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Pension Funds Cannot Compel Speech Through ESG Investments

Traders work on the floor of the New York Stock Exchange in New York City, March 16, 2023.*(Brendan McDermid/Reuters)*

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Pension funds should not be playing politics with other people's money.

IMAGINE your hard-earned retirement savings subsidizing causes you vehemently oppose. But you don't have to imagine. It is happening now.

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Public pension funds now account for some $6 trillion, and they are increasingly involved in Environmental, Social, and Governance (ESG) investing, potentially turning pensioners' money into material support for environmental crusaders and social-justice warriors.

Investing by public pension funds in ESG essentially compels the speech of pensioners (other than those who have given their specific consent) whose personal beliefs may not align with ESG goals and values, including issues such as boycotting energy firms or weighting investment selection toward companies with diversity, equity, and inclusion (DEI) policies.

Recently, we have seen some high-profile examples of public pension funds pushing a social and environmental agenda through ESG-weighted portfolios. Consider New York City's commitment to net-zero investments by 2040. Or consider that the United Nations Principles of Responsible Investing (UNRPI) were signed by CalPERS in 2008, CalSTRS in 2010, and the University of California system in 2014. The debate over the prudence of these investments centers on whether these funds should prioritize return or broader societal issues. It adds insult to injury when those issues are extremely controversial.

The Employee Retirement Income Security Act (ERISA), a federal law covering private-industry pensions, does not govern state investments of pension funds. State pensions are constrained by that state's fiduciary-duty laws — like financial guardrails — which may limit support for social or environmental causes through index funds (if those investments risk negative long-term returns). A recent meta-analysis of 153 empirical studies and over 1,000 observations provides mixed results on the link between ESG ratings and financial performance. For example, one recent study reports that ESG mutual funds perform worse financially and charge higher fees.

In the 2018 *Janus v. American Federation of State, County, and Municipal Employees* case, the Supreme Court struck down an Illinois law requiring public workers to pay union fees if they disagreed with the union's actions. The Court reasoned that forcing individuals to support opposing ideas violates the Constitution's First Amendment, and that compelled speech is particularly harmful. "Because the compelled subsidization of private speech seriously impinges on First Amendment rights, it cannot be casually allowed," wrote Justice Alito.

Enter Mark Kubisch, a professor at Pepperdine's Caruso School of Law. His recent journal article argues that the Supreme Court's stance on compelled speech in *Janus* might render public pension funds' ESG investments unconstitutional.

Why? Because forcing state employees to contribute to these pension funds, which then use the employees' money to support ESG causes, effectively compels their speech. This government arrangement requires public employees to financially endorse the speech of investment managers who decide on ESG investments, thereby violating their First Amendment rights.

This reasoning could lead to significant financial challenges for states. The requirement for individuals to join funds engaging in political advocacy could disrupt automatic-enrollment plans, particularly when those funds endorse ESG causes and activism.

What if the states reimburse pensioners (or, potentially, taxpayers if they were underwriting the funds) for the losses suffered or profits foregone as a result of investment decisions driven by ideological rather than pecuniary considerations, losses that were made possible by compelled speech? It's not hard to see how this could mean difficulty for the more cash-strapped among them.

At the very least, applying the *Janus* principles to public pension funds should mean that the operation of automatic-enrollment plans designed to encourage retirement savings will need to be modified, unless those plans already require positive assent to investment in funds that apply ESG principles.

Let's applaud the litigators ready to take on abusive pension funds. They could rescue retirees from the costs of inserting political agendas into what is supposed to be responsible investing. Unless otherwise agreed to by its beneficiaries, a pension fund should be managed to maximize risk-adjusted return for its beneficiaries. Pension funds should not be playing politics with other people's money.

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