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KEEPING POLITICS OUT OF STATE PENSIONS: A MULTI-STATE SURVEY OF PROXY VOTING PRACTICES

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This publication is an update to our previous publication "Keeping Politics Out of Texas Pensions: Proxy Voting Reforms" with additional data.

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KEY POINTS

- **Consolidation in the finance industry** has enabled political activists to pressure corporations into advancing progressive policies on issues ranging from climate change to abortion. This activism undermines the financial performance of American businesses, democratic institutions, and the market economy.
- **While most state pensions** do not actively promote environmental, social, and governance (ESG) investing, they are drawn into ESG trends through the influence of advisors and consultants who promote ESG.
- **The feedback loop** between public opinion, government policy, and corporate actions that drives woke capitalism must be broken to prevent the takeover of key industries by government and crony corporatists.
- **State agencies and pensions** should not become counter-activists against the ESG movement but must ensure their employees and consultants fulfill their fiduciary duty. Additionally, state legislatures must create policies to protect businesses and consumers from corporate political activism.

EXECUTIVE SUMMARY

Over the past decade, the rise of the environmental, social, and governance (ESG) investing trend has created a new form of activism that seeks to turn companies into agents of societal change. Corporate raiders of old used their influence as share-holders to direct companies to take actions that they deemed to be more profitable. ESG activists use similar tactics but operate not under a financial rationale but rather a political and social activism rationale, attempting to cudgel companies to support progressive policies on issues ranging from climate change to abortion.

The investment industry is more heavily consolidated today than at almost any point in its history. A large portion—up to 20%—of the voting shares in many public companies is now controlled by three asset managers: Vanguard, BlackRock, and State Street (Fitchner et al., 2017). These firms heavily market their ESG funds and credentials, which allow them to sell higher fee products and services to counter a market environment of declining fees and margins. The market for proxy voting advisory services—which is used by pensions, foundations, and endowments, as well as many asset managers to facilitate voting in thousands of corporate elections each year—is even more concentrated. Two firms, Institutional Shareholder Services Inc. (ISS) and Glass Lewis, hold more than 90% of the market share (Rose, 2021, p. 4) and have become major ESG promoters because the increasing number and complexity of shareholder resolutions from ESG activists increases the demand for proxy advising and related services.

Public pensions, being some of the largest institutional investors in the world, are important trendsetters in the investment industry. Several state pensions, particularly the two largest public pensions in the country—California State Teachers' Retirement System (CalSTRS) and the California State Employees' Retirement System (CalPERS)—have led the charge in ESG activism. But even state

pensions that do not openly espouse ESG activism are being drawn into these trends, largely through the actions of advisors and consultants that they use. This is particularly true when it comes to how state pensions vote in corporate elections. In fact, on the subset of environmentally focused shareholder resolutions documented in this research, state pensions (on average) voted for more resolutions than Vanguard, BlackRock, and State Street.

More than 20 states have taken some form of action—being either legislation or executive actions by governors and treasurers—to guard against ESG trends impacting their investments and banking relationships (Ropes & Gray, 2024). But even in these states, the proxy voting records of their pensions show that work still needs to be done. States should establish more clarity in their statutes stating that any promotion of social or political goals—either through proxy voting or investment choices—violates their fiduciary standards. Pensions should be required to do three things: 1) adopt custom proxy voting policies that adhere to those standards, 2) allow their proxy votes and corporate engagement to be audited by a third party, and 3) revoke proxy voting and investment management authority from any asset manager that is found to be in violation of the fiduciary standard. Exercising this increased oversight will require effort to maintain accountability, but the effort is worth it to ensure that state pensions stand against the wave of political activism that is threatening their investment returns and undermining vital American businesses.

INTRODUCTION

Proxy voting and ESG investing strategies are frequently used as vehicles for activists to promote environmental and social policies through corporate actions and policies. State pensions are instigating this activism, and in other cases can be pulled into it by their use of activism advisors, managers, and consultants. This study examines the proxy voting and engagement activities of state pensions and endowments in states that are taking steps to oppose ESG activism and see how well their actions align with their stated policies, with a particular focus on environmental issues facing public energy and financial firms.

A proxy vote refers to "a ballot cast by a single person or firm on behalf of a corporation's shareholder who may not be able to attend a shareholder meeting, or who may not choose to vote on a particular issue" (Kenton, 2020, para. 1). Shareholders vote on various corporate governance issues including (but not limited to) the election of board members, merger or acquisition approvals, actions pertaining to stock compensation plans, and environmental policy proposals.

The use of proxy votes to influence corporate action is rooted in the basic premise of capitalism. This economic system holds that the shareholders (the owners of the company) should have a direct say in the company's operations and in the selection of its board members. In recent years, environmental activists have taken advantage of this process to insert their politics into corporate decision-making. They do this by purchasing stock in public companies and forming coalitions with other shareholders to introduce shareholder resolutions and nominate new board members, copying the decades-old practices of activist hedge funds (Eccles et al., 2021).

But unlike the hedge funds of old, these activists are operating not under a financial rationale but under a political rationale, attempting to influence companies to support progressive policies on issues ranging from climate change to abortion. It is rational for companies to weigh in on policies and regulations that directly affect their finances and their ability to do business. But, while the activists usually claim there is a financial rationale for their actions, forcing actions on issues that are so far removed from a company's balance sheet detracts from the ability of executives to make decisions that will produce the highest financial returns for their shareholders.

One example of this activist pressure at work is the campaign to force major oil and gas companies to adopt "net zero by 2050" carbon emissions targets, and to essentially embark on a 30-year effort to cannibalize their existing businesses in favor of low- or zero-carbon alternatives. Some groups like Climate Action 100+ (CA100+), As You Sow, and Follow This focus solely on corporate engagement. Traditional environmental groups, like the Sierra Club, also engage heavily in this field. Despite projections that global fossil fuel demand will continue to grow over the next 30 years (EIA, 2023, p. 2), these activists claim that government policies will be able to dictate a rapid transition away from fossil fuels and that companies need to manage so-called "transition risk" (Climate Action 100+, n.d.-c).

The purpose of this activism is not to help energy companies better position themselves for new policies and reduce risk, as the activists often claim, but to weaken their resolve to fight such policies. One success of ESG activism is that the American Petroleum Institute, the oil and gas industry's main trade group, has recently begun advocating for methane regulations and carbon taxes, which will hurt most of its members but help its larger members meet their ESG goals (American Petroleum Institute, 2021, pp. 11-16). It is a perverse situation to have an industry group advocating for more taxes and regulations on its products, but that is that exactly kind of problem ESG investing can create.

ESG activists would be sideshows in most public company elections if not for the influence of two important groups of participants in the proxy voting process: investment managers and proxy voting advisory firms. Consolidation in the investment industry and the rise of large, passively managed index funds have brought a large portion of the proxy votes of the largest U.S. companies under the control of three asset managers (hereafter called the Big Three): Vanguard, BlackRock, and State Street. Some estimates place their combined ownership share of the largest publicly traded U.S. companies, as of 2021, at more than 20% (Bebchuk and Hirst, 2021, p. 8). When these companies vote together, they have tremendous power to sway corporate elections—a fact that ESG activists have long been aware of and are using to their advantage.

An even higher degree of consolidation has occurred in the market for proxy voting advisory services, which is now dominated by two firms: Institutional Shareholder Services Inc. (ISS) and Glass Lewis, which together comprise more than 90% of the proxy advisory market (Rose, 2021, p. 4). Institutional investors—including pensions, foundations, and endowments—and asset managers and mutual funds often own shares in thousands of public companies and pay companies like ISS and Glass Lewis to advise and facilitate voting on board elections and shareholder proposals. In many cases, investors have automated voting process set up with these firms, such that the shares are voted according to the recommendations of ISS or Glass Lewis, unless directed otherwise (Rose, 2021).

While the share of global assets held by institutional investors has declined over the past decade, it was still about 30% in 2021 and projected to remain above 25% for the rest of this decade (INDEFI, 2022, p. 4). With a 30% share of the votes, the effect of institutional investors voting in unison can be more powerful than the combined vote of the Big Three, and the dominant market position of ISS and Glass Lewis give them heavy influence over how institutional investors vote. Adding together the influence of the Big Three investment firms and the two proxy advisory firms, it is often the case that close to half the votes in a public company election can be controlled or swayed by these five firms.

State pension plans are also a big part of the ESG movement, with collective holdings of more than $5.5 trillion in 2023 (U.S. Census Bureau, 2024) and an outsize influence on general trends within the investment industry. The two largest state pensions, the California State Teachers Retirement System (CalSTRS) and the California State Employees' Retirement System (CalPERS), together managed $834 billion as of May 2024 (CalSTRS, 2024; CalPERS, 2024) and have been far ahead of the broader investment industry with their embrace of ESG principles.

Many other state pensions do not openly embrace ESG in the same way, but even state pensions whose employees hew closely to their fiduciary duty are influenced by outside advisors and consultants. Nowhere is this truer than in the proxy voting space, where many state pensions use ISS and Glass Lewis as their proxy advisor and, as this study documents, closely follow their advisor's voting recommendations. As shown in **Figure 2**, most state pensions have voted in favor of as many or more environmental shareholder resolutions as the Big Three over the past four years.

Many states have taken actions over the past several years, both legislative and executive, to change their proxy voting and investment practices to either promote or avoid ESG criteria. A comprehensive review of these actions is outside the scope of this paper, but the law firm Ropes & Gray LLP maintains a webpage that lists the specific actions taken by each state (Ropes & Gray LLP, 2024). The purpose of this study is to examine the degree to which these changes are reflected in proxy voting outcomes and to highlight additional legislative and executive policy changes that states should take to protect their investments from ESG activism and to send a clear message that they will oppose the politicization of corporate activities.

HOW PROXY VOTING IMPACTS CORPORATE ENVIRONMENTAL POLICIES

Most investors invest through mutual funds and other investment vehicles in which other entities (primarily investment firms such as the Big Three) vote their shares for them. Even investors who own individual stocks do not often vote their own proxies. Therefore, it is difficult for investors to find out how their proxies are voted and how their shares are used to impact corporate policies and decision-making processes. The focus of this paper will be about the impact of shareholder activism on the investment activities and environmental policies of American energy companies.

The most visible form of ESG activism is voting against or replacing board members, but this is usually done as a last resort. The primary avenue for activists to influence corporations is through shareholder resolutions and direct lobbying of board members and executives, which is often euphemistically described as "corporate engagement." As detailed later in this paper, ExxonMobil and Chevron (the two largest publicly traded energy companies in the world) were subject to 28 environmentally focused shareholder proposals from 2019 to 2023 (see **Table 1**), and five of those proposals received a majority of shareholder votes.

Shareholder resolutions are rarely successful and are not binding when they do pass, but what happens more frequently is that companies agree informally to perform certain actions to satisfy shareholders and avoid a public battle that could lead to board members being replaced. For example, State Street notes in its 2021 investment stewardship report that HSBC Holdings PLC was the target of a shareholder campaign to set stringent GHG emissions targets for their lending portfolio. The report states, "After engaging with our team, along with other shareholders, the company committed to phase out financing of coal-fired power and thermal coal mining in the EU and OECD by 2030 and other regions by 2040, and as a result, the proposal was withdrawn by the proponent," (SSGA, n.d., p. 7). This engagement is the primary technique that ESG activists and large asset managers use to motivate corporations to adopt ESG policies.

These events reveal a feedback loop between government policy, public opinion, and corporate actions that lies at the heart of ESG investing. BlackRock CEO Larry Fink's 2022 letter to CEOs puts it succinctly: "When we harness the power of both the public and private sectors, we can achieve truly incredible things. This is what we must do to get to net zero" (Letter from Larry Fink, 2022, para. 33). On the issue of climate change, public opinion in favor of reducing GHG emissions has driven government policies that favor low-carbon investments and punish investments in high-carbon businesses, which in turn has changed the activities of both energy producers and consumers. ESG closes this

Sidebar: The Battle for the Future of ExxonMobil

The most well-known example of a successful pressure campaign was the replacement of three directors on the board of ExxonMobil in May 2021 (Phillips, 2021), which was followed several months later by ExxonMobil adopting a "net zero by 2050" goal for its operated assets (ExxonMobil, 2022). The campaign was led by a little-known hedge fund named Engine No. 1, which put up four new board members on a dissident ballot at ExxonMobil's annual meeting in 2021 (Reenergize Exxon, 2021a, pp. 20-23).

Hedge funds and wealthy shareholders have long used such actions to replace board members and gain control of companies, with many well-known practitioners such as Carl Icahn and T. Boone Pickens. What was novel about Engine No. 1's activism (aside from involving the most high-profile energy company in the world) was that it was focused on ExxonMobil's greenhouse gas (GHG) emissions targets and on the assertion that the company was not investing enough in low-carbon businesses (Reenergize Exxon, 2021a, p. 6). Emissions targets have been a subject of ESG activism for years but had never risen to the level of a high-profile corporate proxy battle until this occasion.

Engine No. 1's tactics to completely restructure the board were also somewhat novel . They only owned 0.02% of ExxonMobil at the time of the annual meeting (Phillips, 2021) and based their strategy on persuading the Big Three, which collectively owned nearly 20% of ExxonMobil, and ISS and Glass Lewis, which influenced a large number of institutional investor votes, to back their candidates. Engine No. 1 crafted their pitch to appeal to Wall Street, citing the underperformance of ExxonMobil's stock relative to its peers and its continued investment in growing production, despite the possibility that "fossil fuel demand may decline in decades to come," a reference to the supposed energy transition to wind and solar that Engine No. 1 believes is imminent (Reenergize Exxon, 2021a, p. 6). BlackRock cited similar reasons for voting in favor of three of Engine No. 1's nominees in their 2021 vote bulletin (BlackRock, 2021, pp. 3–4).

At the same time Engine No. 1 was pitching to Wall Street, it was also pitching to activist groups such as Climate Action 100+ (Reenergize Exxon, 2021b), which hailed the vote as a "day of reckoning" and gave an urgent call for board members to be "climate competent" (Climate Action 100+, 2021, first quote). The Sierra Club signaled the vote as a message to fossil fuel producers that "their era is over" (Sierra Club, 2021, para. 3). In essence, Engine No. 1 was trying to put a "clean energy halo" on the financial motives of Wall Street investors and establish a financial rationale behind the political motives of ESG activists, and the organization succeeded wildly in convincing both groups to support them.

Ironically, in the months following the election of the new board members and the adoption of ExxonMobil's new net zero by 2050 target, energy prices skyrocketed after Russia invaded Ukraine. ExxonMobil profited handsomely while recommitting to increase its oil production for the rest of this decade (Valle, 2023). The recurring theme is that reality trumps sustainability pledges every time. As net zero pledges become more distant from reality, it's a sure prediction that companies will back away from or modify those pledges.

loop by driving companies to use their clout to influence public opinion and encourage policymakers to support climate policies, and by convincing investors to favor businesses that are prepared for the "energy transition." Energy companies are both affected by this feedback loop and are active participants in it by adopting net zero goals and advocating in favor of policies such as carbon taxes (Woods, 2021).

NONPROFIT ORGANIZATIONS, PUBLIC PENSIONS, AND PROXY ADVISORS PROMOTING ESG

The organizations driving the feedback loop between ESG investing and public policy include several nonprofit organizations dedicated to shareholder activism on environmental issues. As You Sow is one of the oldest and largest shareholder activist groups in the world, as it submits proposals on a wide range of topics, from climate change to waste management to diversity and social justice (As You Sow, n.d.). Follow This is a smaller group that began out of an effort to convince Shell to adopt climate policies, and their efforts have now spread to include other multinational energy companies (Follow This, n.d.). More than one third of the proposals reviewed for this study—which focused on 20 U.S.-listed energy, utility, and finance companies that were the subject of significant shareholder activism—were put forward by As You Sow or Follow This. Many other environmental organizations, such as the Sierra Club (Sierra Club, n.d.), also have teams that focus specifically on shareholder advocacy.

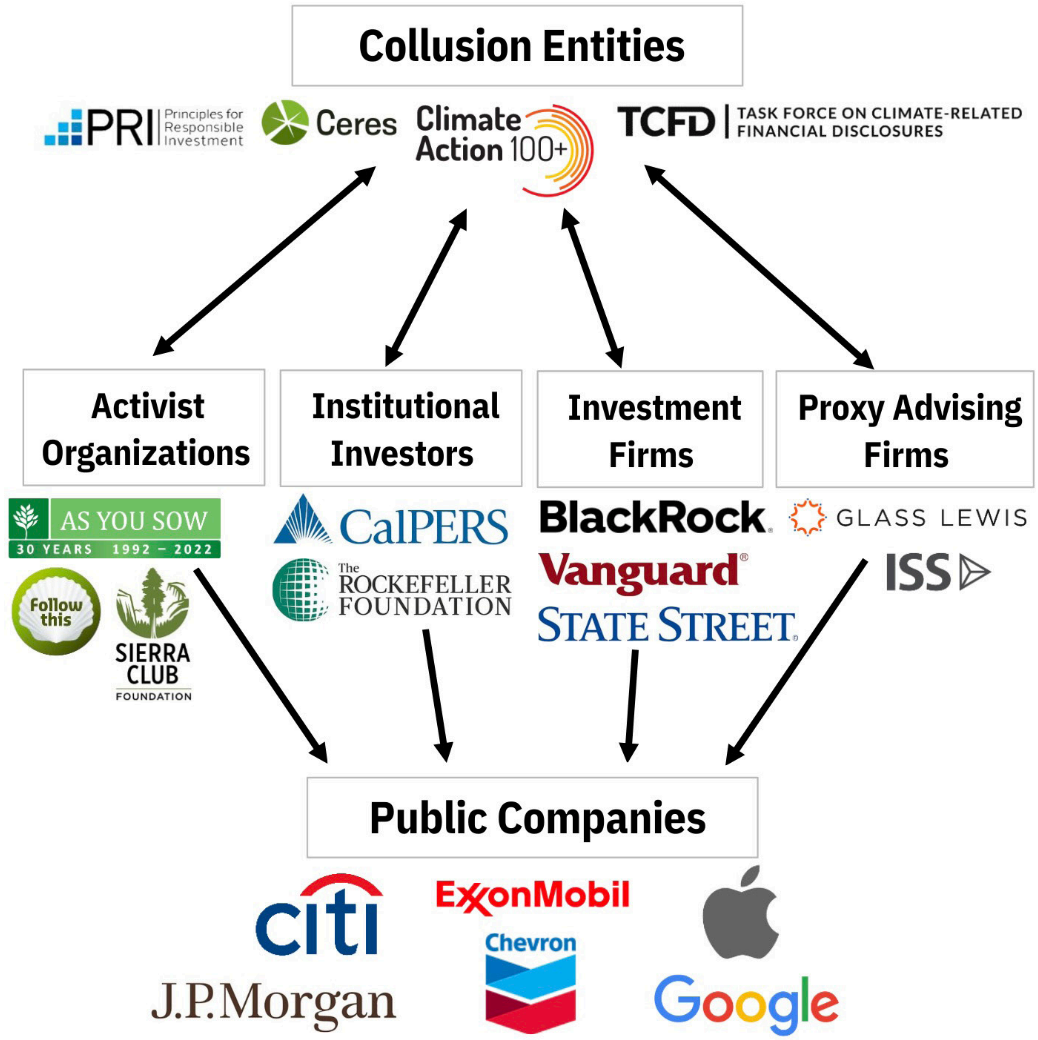
While these activists are numerous and well-funded, they would not have any power without the ability to influence large asset managers like the Big Three and institutional investors like state pensions. The activists only need to own $2,000 of a company's shares for three years to submit a proposal (Procedural requirements and resubmission thresholds, 2020, p. 70241), but they need a majority of shareholders to vote for it in order for it to pass. Therefore, the activists have created organizations specifically to bring investors together and influence their votes. The most influential of these organizations are Ceres, which was founded in 1989 in response to the Exxon Valdez oil spill (Ceres, n.d.-a), and its climate-focused offshoot, Climate Action 100+, a group of more than 700 investment firms founded in 2017 "to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change" (Climate Action 100+, n.d.-a, para. 1).

Public pensions can also bring attention to proxy battles and drive support for ESG activism because they collectively manage trillions of dollars in assets and serve as trendsetters in the institutional investment world. CalPERS and CalSTRS have been at the forefront of ESG movement activism. CalPERS is a founding member of CA100+ (Climate Action 100+, n.d.-b) and has a seat on their steering committee (Climate Action 100+, n.d.-a). The CEO of CalPERS and an investment director at CalSTRS, as well as California's former Controller, all have seats on the board of Ceres (Ceres, n.d.-b). The support of CalSTRS was widely cited as a critical part of Engine No. 1's battle with ExxonMobil (Kaufman & Kishan, 2021). The New York Comptroller, Thomas DiNapoli, who is also on Ceres' board, garnered international attention by supporting a series of shareholder resolutions that required major banks to end all new fossil fuel financing by the end of 2023 (Kerber, 2022).

The power of activist groups and institutional investors is further abetted by the endorsements of ISS and Glass Lewis, who are by far the most influential outside actors in the corporate engagement process. The Employee Retirement Security Act of 1974 (ERISA) requires institutional investors and asset management firms holding shares on behalf of retirees to vote those shares, unless the cost to do so can be documented to outweigh the potential economic benefits (Interpretive bulletin relating to exercise of shareholder rights, 2008, p. 61733). While the largest asset managers like the Big Three have their own stewardship teams, ISS and Glass Lewis have a large captive market of investors, including state pensions, that cannot economically manage thousands of different votes on their own. These proxy advisors serve an important role in providing economies of scale and special expertise to enable smaller investors to meet their obligations.

Figure 1

How Politically Motivated Investing Practices are Propagated Through Corporate America



Note: Investment firms, activist groups, large investors like state pensions and private foundations, proxy advising firms, and consultants collaborate through collusive networks like Climate Action 100+ to develop shared principles, such as net zero by 2050. Those entities then impose their principles on public companies through proxy voting, board elections, and "engagement" pressure.

ISS and Glass Lewis combine their power to push the goals of activist groups, even going so far as to directly adopt their policies and standards. As of February 2024, ISS' U.S. benchmark policy recommends voting against board directors of companies on the CA100+ Focus Group list if those companies fail to set "appropriate GHG emissions reductions targets," which it defines as "medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for a company's operations (Scope 1) and electricity use (Scope 2)" (ISS, 2024, p. 17-18). Glass Lewis has a Climate Action 100+ System Watch List in its proxy voting software to allow clients to automatically flag information about companies on the CA100+ Focus Group list. Clients can also create a library of "pre-defined rationales" to document their decisions as they vote on "meetings related to Climate Action 100+" (Glass Lewis, n.d.-b).

The primary problem with proxy advising firms, outside of the market power wielded by ISS and Glass Lewis, is that they have many financial incentives to support shareholder activism and ESG. Proxy advisors sell consulting services to both investors and issuers, which not only can bias their recommendations (Li, 2016) but also gives them a strong economic incentive to encourage a larger number of controversial shareholder resolutions and engagements. These actions generate a greater need for their services among investors who must increasingly execute more complex voting decisions. Both ISS (n.d.) and Glass Lewis (n.d.-a) promote services related to ESG, including corporate ESG scores, ESG research, and engagement consulting. As noted on ISS's website under a section titled "ESG no longer optional," "ISS ESG's full product portfolio supports the implementation of global stewardship codes and principles in the investment industry, including the PRI [United Nations Principles for Responsible Investing]" (ISS, n.d.).

Ideally, state pensions and endowments should avoid using proxy advisors that do not follow the pensions' fiduciary policies and that require extensive oversight to cast votes in line with the pensions' policies. However, the dominance of ISS and Glass Lewis in this market leaves few options available. As officials from the Employees Retirement System of Texas noted in a May 2022 Texas Senate State Affairs Committee hearing, ISS was the sole eligible bidder on their request for services (Texas Senate, 2022a, 2:50:30), and the pension is under a multiyear contract with ISS.

Given this environment, states usually have to choose between working with ISS or Glass Lewis, using a smaller but more expensive advisor, or attempting to manage their voting internally. States should continue to review the market for other providers, especially with the potential for new proxy advisors to enter the market in response to the growing public backlash against ESG. However, if better options are not available, it is critical for state pensions and endowments to work with their existing advisors to develop custom voting policies that ensure they are not voting in favor of ESG proposals.

CASE STUDY: MISALIGNMENT OF PROXY VOTING POLICIES AND VOTING ACTIVITY IN TEXAS PENSIONS

California and New York have the largest state pensions in the country and an outsize influence in driving trends among institutional investors. Therefore, it is not surprising that firms catering to institutional investors favor ESG principles, especially when doing so allows a firm to sell more profitable services, as is the case with ISS and Glass Lewis. While working with such firms does not present a conflict for California or New York, it does for Texas, which has never embraced ESG and has passed laws directly opposing ESG principles (SB 13, 2021; SB 19, 2021). The state's two largest pension systems, the Teacher Retirement System of Texas (TRS) and the Employees Retirement System of Texas (ERS), exemplify the challenges faced by many state pensions and endowments governed by statutory provisions or internal policies that circumscribe or prohibit the endorsement of political causes through their investing practices.

TRS and ERS have published a limited history of their proxy voting records online (TRS, n.d.; ERS, n.d.), which enables a straightforward case study of how the pensions are managing this problem. Despite having proxy voting policies that circumscribe ESG activism, prior to 2023, TRS and ERS voted for more environmental shareholder proposals on average than the Big Three firms. The root of the problem can be traced to their overreliance on their proxy advisor (ISS) and, prior to 2023, their lack of oversight on how ISS was voting their shares, which enables a straightforward case study of how the pensions are managing this problem.

Interestingly, although TRS and ERS use the same ISS advising services, they have not always voted the same way on activist shareholder proposals. Part of this discrepancy might be due to how ISS has interpreted ERS' firm prohibition against "establishing or endorsing social policy" in their proxy voting decisions:

> Intangible factors such as social and environmental issues are increasingly being incorporated into valuation models to better quantify the risks and opportunities of long-term investing in a company. ERS' voting of social and environmental proposals will be based solely on enhancing or protecting long-term value to ERS and not on establishing or endorsing any social, political or ideological interests. As part of its fiduciary duty, ERS shall consider only those factors that relate to the economic value of ERS' investment and shall not subordinate the interests of ERS' participants and Beneficiaries to unrelated objectives. (ERS, 2011, p. 3)

TRS only adopted a formal investment policy regarding ESG factors in September 2021, and their policy is less stringent than ERS's:

> Environmental, social, and governance (ESG) factors influence the performance of TRS's investments. In making investment decisions, the Investment Division will consider ESG factors that are material to long-term returns and levels of risk. Materiality of specific ESG factors vary across strategies, companies, sectors, geographies, and asset classes.
>
> All investments must be made prudently and in accordance with fiduciary and ethical standards, without promoting interests unrelated to the portfolio's stated objectives of controlling risk and achieving a long-term rate of return. (TRS, 2023, p. 8)

While the policy discrepancy is notable, what matters is how the policies are being applied, and the voting records of TRS and ERS indicate that they have not applied their policies consistently. A simple case study is to consider the votes of TRS and ERS on 28 environmentally focused shareholder proposals at ExxonMobil and Chevron between 2019 and 2023 (*see* **Table 1**). Among domestic energy companies, these two companies have fielded the most ESG-related proposals. Studying multiple proposals at the same company across multiple years is a better way to measure voting patterns than studying distinct proposals at many different companies.

Several notable trends appear in the data. First, of the 19 proposals prior to 2023, TRS voted in favor of 10, while ERS voted in favor of six. By comparison, BlackRock voted for seven, State Street voted for six, and Vanguard voted for two. In other words, while ERS' policy clearly states that "establishing or endorsing social policy" is forbidden (ERS, 2011, p. 3) and TRS cannot promote "interests unrelated to the portfolio's stated objectives of controlling risk and achieving a long-term rate of return," (TRS, 2023, p. 8) the pensions voted for more of those proposals than the average of the Big Three, all of which openly endorse the net zero agenda. Prior to 2023, across the entire spectrum of 19 companies examined in this study, TRS voted for 39% of environmentally focused shareholder proposals and ERS voted for 35%.

Many of the individual votes in the table showcase an obvious lack of consistency between TRS's and ERS's stated policies and their actual votes. For example, two proposals required reports on Chevron and ExxonMobil's lobbying activities align with the Paris Agreement. The supporting statements for these proposals make it clear that the proponents want to pressure the companies to lobby national governments to take "the actions required to prevent the worst effects of climate change" (ExxonMobil, 2021). Despite the obvious political bent of these two proposals, both TRS and ERS voted for them.

Prior to 2023, it appeared that the pensions had a pattern of voting for some—but not all—proposals to produce disclosures and reports, while also voting against more prescriptive proposals regarding company investments. However, even applying that paradigm, it is not clear why TRS voted for a proposal requiring Chevron to "substantially reduce the greenhouse gas (GHG) emissions of their energy products" in 2021 (TRS, n.d.), especially when they voted against a different GHG emissions proposal for ExxonMobil and Chevron in 2022. Regarding proposals to create a climate change board committee, TRS and ERS voted against such proposals for ExxonMobil and Chevron in 2019 but voted for a similar proposal for Chevron in 2020.

Table 1

Summary of TRS and ERS Votes on Environmentally Focused Shareholder Resolutions at ExxonMobil and Chevron from 2019 to 2023

Company	Date	Proposal	Votes For	TRS	ERS
ExxonMobil	5/29/2019	Report on Risks of Petrochemical Operations in Flood Prone Areas	25.00%	Against	Against
ExxonMobil	5/29/2019	Establish Environmental/Social Issue Board Committee	7.40%	Against	Against
ExxonMobil	5/27/2020	Report on Risks of Petrochemical Operations in Flood Prone Areas	24.50%	Against	Against
ExxonMobil	5/26/2021	Issue Audited Report on Financial Impacts of IEA's Net Zero 2050 Scenario	48.90%	For	For
ExxonMobil	5/26/2021	Report on Climate Lobbying	63.80%	For	For
ExxonMobil	5/25/2022	Set GHG Emissions Reduction Targets Consistent with Paris Agreement Goal	27.10%	Against	Against
ExxonMobil	5/25/2022	Report on Low Carbon Business Planning	10.50%	Against	Against
ExxonMobil	5/25/2022	Report on Scenario Analysis Consistent with IEA's Net Zero by 2050	51.00%	Against	Against
ExxonMobil	5/25/2022	Report on Reducing Plastic Pollution	36.50%	For	Against
ExxonMobil	5/31/2023	Recalculate GHG Emissions Baseline to Exclude Emissions from Material Divestitures	18.40%	Against	Against
ExxonMobil	5/31/2023	Adopt Medium-Term Scope 3 GHG Reduction Target	10.50%	Against	Against
ExxonMobil	5/31/2023	Commission Audited Report on Reduced Plastics Demand	16.00%	Against	Against
ExxonMobil	5/31/2023	Issue a Report on Worst-Case Impacts of Oil Spills from Operations Offshore of Guyana	13.30%	Against	Against
ExxonMobil	5/31/2023	Report on Social Impact from Plant Closure or Energy Transition	25.30%	Against	Against
ExxonMobil	5/31/2023	Report on Methane Emission Disclosure Reliability	36.40%	Against	Against
Chevron	5/29/2019	Report on Reducing Carbon Footprint	33.20%	For	Against
Chevron	5/29/2019	Climate Change Board Committee	7.60%	Against	Against
Chevron	5/27/2020	Report on Climate Lobbying	53.50%	For	For
Chevron	5/27/2020	Create Board Committee on Climate Risk	8.20%	For	For
Chevron	5/27/2020	Report on Petrochemical Risk	46.00%	For	For
Chevron	5/26/2021	Request Company to Substantially Reduce GHG Emissions	60.70%	For	Against
Chevron	5/26/2021	Report on Impacts of Net Zero 2050 Scenario	47.80%	For	For
Chevron	5/25/2022	Oversee and Report on Reliability of Methane Emission Disclosures	98.00%	For	Against
Chevron	5/25/2022	Issue Audited Net-Zero Scenario Analysis Report	38.70%	Against	Against
Chevron	5/25/2022	Adopt Medium and Long-Term GHG Emissions Reduction Targets	32.60%	Against	Against
Chevron	5/31/2023	Recalculate GHG Emissions Baseline to Exclude Emissions from Material Divestitures	18.30%	Against	Against
Chevron	5/31/2023	Adopt Medium-Term Scope 3 GHG Reduction Target	9.60%	Against	Against
Chevron	5/31/2023	Report on Social Impact from Plant Closure or Energy Transition	18.60%	Against	Against

Note. Data for TRS and ERS votes are from Proxy Voting Search, Teacher Retirement System of Texas (https://vds.issgovernance.com/vds/#/MzQ1Ng==) and Proxy Voting Search, Employees Retirement System of Texas (https://vds.issgovernance.com/vds/#/MTE1). Total vote count is from Proxy Monitor, Manhattan Institute (https://www.proxymonitor.org/). As of this writing, ERS proxy voting records prior to 2023 are no longer available on their website and must be obtained from ERS directly.

Some light was shed on the causes of these problems in the May 2022 Texas Senate State Affairs hearing. When ERS executives were questioned about a series of proxy votes in favor of shareholder proposals requiring financial institutions to stop financing new fossil fuel projects after 2023 (Texas Senate, 2022, 2:40:20), they explained that they had a problem with their custom voting policy with ISS, which had not properly updated the policy to incorporate this type of proposal. TRS noted that they updated their proxy voting policy, including their policy on climate change proposals, in December 2021 and were able to adjust to these new proposals and vote against them (Texas Senate, 2022, 3:01:30). Both pensions made firm commitments to update their proxy voting practices before the 2023 proxy season, and both appear to have followed through on that commitment. In 2023, neither TRS nor ERS voted for any of the environmental shareholder resolutions among the 19 companies in this study, a sharp reversal from their previous voting practices.

To summarize, the root of the problem is not that Texas pension officials desire to promote these political causes or that they disagree with the intent of their stated policies. Rather, they are relying on ISS to automate the voting process, and they are not giving specific enough instructions or ISS is misinterpreting their instructions. These types of voting policies are something that Dr. Paul Rose, a professor at The Ohio State University, documents in a paper showing how much institutional investors rely on their proxy advisors (Rose, 2021). While the policies used by TRS and ERS may default to ISS's recommendations, they also offer a high degree of customization that allows ERS and TRS to vote against ESG proposals that ISS might favor in its benchmark policy. Pensions must actively manage those customization options to make them effective, which is apparently what TRS and ERS did beginning in 2023.

The rapid changes implemented by these two pensions shows that (a) they either agree that voting for activist resolutions is not consistent with their fiduciary duty, or (b) that they are agnostic to the proposals and therefore can safely vote against them to avoid the appearance of supporting the politics behind the proposals. It also appears that changing the pensions' voting practices was not prohibitively expensive or difficult due to more advisors and investment managers offering a broader range of custom voting policies.

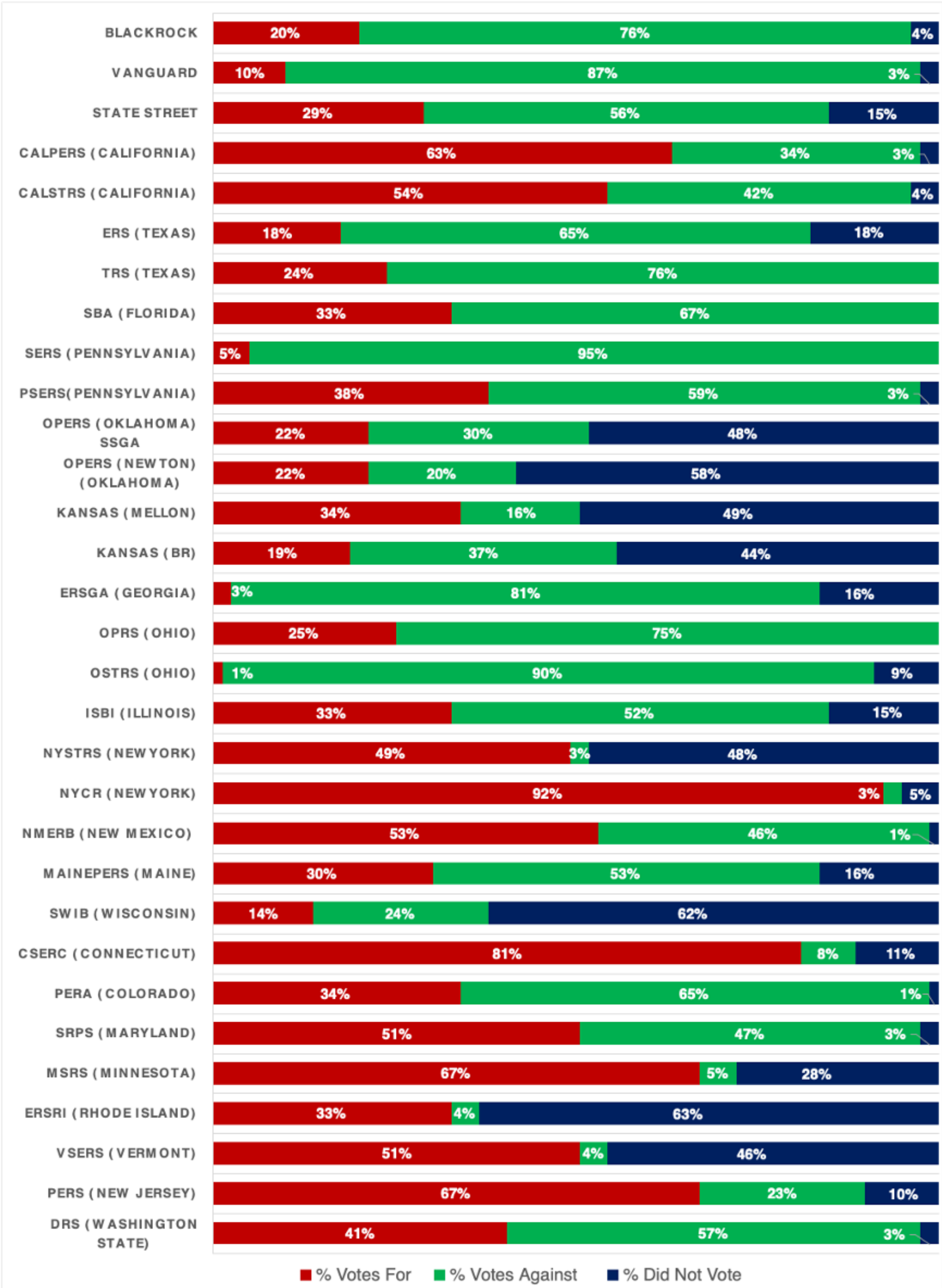
PROXY VOTING RECORD OF STATE PENSIONS IN PUBLIC ENERGY COMPANY ELECTIONS

The problem facing Texas pensions is the same problem faced by other state pensions and endowments that do not seek to endorse ESG principles but are pulled into doing so by working with investment managers and proxy advisors that default to supporting those principles. The extent to which other state pensions are following the common ESG trends can be discerned by comparing their votes to California's pensions. Of the 28 proposals at ExxonMobil and Chevron from 2019 to 2023, CalSTRS (CalSTRS, n.d.) voted for 18, and CalPERS (CalPERS, n.d.) voted for 23. Across the broader range of 19 companies in this study, CalSTRS voted for 55% of environmental proposals and CalPERS voted for 63%, while BlackRock voted for 21%, Vanguard 10% and State Street 29% (see **Figure 2**).

Figure 2 provides a broad summary of how a selection of state pensions voted on these environmental proposals from 2019 to 2023. New York's pensions voted in favor of more resolutions than even California's pensions, with the New York City retirement fund voting for more than 90% of resolutions. That state pensions in California, New York, New Jersey, and Connecticut side with activists is not surprising, given the stated goals of those pensions and their state leaders to promote net zero and other ESG policy goals. What is surprising, however, are the voting records of some pensions in more conservative states such as Kansas and Florida, which supported more than 30% of these resolutions. Most pensions in moderate states, such as Pennsylvania, Maryland, and Colorado, also voted for more than 30% of these resolutions, which is more than any of the Big Three firms voted for. While there are significant variations and exceptions, including between

Figure 2

Vote Totals on Environmentally Focused Shareholder Resolutions at 19 American Energy and Utility Companies from 2019 to 2023



Note. See Appendix A for data sources and methodology.

different pensions in the same states, the clear trend is that state pensions are voting for more activist proposals than the broader scope of investors.

As with TRS and ERS, the propensity of state pensions to vote in favor of so many ESG proposals is likely due to automatically voting with the recommendations of their proxy advisor and not applying a custom policy or a stringent screening procedure. Of the dozens of state pensions documented in Dr. Rose's research, with the exception of the Illinois Municipal Retirement Fund, all voted with their proxy advisor more than 99% of the time in 2019 and 2020 (Rose, 2021, p. 21). Close to 99% of proposals are management proposals—primarily uncontested board director elections that do not merit close scrutiny—with the remaining 1% being shareholder proposals, many of which relate to ESG issues (BlackRock, 2022, p. 16). A large degree of voting alignment on management proposals makes sense, which is why Dr. Rose says that at least 99.5% alignment is needed to indicate an investor is following a proxy advisor's benchmark policy (Rose, 2021, p. 10).

Despite this high percentage of management proposals, with more than 100,000 proposals being voted on across the public company universe each year (p. 10), at least several hundred shareholder proposals each year (in addition to contested board elections) require closer scrutiny. It is not common for management to support shareholder proposals, which are usually put forward to rebuke or change current management practices. In fact, only one of the proposals in this study—the 2022 Chevron proposal to report on the reliability of methane emission disclosures—was supported by management.

In most cases, company executives should be the best-informed party about what will improve the financial performance of the company, and voting against management should require a high bar of evidence. But the ESG movement has turned this logic on its head by pitting shareholders against management, the latter of which are cast as obstructing progress on carbon emissions and denying the "inevitable" reality of an energy transition in the near future, all to the ultimate detriment of their company's financial performance.

Finally, it is important to point out some new trends that began to emerge in 2023. First, the number of environmental and social resolutions across U.S. public companies is increasing dramatically, from 171 in 2021 to 273 in 2022 (60% increase) to 337 in 2023 (23% increase) (Stewart, 2023), and the proposals are becoming more prescriptive in nature. This increase can be attributed primarily to a policy change by the SEC in November 2021 to begin allowing "certain proposals that raise significant social policy issues" that "transcend the ordinary business of the company" (SEC, 2021, Sec. B.2). In other words, the SEC is relaxing its role as the gatekeeper of which proposals can be considered at annual meetings, and shareholder activists are running through the gate at full tilt.

Second, in large part due to the increasing number of proposals, the proportional amount of support for environmental and social resolutions dropped in 2023, with the average resolution receiving only 20% support in 2023 compared to 30% support in 2022 (Stewart, 2023). For the 19 companies covered in this study, BlackRock and Vanguard voted for only two of the 35 resolutions in 2023, and State Street voted for nine. Each of the Big Three supported fewer resolutions in 2023 than their average level of support over the past five years.

Third, some of the state pensions highlighted in **Figure 2** also changed their voting patterns significantly. As noted above, Texas' TRS and ERS voted for none of the 30 resolutions in 2023 that are covered by this study. Ohio's two major pensions also voted for none of them. Florida's pensions made significant policy changes over the past two years (State Board of Administration of Florida, 2022) but still voted for five of the 30 resolutions. The Kansas Public Employee Retirement System switched proxy advisors in 2023 (Johnson, 2024, p. 13) and will likely make significant changes in their 2024 voting patterns. If this trend continues, the 2024 proxy season should see more state pensions move away from siding with activists.

Consistency in proxy voting practices—supported by clear requirements in statute, good reporting, and sound implementation—is necessary to ensure voting practices that promote political activism are not being proliferated across the trillions of dollars managed by state and local pensions in the U.S. In addition, as the examples of the Texas and Kansas pensions shows, state pensions and endowments can quickly and effectively change not just who they work with but most importantly, how they implement their proxy voting policies and oversee the work of their advisors and consultants.

WHAT STATES NEED TO DO TO GUARD AGAINST ESG ACTIVISM

Given the increasing pervasiveness of ESG activism and the influence of investment managers and proxy voting advisors that are not just ideologically aligned with ESG principles but financially incentivized to promote them, states need to actively guard against ESG to protect the financial interests of their pensioners and taxpayers. Fortunately, states can quickly begin the reform process by enacting legislation (Heritage Foundation, n.d.) and policies that encompass the following principles:

- Clearly define in statute that ESG investment strategies and ESG shareholder resolutions run counter to the fiduciary duty of state pensions and should be avoided in all forms. As noted earlier in this paper, several states have already passed reforms to this effect. In addition, several state attorneys general have already issued opinions noting that ESG investment practices violate state fiduciary standards. (Landry, 2022; Iccarino & Richards, 2022)

- Revoke all proxy voting authority that has been given to outside investment managers and third-party firms, unless those managers offer voting policies that enable state pensions to vote against ESG shareholder proposals.

- Require state officials and outside managers to vote any shares held by state pensions solely in the financial interest of the beneficiaries of such funds and, when necessary, to justify that they are not acting for ideological, social, or political purposes.

- Determine a process for auditing and overseeing the proxy voting practices of state and local pensions and outside managers, with a focus on examining board elections and proxy votes that run counter to management recommendations.

- Task a review board or auditing committee with regularly surveying and reporting on the proxy votes of state and local pensions and provide reporting tools that enable the attorney general to quickly investigate and prosecute fiduciary violations in investments and proxy voting.

In addition to ensuring that state pensions are not supporting ESG activism through their proxy voting and investment practices, states need to develop other tools to mitigate the potential harm ESG practices can create for their taxpayers, pensioners, and businesses. Numerous industries, from energy to firearms to private prisons to agriculture, are being targeted by ESG activists and should be incorporated within the framework of legislation that prohibits state entities from doing business with firms that engage in such boycotting and sanctioning practices. Coordinated boycotts by insurance companies, ratings agencies, and other financial services providers should be investigated under existing antitrust laws.

The key challenge is how to implement these policies in a transparent and cost-efficient manner. There is no question that pensions will need extra resources to manage their proxy votes more actively and to enable more reporting. However, that resource allocation should be small, and the benefits will be many. State pensions should not support actions that harm the profitability of the firms that they invest in and penalize the industries that are critical to their state economies. Also, by enacting these policies, states will send a message that they are standing as a bulwark against the assault of the ESG movement on the companies that undergird the U.S. economy. J.P. Morgan, State Street, and BlackRock's U.S. subsidiaries all recently pulled out of Climate Action 100+ (Marsh et al., 2024), and these actions show that these firms will respond when states and a large part of the American public turn against the ESG agenda. Such resolve must be maintained for the U.S. economy to remain a beacon of freedom and flourishing. ■

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APPENDIX A: SOURCES AND METHODS FOR FIGURE 2

The dataset underlying **Figure 2** covers 79 environmental shareholder proposals from 2019 through 2023 across 19 U.S.-listed energy and finance companies: Bank of America, Berkshire Hathaway, Chevron, Chubb Ltd., Citigroup, ConocoPhillips, Dominion Energy, DTE Energy, Duke Energy Corp, ExxonMobil, Goldman Sachs, JPMorgan Chase & Co., Marathon, Occidental, Phillips 66, Sempra Energy, The Hartford, Valero, and Wells Fargo.

The following voting records were retrieved from a publicly available databases: DRS (Department of Retirement Systems Washington State Investment, n.d.), PERS (New Jersey Public Employee Retirement System, n.d.), VSERS (Vermont State Employees' Retirement System, n.d.), ERSRI (Employees' Retirement System of Rhode Island, n.d.), MSRS (Minnesota State Retirement System, n.d.), SRPS (Maryland State Retirement and Pension System, n.d.), PERA (Colorado Public Employees' Retirement Association, n.d.), CSERC (Connecticut State Employees' Retirement Commission, n.d.), SWIB (State of Wisconsin Investment Board, n.d.), MainePERS (Maine Public Employees Retirement System, n.d.), NMERB (New Mexico Educational Retirement Board, n.d.), NYCR (New York State Common Retirement Fund, n.d.), NYSTRS (New York State Teachers' Retirement Fund, n.d.), ISBI (Illinois State Board of Investment, n.d.), PSERS (Pennsylvania Public School Employees' Retirement System, n.d.), SERS (Pennsylvania State Employees' Retirement System), ERS (Employees Retirement System of Texas, n.d.), SBA (State Board of Administration (SBA) of Florida, n.d.), TRS (Teacher Retirement System of Texas, n.d.), CalPERS (California State Employees' Retirement System, n.d.), CalSTRS (California State Teachers' Retirement System, n.d.), Vanguard (Vanguard Institutional Index Funds, n.d.-a; Vanguard Institutional Index Funds, n.d.-b; Vanguard Institutional Index Funds, n.d.-c; Vanguard Institutional Index Funds, n.d.-d; Vanguard Institutional Index Funds, n.d.-e) Blackrock (BlackRock Funds, n.d.-a; BlackRock Funds, n.d.-b; BlackRock Funds, n.d.-c; BlackRock Funds, n.d.-d; BlackRock Funds, n.d.-e), and State Street (SSGA Funds, n.d.-a; SSGA Funds, n.d.-b; SSGA Funds, n.d.-c; SSGA Funds, n.d.-d; SSGA Funds, n.d.-e)

The remaining pension funds required public information requests to obtain their voting records: OSTRS (Ohio State Teachers Retirement System), OPRS (Ohio Public Employees Retirement System), ERSGA (Employees Retirement System of Georgia). KPERS (Kansas Public Employees Retirement System), and OPERS (Oklahoma Public Employees Retirement System). KPERS and OPERS are single pension funds with several different asset managers. In these cases, only two asset managers for each state were reported in the table because the other managers only voted on a few of the proposals covered in this study. For KPERS we reported the votes of funds managed by BlackRock and Bank of New York Mellon. For OPERS, we reported the votes of funds managed by Newton Investment Management and State Street Global Advisors.

The percentage of votes "For" or "Against" reflect proposals that a pension voted in favor of or not as a percentage of the total. The "Did Not Vote" percentage reflects instances where either the pension abstained from voting or did not hold any of the company's shares at the time of voting.

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