests that the actual financial impact of ESG strategies on pension performance remains frustratingly elusive to measure.

Three key insights emerge from our investigation. First, despite bold public declarations about climate commitments and sustainability goals, pension funds in California and New York have not widely divested from fossil fuel companies. Their equity portfolios maintain billions in traditional energy investments, with only minimal allocation to alternative energy technologies. This selective approach to divestment—targeting politically contentious but financially negligible sectors, such as firearms and tobacco, while maintaining substantial positions in fossil fuels—suggests a careful balancing act between progressive positioning and fiduciary responsibility.

Second, the ESG activity of these public pension funds primarily manifests through corporate engagement rather than portfolio construction. The extensive proxy voting, shareholder resolutions, and corporate pressure campaigns documented in our study represent the actual mechanics of pension ESG activism. This strategy has profound implications for the financial system: unlike divestment, which affects only the institution making the divestment, engagement-driven changes to corporate behavior impact all investors holding these securities. The costs are thus diffused across the entire market, making them virtually impossible to isolate in performance metrics.

Third, we found no conclusive evidence that ESG activities significantly impact pension fund returns. The three most ESG-active systems averaged 7.93 percent in ten-year returns, compared to 8.10 percent for less ESG-involved systems—a difference too small to attribute to ESG factors alone definitively. Asset allocation decisions and broader investment strategies appear to impact overall performance significantly more than ESG considerations.

This research highlights a critical gap in the public discourse around ESG investing. While political battles rage over the appropriate role of environmental and social considerations in institutional investing, the practical reality is that pension funds have developed methods to advance ESG objectives without significantly altering their investment portfolios.

Through engagement rather than divestment, these institutions have found ways to influence corporate America while maintaining plausible deniability about sacrificing returns.

As pension funds continue to navigate the politically charged waters of ESG investing, the retirement security of millions of public servants hangs in the balance. Our findings suggest that a more nuanced, evidence-based approach to evaluating the financial impact of ESG is urgently needed—one that looks beyond simple portfolio comparisons to capture the complex, market-wide effects of institutional investor activism. Until such methods are developed, the actual cost of ESG investing on public pension performance will remain hidden in plain sight.

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