How Anti-ESG Pressure Affects Investment: Evidence from Retirement Savings

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ESG and politics

- ESG gained significant attention in the past decade.
- ESG investment is not just a **financial debate**, but a **political matter**.
  - Florida Gov. Ron DeSantis: No ESG in pension funds.
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- **Does political pressure affect households' access to ESG**?

This paper

- ESG investment opportunities in **retirement savings**, **401(k) plans**
- **Judicial channel**: Legal discretion of politically-oriented federal judges

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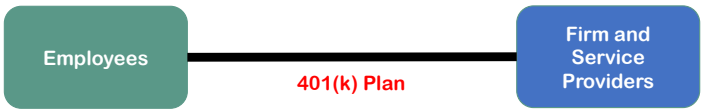

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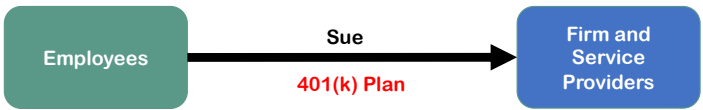
- Firms are bound by fiduciary duty. They must represent the best financial interest of employees.



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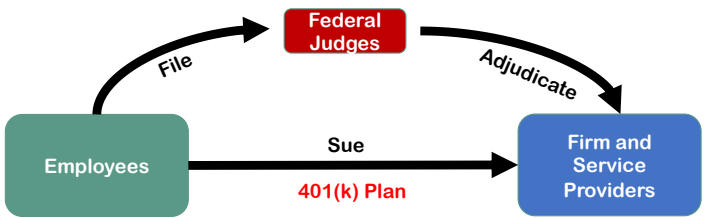

Testing the judicial channel

- **ESG offering gap** between **liberal vs conservative circuits**

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    - Demographic characteristics
    - Firm characteristics
    - Local political leanings

Testing the judicial channel

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  - Firms in conservative circuits are up to 6% less likely to offer ESG than liberal circuits.
  - Robust to **controlling** for
    - Demographic characteristics
    - Firm characteristics
    - Local political leanings
- **Causal evidence** of the **judicial channel**
  - **Quasi-natural experiment**
    - Reform **reduces** judge discretionary power.
    - 40% of the ESG political gap is closed.

How does the judicial channel work?

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  - Green firms
  - Small firms
  - Firms in liberal counties within conservative circuits
  - National service providers

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- Increase **total contributions** to retirement savings
  - Total contributions/plan assets increase 0.9 percentage points.
  - No crowding out of existing investment
- **ESG fund performance and expense**
  - No sacrifice in financial returns
  - Expensive to invest
  - Plans offering ESG are more expensive than non-offering plans.
    - Especially in conservative circuits, where legal scrutiny is high

Literature Review

- 401(k) menu designs:
  Pool, Sialm, and Stefanescu (2016), Goyal and Wahal (2008), Sialm, Starks, and Zhang (2015), Bhattacharya and Illanes (2021), Davis and Kim (2007), Gropper (2023)
  How the legal pressure faced by trustees influences menu designs.
- Retirement saving behaviors:
  Benartzi and Thaler (2007), Elton, Gruber,and Blake (2007), Del Guercio and Tkac (2002), Choi (2015), Yogo, Whitten, and Cox (2022), Chalmers, Mitchell, Reuter, and Zhong (2022), Egan, Mackay, and Yang (2023)
  The effect of heterogeneous investor preferences in retirement savings.
- ESG investment:
  Pastor et al. (2021), Pedersen et al. (2021), Baker et al. (2022), Hong and Kacperczyk (2009), Di Giuli and Kostovetsky (2014), Edmans (2011), Dimson et al. (2015), Rajgopal et al. (2023)
  The impact of anti-ESG pressure through the judicial channel.

Outline of talk

Data and background

ESG political gap

Legal Discretion and ESG Investment

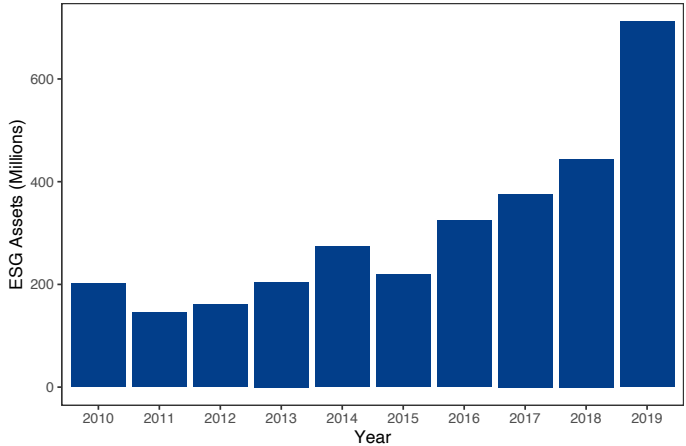
Who Was Constrained by Legal Pressure?

Data and background

Data

- **401(k) plan from 2010 to 2019**
  - BrightScope database
    - File Form 5500
    - Sourced from DOL, IRS, FOIA and Audited Financial Statements
- **ESG Fund: MorningStar sustainable fund classification**
  - Annual sustainability report
  - Most relevant to retail investor experience and litigation risk

ESG investment in 401(k) plans



- 8% of plans offer ESG funds.
- Conditional on offering: one option.

Lawsuit concerns over ESG

- **Key act that defined fiduciary duty** : ERISA (1974)
  - **Maximize financial returns**
  - Even **providing the ESG option** could make the fiduciaries get sued.
- Survey of plan sponsors: 26% say "**Unclear regulatory factors**" preclude them from ESG.
- Litigation risk
  - Bob Salerno, Fidelity Investments: "**We'll all go to jail**", when his group recommends including ESG funds.
  - Marina Severinovsky, Schroders: "You don't want to **get sued**, and [you want to] do right by your plan participants."
  - **ESG Catch 22**

Pilot Sues American Airlines Due to ESG 401(k) Investing Strategy

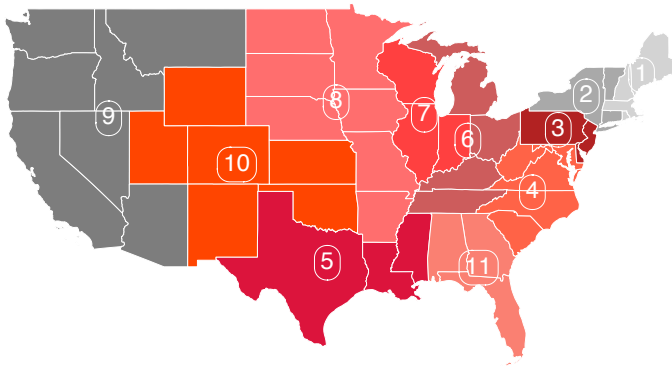
The retirement committee, recordkeeper Fidelity Investments and financial advice provider Edelman Financial Engines were accused of sacrificing fiduciary duty to pursue 'leftist political agendas.'

Reported by ALEX ORTOLANI

Return

ESG political gap

Geographic boundaries of U.S. circuits



- Political leaning of judges
- Grey areas: Liberal circuits vs. Red areas: Conservative circuits

Legal circuits and ESG offering

$$\textit{ESG Offering}_{i,c,t} = \alpha + \beta \textit{Conservative Circuit}_c + X_{i,c,t}\phi + \lambda_t + \eta_m + \epsilon_{i,c,t}$$

	ESG Offering
Conservative Circuit	-0.063^{***}
	(9.14)
Observations	8,646
R^2	0.082
Year FE	✓
Plan Provider FE	✓
Note:	*p<0.1; **p<0.05; ***p<0.01

- Firms in conservative circuits are **6.3%** less likely to offer ESG than liberal circuits.

Legal circuits and ESG offering

$$\textit{ESG Offering}_{i,c,t} = \alpha + \beta \textit{Conservative Circuit}_c + X_{i,c,t}\phi + \lambda_t + \eta_m + \epsilon_{i,c,t}$$

	ESG Offering	
Conservative Circuit	-0.063^{***}	-0.030^{***}
	(9.14)	(4.60)
Demographic characteristics	×	✓
Observations	8,646	8,646
R^2	0.082	0.092
Year FE	✓	✓
Plan Provider FE	✓	✓
Note:		*p<0.1; **p<0.05; ***p<0.01

- **Demographic variables**: Income, Age, and Housing value

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	ESG Offering		
Conservative Circuit	-0.063^{***}	-0.030^{***}	-0.030^{***}
	(9.14)	(4.60)	(4.60)
Demographic characteristics	×	✓	✓
ESG score	×	×	✓
Observations	8,646	8,646	8,646
R^2	0.082	0.092	0.092
Year FE	✓	✓	✓
Plan Provider FE	✓	✓	✓
Note:			*p<0.1; **p<0.05; ***p<0.01

- **Green** firm employees: **Preference** for ESG investment

Legal circuits and ESG offering

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	ESG Offering			
Conservative Circuit	-0.063^{***}	-0.030^{***}	-0.030^{***}	-0.030^{***}
	(9.14)	(4.60)	(4.60)	(4.64)
Demographic characteristics	×	✓	✓	✓
ESG score	×	×	✓	✓
Political leaning	×	×	×	✓
Observations	8,646	8,646	8,646	8,277
R^2	0.082	0.092	0.092	0.094
Year FE	✓	✓	✓	✓
Plan Provider FE	✓	✓	✓	✓

Note: *p<0.1; **p<0.05; ***p<0.01

- **Conservative-leaning employees**: Less interested in ESG investment
- **Local political belief**: Vote ratio measured at **County level**

Legal circuits and ESG offering

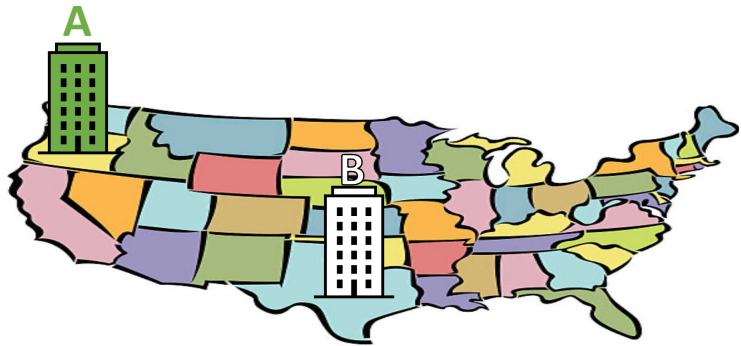
$$\textit{ESG Offering}_{i,c,t} = \alpha + \beta \textit{Conservative Circuit}_c + X_{i,c,t}\phi + \lambda_t + \eta_m + \epsilon_{i,c,t}$$

	ESG Offering				
Conservative Circuit	−0.063***	−0.030***	−0.030***	−0.030***	−0.029***
	(9.14)	(4.60)	(4.60)	(4.64)	(4.62)
Demographic characteristics	×	✓	✓	✓	✓
ESG score	×	×	✓	✓	✓
Political leaning	×	×	×	✓	✓
Firm characteristics	×	×	×	×	✓
Observations	8,646	8,646	8,646	8,277	8,277
R^2	0.082	0.092	0.092	0.094	0.095
Year FE	✓	✓	✓	✓	✓
Plan Provider FE	✓	✓	✓	✓	✓

Note: *p<0.1; **p<0.05; ***p<0.01

- A substantial share of gap (**54%**) is closed.
- Conservative circuits are **2.9%** less likely to offer ESG funds than liberal circuits.

ESG investment opportunities vary with circuits



- **Washington County in Oregon** and **Dallas County in Texas**
- **Same** demographics, local politics, investor preferences, firm characteristics
- **Less** ESG offering in conservative circuits than liberal circuits

Legal Discretion and ESG Investment

2015 Legal Guidance from Dept. of Labor (DOL)

- **Clarifies the legal environment for ESG and fiduciary duty**
  - First DOL interpretative bulletin to mention ESG
    - October 2015: Field Assistance Bulletin No. 2015-01
    - Previous bulletin set ambiguous standard for ESG
  - Attempted to remove the perceived stigma
- Retirement plan providers and industry lobbying organizations quickly voiced support.

How to comply with ERISA fiduciary standards:

- **Two opportunities to consider ESG goals**:
  1. Risk and return profile
  2. Collateral benefits: tie-breakers between otherwise equal investment opportunities
- No additional scrutiny on ESG investments.

Convergence between liberal and conservative circuits

- **2015 Legal clarification reduces the judge discretion.**
  - Effectively **neutralized the role of circuit courts** in deciding if considering/offering an ESG fund met a plan's fiduciary role
- **Firms located in conservative circuits**:
  - Historically faced **greater legal pressures** to incorporate ESG funds
  - Exhibited a **larger expansion** in ESG investments

Difference in difference framework

- $y_{i,c,t} = \alpha + \beta(Conservative\ Circuit_c \times Post_t) + X_{i,c,t}\Phi + \lambda_t + \gamma_s + \epsilon_{i,c,t}$
- $y_{i,c,t}$ **is either**:
  1. ***ESG offering***$_{i,c,t}$: Dummy variable equals 1 if there is **at least one ESG option** in a 401(k) plan.
  2. ***ESG holdings***$_{i,c,t}$: **Allocation percentage of ESG investment**.
     - Relative to all mutual funds in a 401(k) plan.
     - Participate loans are extracted from plan assets.
     -
$$\textit{ESG holdings}_{i,t} = \frac{\sum_{j=1}^{c} \text{Fund Balance}_{i,j,t} \times \text{I(ESG Fund}_j)}{\text{Plan Assets in Mutual Funds}_{i,t}}$$
- $\boldsymbol{X}_{i,c,t}$: Demographic characteristics, political leaning, firm characteristics.
- λ_t and γ_s: **Year** and **State** fixed effects.

ESG offering

	ESG Offering	
	(1)	(2)
Conservative Circuit × Post	3.2**	2.7**
	2.13	1.99
Controls	✓	✓
Observations	8,102	8,102
R^2	0.056	0.109
Year FE	✓	✓
State FE	✓	✓
Provider ID	✗	✓

Note: *p<0.1; **p<0.05; ***p<0.01

- **Increase in ESG offering**: Firms in conservative circuits more than firms in liberal circuits.
- **2.7** percentage points conditional on the **same** service provider

ESG holdings

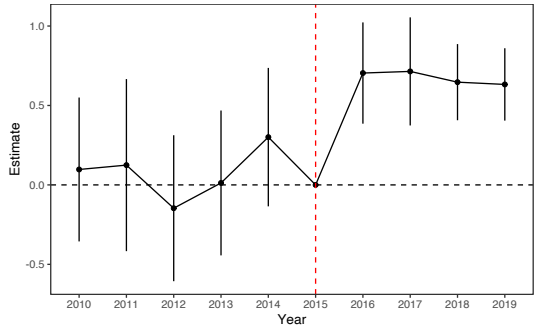
	ESG Holdings	
	(1)	(2)
Conservative Circuit × Post	0.83***	0.60***
	5.07	4.39
Controls	✓	✓
Observations	8,089	8,089
R^2	0.013	0.106
Year FE	✓	✓
State FE	✓	✓
Provider ID	✗	✓

Note: *p<0.1; **p<0.05; ***p<0.01

- **Increase in ESG holdings**: Firms in conservative circuits more than firms in liberal circuits.
- **0.83%** of mutual fund account balance, **$470** per account
- **$340** per account conditional on the same service provider

Convergence between circuits after 2015

Event Study Estimates:
Differences in ESG Holdings between the Conservative and Liberal Circuits



- Jump in 2016
- Persistent change of investor behavior in ESG holdings

Does access to ESG increase retirement contributions?

- **Schroders 2022 U.S. Retirement Survey**
  - 74% of people would participate more in their plans if given access to ESG investment options.
  - Among 31% know their plan offers ESG options:
    - 90% invest.
    - 73% estimate that they allocate >=50%.
- **Matched sample**
  - Challenge: Different saving behaviors in liberal and conservative circuits
  - **Identification strategy**: Coarsened Exact Matching
  - Firms in liberal and conservative circuits with the **same** characteristics

Retirement contributions increase

	Total Contribution/Plan Assets	ESG Holdings
Conservative Circuit × Post	0.90**	0.86***
	2.15	2.78
Observations	7,461	7,451
R^2	0.097	0.099
Year	✓	✓
State	✓	✓
Subgroup × Year	✓	✓
Note:		*p<0.1; **p<0.05; ***p<0.01

- Change in Total Contributions/Plan Assets: 0.9 percentage points each year
- **No crowding out** of existing investment
- Primarily driven by **employee contribution**

Who Was Constrained by Legal Pressure?

Who was constrained by legal pressure pre-2015?

- Why do firms and employees in conservative circuits increase more ESG investment than liberal circuits?
  - Household preference heterogeneity
    - Green firms ⏩ Greenness
    - Liberal counties with conservative circuits ⏩ Local politics
    - Plan size ⏩ Plan size
    - Demographics ⏩ Age
  - Financial institution heterogeneity
    - National and local service providers ⏩ Providers
    - Market share of service providers ⏩ Providers

Plan performance and expense

- **Risk and return profile**
  - I do not observe that ESG funds in 401(k) sacrifice financial returns.
    - ESG funds perform **better** than non-ESG funds in my sample.
    - **No difference** when benchmarked against funds in the same risk category
  - Conservative circuits: lower market risk by asset managers

- **Plan Expense**
  - Plans offering ESG: **higher** average expense ratio than non-offering plans ⏩ Figure
  - **Conservative circuits**: 7.5 basis points higher. ⏩ Table
  - The legal clarification: a 3% reduction in plan expense ⏩ Legal shock

Implications & Conclusion

- Political environment, beyond the investor preference, impacts ESG investments.
- **Judicial channel** explains a significant part of the ESG political gap.
- Heterogeneous belief: Households have ESG preferences but are constrained from such investment.
- Providing investors with greater flexibility, particularly in the form of ESG investments, leads to an overall **rise in their contributions** to 401(k) plans.

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- Heterogeneous belief: Households have ESG preferences but are constrained from such investment.
- Providing investors with greater flexibility, particularly in the form of ESG investments, leads to an overall **rise in their contributions** to 401(k) plans.
- **Not the end of the story!**
  - Utah et al. v. Walsh: 25 conservative state attorneys file a lawsuit against DOL for allowing ESG factors in retirement savings.

Firm's greenness link

	Dependent variable:			
	ESG Offering		*ESG Holdings*	
	All	Green firms	All	Green firms
Conservative Circuit × Post	0.027**	0.047***	0.60***	0.80**
	1.99	2.78	4.39	2.18
Controls	✓	✓	✓	✓
FE	✓	✓	✓	✓
Observations	8,102	2,966	8,089	2,807
R^2	0.109	0.192	0.106	0.197
Note:				*p<0.1; **p<0.05; ***p<0.01

- Green firms: Top 30% ESG score each year
  - ESG Offering: 4.7%
  - ESG Holdings: 0.8%, $460 per account

Local political leaning link

	Liberal Counties		Conservative Counties	
	(ESG Offering)	(ESG Holdings)	(ESG Offering)	(ESG Holdings)
Conservative Circuit × Post	0.039***	0.872***	-0.039***	-0.125
	2.58	5.37	-3.52	-1.32
Controls	✓	✓	✓	✓
FE	✓	✓	✓	✓
Observations	7,034	7,021	1,243	1,243
R^2	0.063	0.013	0.115	0.046
Note:				*p<0.1; **p<0.05; ***p<0.01

- Liberal counties in conservative circuits: ✓

Median Age of County link

	Dependent variable:		
	ESG Holdings		
	Old	Mid	Young
Conservative Circuit × Post	0.02	0.70**	0.15
	0.92	2.11	0.66
Controls	✓	✓	✓
FE	✓	✓	✓
Observations	3,063	3,182	3,086
R^2	0.120	0.259	0.085
Note:	*p<0.1; **p<0.05; ***p<0.01		

- Mid age group: around 38 years old.
- Young age group: not motivated enough to invest outside of default option.

Plan size link

	Dependent variable:			
	ESG Holdings		ESG Offering	
	Large	Small	Large	Small
Conservative Circuit × Post	0.161***	1.872**	0.038***	0.090**
	3.32	2.54	2.80	2.45
Controls	✓	✓	✓	✓
FE	✓	✓	✓	✓
Observations	5,002	2,020	5,013	2,022
R^2	0.089	0.558	0.119	0.222
Note:				*p<0.1; **p<0.05; ***p<0.01

- Small size plans: ✓
- Large size plans: more cautious.

Service providers link

Panel A: National and Non-national Providers

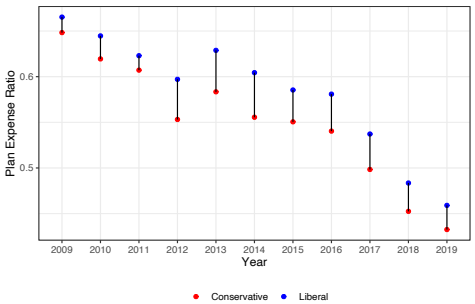
	ESG Offering	
	(National)	(Non-national)
Conservative Circuit × Post	3.4***	-0.2
	2.87	-0.12
Controls	✓	✓
FE	✓	✓
Observations	6,610	4,641
R^2	0.074	0.228

Panel B: Market Shares

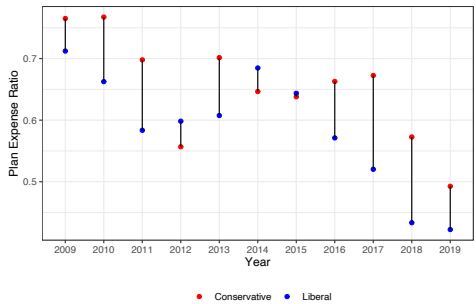
	ESG Offering	
	(Top3)	(Non-top3)
Conservative circuit × Post	4.7**	2.1*
	2.46	1.84
Controls	✓	✓
FE	✓	✓
Observations	6,912	1,730
R^2	0.060	0.075
Note:	*p<0.1; **p<0.05; ***p<0.01	

Plan expense ratio link

- Plan expense ratio = Average expense of all mutual funds on a 401(k) plan menu



401(k) plans



401(k) plans conditional on offering ESG options

- **Unconditionally**, plans in liberal circuits are more expensive.
- **Conditional on offering ESG**, plans in conservative circuits are more expensive.

Legal circuit and plan expense link

	Dependent variable:		
	Plan Expense		
	(All)	(Liberal)	(Conservative)
ESG Offering	0.037***	0.041***	0.112***
	6.21	6.09	3.28
ESG Offering × Conservative Circuit	0.075**		
	2.21		
FE	✓	✓	✓
Observations	8,297	3,061	5,230
R^2	0.513	0.544	0.517
Note:		*p<0.1; **p<0.05; ***p<0.01	

Legal discretion and plan expense: change after 2015 link

	Dependent variable:	
	Plan Expense	
	(1)	(2)
ESG Offering	0.075***	0.057***
	3.61	5.56
Conservative Circuit × ESG Offering		0.066*
		1.75
ESG Offering × Post	**-0.023***	**-0.033****
	-1.88	-4.02
Conservative Circuit × Post		-0.019
		-1.62
Conservative Circuit × ESG Offering × Post		0.022
		0.61
FE	✓	✓
Observations	8,123	8,123
R^2	0.513	0.515
Note:	*p<0.1; **p<0.05; ***p<0.01	

Labor Secretary Thomas Perez

- "Contains much clearer discussion and explanation of how responsible fiduciaries should and should not use ESG/ETI factors while creating and managing portfolios under ERISA."
- "[Retirement planning space is] a decade or more behind other segments of the investing markets when it comes to ETI." link