

**Statement to the Senate Committee on Health, Education, Labor, and Pensions**

***Hearing:***

*The Future of Retirement*

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Dirksen Senate Office Building, Room 430

***ESG Investing, ERISA, and Pension Security***

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*The Manhattan Institute for Policy Research does not take institutional positions on legislation, rules, or regulations. Although my comments draw upon my research as an Institute scholar, my statement before the subcommittee is solely my own, not my employer's.*

## Written Statement

Chairman Cassidy, Ranking Member Sanders, and Senators, thank you for opportunity to testify before this Committee. My name is James R. Copland. Since 2003, I have been affiliated with the Manhattan Institute for Policy Research, a nonprofit public-policy think tank in New York City, where I have long been a senior fellow and directed the Institute’s legal policy research. Although my comments draw upon such research conducted for my employer, my statement before the Committee is solely my own.

The subject of today’s hearing—the future of retirement—could not be more pressing. The United States faces a twin retirement challenge: our Social Security system is on an inexorable path toward paying reduced benefits within the next decade or so, absent substantial tax increases that would have a host of deleterious macroeconomic consequences; and a large percentage of American workers have insufficient private savings to withstand those looming Social Security cuts.

As my Manhattan Institute colleague Jessica Riedl has long emphasized, Social Security’s financing structure is far more fragile than commonly understood.<sup>1</sup> Although the program is often described as “self-financed,” Social Security has been running persistent cash-flow deficits for more than a decade, paying out more in benefits each year than it collects in payroll taxes and other dedicated revenues. The program has been able to maintain full benefit payments only because it is legally entitled to draw down accumulated “trust fund” balances, built during earlier decades when revenues exceeded costs. Those surpluses—roughly \$3 trillion at their peak—are projected to be depleted within the next decade. As Riedl explains: “Current law mandates that when the trust fund balance hits zero . . . the system will be legally forbidden from borrowing or receiving any more general revenues. Program spending must then fall to match the system’s revenues, and that will mean an automatic across-the-board 23 percent benefit cut.”<sup>2</sup>

On top of Social Security’s pending insolvency, our private retirement saving is plainly inadequate for a large fraction of U.S. households. According to the Bureau of Labor Statistics, only about 15 percent of private industry workers have defined benefit pension plans;<sup>3</sup> and according to the Congressional Research Service, only 54 percent of U.S. households have any defined contribution pension plan or other retirement plan assets.<sup>4</sup> Among those that did, the

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<sup>1</sup> See Riedl, “Ten Myths Sabotaging Social Security Reform,” *The Dispatch*, Mar. 1, 2024, <https://thedispatch.com/article/ten-myths-sabotaging-social-security-reform/>.

<sup>2</sup> *Id.*

<sup>3</sup> U.S. Bureau of Labor Statistics, “15 Percent of Private Industry Workers Had Access to a Defined Benefit Retirement Plan,” Apr. 19, 2024, *available at* <https://www.bls.gov/opub/ted/2024/15-percent-of-private-industry-workers-had-access-to-a-defined-benefit-retirement-plan.htm>.

<sup>4</sup> Elizabeth A. Myers, Congressional Research Service, “Ownership of Retirement Accounts in 2022: Amounts in Defined Contribution Plans and Individual Retirement Accounts,” July 29, 2024, *available at* <https://www.congress.gov/crs-product/R48143>.

median retirement account balance was only \$87,000 and the average about \$334,000<sup>5</sup>—hardly adequate to finance comfortable retirements given modern life expectancies.

Although the enormity of this problem is beyond the scope of this written testimony, I would like to draw the Committee’s attention to my research on one issue compounding the problem of pension inadequacy.<sup>6</sup> For pension plans governed under the Employee Retirement Income Security Act (“ERISA”),<sup>7</sup> a series of vacillating guidance and rulemaking from the U.S. Department of Labor over the last 30 years<sup>8</sup> has generated significant uncertainties around pension plans’ actual fiduciary duties to their beneficiaries—compromising plans’ solvency.

### ***ERISA’s Mandate: Maximizing Financial Returns***

A plan manager governed by the Employee Retirement Income Security Act (“ERISA”) has a strict fiduciary duty to manage the plan “*solely* in the interest of the participants and beneficiaries.”<sup>9</sup> ERISA plans must be managed “for the *exclusive* purpose of providing [financial]<sup>10</sup> benefits to participants and their beneficiaries,” balancing those benefits *only* against cost constraints.<sup>11</sup> Implicitly and clearly, other interests beyond maximizing financial benefits and minimizing costs—including environmental, social, and governance (ESG) goals collateral to actual risk-and return analysis—should not, and under the law may not, be considered by ERISA plan fiduciaries.<sup>12</sup>

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<sup>5</sup> *Id.*

<sup>6</sup> This testimony draws from my 2021 comment letter to the Department of Labor on its rulemaking modifying treatment of environmental, social, and governance (ESG) factors in ERISA plan management. See James R. Copland, Comment to the Department of Labor, RIN 1210-AC03, “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” Dec. 13, 2021, *available at* <https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AC03/00793.pdf>.

<sup>7</sup> Employee Retirement Income Security Act of 1974 § 404(a)(1) (emphasis added), *codified at* 29 U.S.C. § 1104(a)(1).

<sup>8</sup> See, e.g., 59 Fed. Reg. 32606 (June 23, 1994); 73 Fed. Reg. 61731 (Oct. 17, 2008); 80 Fed. Reg. 65135 (Oct. 26, 2015); 81 Fed. Reg. 95879 (Dec. 29, 2016); 85 Fed. Reg. 39113 (June 30, 2020); 85 Fed. Reg. 55219 (Sept. 4, 2020); 85 Fed. Reg. 72846 (Nov. 13, 2020); 85 Fed. Reg. 81658 (Dec. 16, 2020); 86 Fed. Reg. 57272 (Oct. 14, 2021).

<sup>9</sup> See 29 U.S.C. § 1104(a)(1) (emphasis added).

<sup>10</sup> Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 420-21 (2014).

<sup>11</sup> ERISA, *supra* note 7, at 1104(a)(1)(A) (emphasis added).

<sup>12</sup> For a description of “collateral benefits ESG” versus “risk-return ESG” investing, see Max M. Schanzenbach & Robert H. Sitkoff, “Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee,” 72 *Stan. L. Rev.* 381, 382 (2020). For a discussion about how this dichotomy should be applied in terms of ERISA fiduciary duties, see Bernard S. Sharfman, “ESG Investing Under ERISA,” 38 *Yale J. Reg. Bull.* 112, 117–19 (2020), <https://digitalcommons.law.yale.edu/jregonline/6>.

### ***Vacillating Determinations of ERISA Duties***

In the waning days of the first Trump administration, the Department of Labor promulgated rules that largely comported with the language of ERISA and the governing judicial opinions. The Department’s rule specified, appropriately:

- “ERISA requires plan fiduciaries to select investments and investment courses of action based solely on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action”;<sup>13</sup>
- “[P]lan assets may not be enlisted in pursuit of other social or environmental objectives”;<sup>14</sup> and
- “ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of non-pecuniary objectives.”<sup>15</sup>

Unfortunately, soon after the change in administration following the 2020 presidential election, the Department of Labor reversed course.<sup>16</sup> Under the Biden administration, the Department jettisoned the just-promulgated standard and instead countenanced—and perhaps even encouraged—pension investments oriented toward ESG concerns that go beyond the exclusive purpose permitted in the ERISA statutory mandate.<sup>17</sup>

### ***Risks of Infusing ERISA Investments with ESG Principles***

With limited exceptions—which do not constitute the strategies employed in the overwhelming majority of current ESG investing—subordinating ordinary financial standards to ESG concerns will lead to reduced returns, either through a lack of diversification or increased costs.<sup>18</sup> To be clear: factors that are commonly characterized as

<sup>13</sup> U.S. Dep’t of Labor, Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39,113 (June 30, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf>. The rule used the language “risk-adjusted economic value” rather than “financial value,” which could have created ambiguity permitting plan managers to sneak in non-pecuniary “risk” concerns. See Sharfman, *supra* note 12, at 113 & n.8

<sup>14</sup> *Id.* at 116. The DoL also should not have allowed a “tie breaker” or “all things being equal” standard, which might allow plan managers principally motivated by collateral concerns to sneak in financially imprudent investment decisions under the guise of apparent but nonexistent equipoise. See Sharfman, *supra* note 12, at 130–31.

<sup>15</sup> *Id.*

<sup>16</sup> U.S. Dep’t of Labor, Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272 (Oct. 14, 2021), available at <https://www.federalregister.gov/documents/2021/10/14/2021-22263/prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights>.

<sup>17</sup> See *id.*; see also Copland, *supra* note 6.

<sup>18</sup> See Bradford Cornell & Aswath Damodaran, Valuing ESG: Doing Good or Sounding Good? (Mar. 20, 2020), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3557432](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3557432) (citing TIAA-CREF Annual Report, 2017, p. 34) (observing that “a constrained optimum can, at best, match an unconstrained one, and most of the time, the constraint will create a cost”).

ESG may be material for active investors to consider when valuing securities. E.g., unless one believes in the strongest form of the efficient market hypothesis,<sup>19</sup> there are situations in which the market may misprice a company’s risk premium associated with global warming (including particularly regulatory risks) or the effectiveness of a company’s board composition or governance structures. And an investor with a strong view of market mispricing may even choose to place bets on such factors—effectively doing in-depth company-by-company analyses and taking long or short positions on a security, much like a merger-arbitrage fund places bets on the risk profile of an announced merger actually taking place.<sup>20</sup>

In a 2020 law review article in the *Stanford Law Review* considering ESG investing and fiduciary duties, law professors Max Schanzenbach and Robert H. Sitkoff characterize this form of ESG investing as “risk-return” ESG investing.<sup>21</sup> In contrast, Schanzenbach and Sitkoff characterize investment strategies that sublimate financial return to nonpecuniary objectives—in purpose or effect—“collateral benefits” ESG investing.<sup>22</sup> The latter form of investing violates fiduciary duties of *prudence* and *loyalty*, duties which can only be satisfied if “(1) the trustee reasonably concludes that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee’s exclusive motive for adopting the ESG investment program is to obtain this direct benefit.”<sup>23</sup>

The actual strategies employed by most ESG-focused funds trading in public securities fail to meet these criteria. As Schanzenbach and Sitkoff explain, there are two broad categories of strategies for trading in securities by using ESG factors on public exchanges: *screens* and *stock picking*. Screening strategies employ simple, consistent criteria to eliminate “bad” companies or select “good” companies from the market universe—e.g., a *market index* limited by some social criteria, such as the MSCI KLD 400 Social Index.<sup>24</sup> However, “empirical studies find that, on a risk-adjusted basis, employing ESG screens leads to performance about the same as or worse than their benchmark indices.”<sup>25</sup> Similarly, there is a well-developed economic literature showing how active stock picking—adjusting for risk

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<sup>19</sup> Cf. *Basic v. Levinson*, 485 U.S. 224, 247 & n.24 (1988) (discussing efficient-market hypothesis).

<sup>20</sup> See Schanzenbach & Sitkoff, *supra* note 12, at 437–39.

<sup>21</sup> *Id.* at 397.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 386.

<sup>24</sup> See Sharfman, *supra* note 12, at 120–21.

<sup>25</sup> Schanzenbach & Sitkoff, *supra* note 12, at 440 (citing Benjamin R. Auer & Frank Schuhmacher, “Do Socially (Ir)responsible Investments Pay? New Evidence from International ESG Data,” 59 *Q. Rev. Econ. & Fin.* 51, 57-60 (2016) (finding little difference between returns for high and low ESG funds in the U.S., though high ESG European funds tend to underperform)).

and transaction costs—tends to underperform passive stock indexing (the very reason for the broad emergence of stock-index funds in the first place<sup>26</sup>).<sup>27</sup>

The aforementioned difficulties aside, there is substantial empirical evidence that certain activist hedge funds have, over the long run, been significantly wealth-enhancing for investors.<sup>28</sup> Successful activist hedge funds accumulate sizable concentrated holdings in idiosyncratic companies based on “a determination by the hedge fund that the target company is currently not maximizing returns, but that if management would implement the hedge fund’s recommended changes, company performance would improve, the stock would increase in value, and the hedge fund would reap excess returns.”<sup>29</sup>

Some ESG plan managers may claim that their engagement strategies with companies—consisting of, e.g., introducing and voting on shareholder proposals or discussing ESG concerns with corporate leadership—are themselves a form of risk-return investing akin to activist hedge fund engagements. But the two strategies could not be more different. Large institutional investor fund families have relatively small corporate-governance and shareholder-engagement operations,<sup>30</sup> only loosely linked to asset managers selecting securities, through which they engage in ESG activism with a host of companies held in heavily diversified portfolios. It strains credulity to believe that these thinly staffed corporate-governance offices will be able to improve firm performance through blunderbuss ESG engagement comparable to the targeted investment strategies of activist investors taking concentrated market positions.

### ***Costs of Subverting ERISA Plans’ Duties to ESG Goals***

Such concerns are not merely theoretical. In 2008, the California State Teachers’ Retirement System (CalSTRS) estimated that the fund had lost \$1 billion in potential gains after State Treasurer Phil Angelides pressured California’s pension funds to divest from

<sup>26</sup> See Jeff Cox, “Passive Investing Automatically Tracking Indexes Now Controls Nearly Half the US Stock Market,” *CNBC.com*, Mar. 19, 2019, <https://www.cnbc.com/2019/03/19/passive-investing-now-controls-nearly-half-the-us-stock-market.html>.

<sup>27</sup> Kenneth R. French, Presidential Address, “The Cost of Active Investing,” 63 *J. Fin.* 1537, 1561 (2008) (concluding that a passive investor from 1980 to 2006 would have beaten an active investor by sixty-seven basis points per year).

<sup>28</sup> See, e.g., Lucian A. Bebchuk, Alon Brav & Wei Jiang, “The Long-Term Effects of Hedge Fund Activism,” 115 *Colum. L. Rev.* 1085, 1085 (2015); Robin M. Greenwood & Michael Schor, “Investor Activism and Takeovers,” 92 *J. Fin. Econ.* 362, 374 (2009); April Klein & Emanuel Zur, “Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors,” 64 *J. Fin.* 187, 213, 217–18 (2009); Alon Brav, Wei Jang, Frank Partnoy & Randall Thomas, “Hedge Fund Activism, Corporate Governance, and Firm Performance,” 63 *J. Fin.* 1729, 1732 (2008); Christopher P. Clifford, “Value Creation or Destruction? Hedge Funds as Shareholder Activists,” 14 *J. Corp. Fin.* 323, 324 (2008).

<sup>29</sup> Paul Rose & Bernard S. Sharfman, “Shareholder Activism as a Corrective Mechanism in Corporate Governance,” 2014 *BYU L. Rev.* 1015, 1034 (2014).

<sup>30</sup> M. Todd Henderson & Dorothy Shapiro Lund, “Index Funds Are Great for Investors, Risky for Corporate Governance,” *Wall St. J.*, June 22, 2017.

tobacco companies—just as their share prices had begun to rebound.<sup>31</sup> In 2015, the chief investment officer of CalSTRS told his board: “I’ve been involved in five divestments for our fund. All five of them we’ve lost money, and all five of them have not brought about social change.”<sup>32</sup>

Nor are these concerns merely anecdotal. In 2015, the Manhattan Institute commissioned an econometric study of shareholder activism and firm value.<sup>33</sup> Tracie Woidtke, a professor at the Haslam College of Business at the University of Tennessee, examined the valuation effects associated with public pension fund influence, measured through ownership, on Fortune 250 companies. Woidtke found that “public pension funds’ ownership is associated with lower firm value” and, more particularly, that “social-issue shareholder-proposal activism appears to be negatively related to firm value.”<sup>34</sup>

In addition to these *prudential* concerns, it is important to recognize that large fund families’ ESG engagement is typically rife with conflicts of interest that implicate ERISA plans’ *duty of loyalty* as well. As Bernard Sharfman wrote in his paper analyzing BlackRock’s shareholder engagement, fund activism is probably best explained—apart from agency costs allowing managers to leverage passive index fund holdings for idiosyncratic personal social goals—as being related to strategic decisions to attract and retain fund capital by *marketing* to millennial and left-leaning investor preferences and by *appeasing* social investors, including public pension funds responsive to political interests and public employee labor unions.<sup>35</sup>

Some fund managers may also prefer to attract new ESG dollars, relative to lower-cost index-fund vehicles, precisely because such funds can maintain a higher overall fee structure for the organization. Low-fee index funds now approach half of all dollars invested through stock mutual funds in U.S. equity markets.<sup>36</sup> Although ESG-focused funds have been losing market share more recently in the United States,<sup>37</sup> they are markedly more common than a decade ago, when then constituted just 1 percent of the U.S. mutual fund market.<sup>38</sup> Put simply: the economic and other interests of fund managers and executives tend

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<sup>31</sup> Pat Geyer, “Report on CalSTRS Meeting,” September 4–5, 2008, 5, <http://www.calrta.org/dbfiles/nn69mgxs9.pdf>

<sup>32</sup> Chriss W. Sweet, “CalSTRS Risks Losing Money if It Divests from Fossil Fuels,” *Breitbart*, April 7, 2015, <http://www.breitbart.com/california/2015/04/07/calstrs-risks-losing-money-if-it-divests-from-fossil-fuels>.

<sup>33</sup> See Tracie Woidtke, Public Pension Fund Activism and Firm Value (Manhattan Institute 2015), *available at* <https://www.manhattan-institute.org/html/public-pension-fund-activism-and-firm-value-7871.html>.

<sup>34</sup> *Id.* at 16.

<sup>35</sup> See Bernard S. Sharfman, “The Conflict Between BlackRock’s Shareholder Activism and ERISA’s Fiduciary Duties,” 73 *Case W. Res. U. L. Rev.* 1240, 1243–44 (2021), <https://scholarlycommons.law.case.edu/caselrev/vol71/iss4/10/>.

<sup>36</sup> See Cox, *supra* note 26.

<sup>37</sup> See James R. Copland, “The ESG Bubble Is Bursting,” *City J.*, Aug. 19, 2025, <https://www.city-journal.org/article/esg-investing-funds-energy-economy>.

<sup>38</sup> See Greg Iacurci, “Money Invested in ESG Funds More Than Doubles in a Year,” *CNBC.com*, Feb. 11, 2021, <https://www.cnbc.com/2021/02/11/sustainable-investment-funds-more-than-doubled-in-2020-.html>.

to be well-aligned with ESG engagement strategies—but not the interests of the underlying investors owed a fiduciary duty.

### *Conclusion*

Congress has been reasonably clear that ERISA fiduciaries should manage funds solely for the exclusive purpose of maximizing plan beneficiaries' financial returns at the lowest cost. Unfortunately, a series of vacillating executive branch rulemakings has muddied the waters. As observed at the outset, the United States has a twin retirement challenge owing to the pending insolvency of the Social Security system and a substantial percentage of Americans with no or inadequate private pension savings. The last thing this fragile system needs is to exacerbate these problems with pension assets diverted away from financially optimal investment strategies in pursuit of environmental and social policy objectives with an attenuated—or inverted—relationship to share value.

I encourage members of the Committee to ask questions, on either the focus of my written testimony or the broader array of issues surrounding this important topic. I will endeavor to answer to the best of my ability. I am also more than willing to follow up later with Senators and staff. Thank you for your time and your invitation.