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Stephen Choi
NYU Law School

Jill E. Fisch
University of Pennsylvania Carey Law School

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On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance

Stephen J. Choi[*] *& Jill E. Fisch*[**]

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INTRODUCTION

In recent years, the California Public Employees Pension System ("CalPERS") has received extensive attention for its active participation in corporate governance. CalPERS's activities established it as a leader among activist institutions.[1] CalPERS's

* Murray and Kathleen Bring Professor of Law, New York University School of Law.

** T.J. Maloney Professor of Business Law, Fordham Law School. Thanks to Jeff Gordon, Keith Johnson, Un Kyung Park, Wayne Schneider, Damon Silvers, Randall Thomas, and John Wilcox for their valuable help in project design and for their useful comments.

1. *See* CalPERS, CalPERS Shareowner Forum, http://www.calpersgovernance.org/forumhome.asp (last visited Dec. 5, 2007) ("The California Public Employees' Retirement System (known as 'CalPERS') has long been a leader in the corporate governance movement.").

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strategy was based on identifying underperforming companies with poor governance practices and then working to change those governance practices and improve performance.[2] Through its implementation of this strategy, CalPERS was at the forefront of broader-based initiatives to increase shareholder monitoring, initiatives that included the use of shareholder proposals to improve corporate governance and support of the SEC's shareholder direct access proposal.[3] CalPERS also embraced Congress's invitation to public pension funds to take an active role in monitoring securities fraud class actions through its visible and influential role in the high-profile *Cendant* litigation.[4]

CalPERS has served as a case study for many as a model of institutional activism. Academics, regulators, and policymakers have looked to the examples of CalPERS and several other public pension funds to support the claims that institutional investors can use their substantial equity stakes and sophistication effectively to overcome collective action problems, and that institutional activism can improve corporate performance.[5] Public pension funds hold approximately 20% of publicly traded U.S. equity and, according to the U.S. Census

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2. *See, e.g.*, Press Release, CalPERS, CalPERS Focus List Targets 11 Companies for Lagging Stock, Financial, Governance Performance (Mar. 15, 2007), *available at* http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2007/march/focus-list-targets-11.xml (describing CalPERS's focus list strategy). At least one study found this strategy to be remarkably successful. *See* Steven Nesbitt, *Long-term Rewards from Shareholder Activism: A Study of the "CalPERS" Effect*, 6 J. APPLIED CORP. FIN. 78 (1994) (finding a cumulative increase averaging 41.3% for each company over a five-year period subsequent to CalPERS's intervention, following a period of relative under-performance); *see also* LILLI A. GORDON & JOHN POUND, ACTIVE INVESTING IN THE U.S. EQUITY MARKET: PAST PERFORMANCE AND FUTURE PROSPECTS: A REPORT PREPARED FOR THE CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM 21, 44 (1993) (finding that activist investment strategies used by CalPERS produced superior returns). *But see* Sanford M. Jacoby, *Convergence by Design: The Case of CalPERS in Japan*, 55 AM. J. COMP. L. 239, 248-49 (2007) (describing conflicting empirical research on the effectiveness of CalPERS's activism).

3. *See, e.g.*, Jacoby, *supra* note 2, at 245-46 (describing CalPERS's frequent use of shareholder proposals relating to corporate governance in the late 1980s).

4. *See In re* Cendant Corp. Litig., 182 F.R.D. 144, 149 (D.N.J. 1998) (appointing the CalPERS Group as lead plaintiff).

5. *See, e.g.*, David L. Gregory, *The Problematic Status of Employee Compensation and Retiree Pension Security: Resisting the State, Reforming the Corporation*, 5 B.U. PUB. INT. L.J. 37, 54 (1995) ("The Calpers model powerfully demonstrates that stockholder activism by public sector pension funds can have very positive influences upon corporate profitability through effective corporate leadership."); Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 251 (1996) (reporting that CalPERS received a return of almost $19 million on its $3.5 million investment in activism during the period from 1987 to 1993); *see also* S. REP. NO. 104-98, at 11 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690 (explaining the adoption of the lead plaintiff provision in the Private Securities Litigation Reform Act of 1995, stating that "[t]he Committee believes that increasing the role of institutional investors in class actions will ultimately benefit the class and assist the courts").

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Bureau, held over $2.5 trillion in cash and securities as of the end of 2004-05.[6] Collectively, public pension funds have the potential to be a powerful shareholder force, and the example of CalPERS and its activities have spurred many to advocate greater institutional activism.

CalPERS is only one fund, however. There are a substantial number of public pension funds—at least 2,656 as of 2005.[7] Many of these funds are relatively new; they were formed as a result of revisions to state and municipal benefit programs.[8] Accordingly, in order to understand the potential role of public pension funds in corporate governance, we go beyond CalPERS in this Article. Little is known about the vast majority of public pension funds and their involvement in corporate governance. What, if any, governance activities are other public pension funds involved in, and why?

This Article offers some preliminary data. Using a combination of publicly available information, interviews, and survey data, the Article provides a status report on the developing role of public pension funds in corporate governance. In part, a description of institutional activism is a moving target. Many funds report that they have increased or changed the nature of their activity in response to legislation, experience, or market developments. At the same time, our data reveal important factors concerning the overall level and type of public pension fund activism. Our primary focus is on discerning what factors correlate with (and potentially cause) public pension funds to engage in a particular form of activism.

What have we learned? First, activity levels vary dramatically. Although some funds engage in a substantial amount of governance activity, a significant number do little or nothing. The most significant factor distinguishing among funds is size: funds with more assets under management are far more active in corporate governance. Second, public pension funds engage in a very limited spectrum of activities. Virtually no funds in our sample played any role in the nomination of director candidates, formally or informally. Similarly, although CalPERS has made high profile use of the shareholder

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6. U.S. Census Bureau, National Summary of State and Local Government Employee-Retirement System Finances: Fiscal Year 2004-2005 (Sept. 22, 2007), http://ftp2.census.gov/govs/retire/2005ret01-txt.txt.

7. *See* U.S. Census Bureau, 2005 State and Local Government Retirement System Survey (2005), *available at* http://www.census.gov/govs/www/retire05view.html (reporting that 2005 survey "covered 2,656 public employee retirement systems").

8. *See* Marguerite Schneider, *The Status of U.S. Public Pension Plans*, 25 REV. PUB. PERSONNEL ADMIN. 107, 108 (2005) (reporting that, in 1998, there were only 700 public employee retirement systems).

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proposal process, very few other funds have followed its example. For the most part, public pension fund activism is limited to low-visibility activities, such as participation in corporate governance organizations or withholding votes from a management nominee. One of the best examples is the widespread willingness to withhold votes from director candidates. Proxy advisory services frequently will recommend a director "withhold" vote, and many institutions follow such recommendations. Unlike other forms of activism, such as nominating a competing slate of directors, a director withhold vote does not single out a fund as an activist. This makes withholding votes a relatively low cost and low risk form of activism.

Finally, our data reveal a marked contrast between litigation—specifically service as lead plaintiff in securities fraud litigation—and non-litigation activism. Smaller funds and funds that delegate more functions and rely on the resources and incentives of outside agents—including active portfolio managers and proxy advisory services, such as Institutional Shareholder Services ("ISS")—engage in less non-litigation activism. Public pension funds participate much more extensively in shareholder litigation than in other governance activities. Despite the importance of asset size and delegation for non-litigation participation levels, we also find that for litigation-related activism, smaller funds and funds that delegate participate with equal frequency.

What is the significance of these findings? Our findings offer reasons to be skeptical of the so-called promise of institutional activism. If the vast majority of public pension funds do not participate extensively in corporate governance, reforms such as the 1992 amendments to the federal proxy rules, which eased restrictions on the ability of funds to communicate on matters relating to a proxy vote, may be of limited value. Limited shareholder participation also may hamper the potential effectiveness of proposals that would allow direct shareholder nomination of directors. Most importantly, we report extensive delegation of governance decisions to external agents, including portfolio managers and proxy advisors. This delegation raises a substantial concern that the effectiveness of institutional activism will be limited by fund agency problems, including the economic incentives of those exercising delegated governance powers.

Our predictions in this context are limited to public pension funds. To the extent that reform proposals to facilitate shareholder activism are implemented, those reforms may, of course, be used by other types of institutions. Current evidence shows, for example, that

hedge funds are far more active than public pension funds in seeking board representation.[9] Similarly, union funds, unlike public pension funds, make regular use of the shareholder proposal rule.[10] Investment companies (mutual funds) generally are reluctant to engage in more visible forms of activism and have not taken an active role in shareholder litigation.[11]

Despite the pessimistic outlook for public pension fund activism in general, the reluctance on the part of funds to engage in visible activism has led to limited coalition-building efforts between more activist and less activist funds. Public pension funds may lend support to other more activist shareholders. The simplest form of "coalition" involves anonymously voting with a more activist fund. While few institutions are willing to take up the high profile activism of CalPERS, many more institutions are willing to support CalPERS with their votes. Our interviews reveal that activist union funds (often larger, national union funds) are particularly eager to solicit the support of more activist public pension funds, which can add both legitimacy and votes to union-sponsored initiatives.

The difference between public pension fund participation in litigation and non-litigation forms of governance sheds light on what motivates funds toward activism. The extensive participation in litigation by both larger and smaller funds is in marked contrast to some of the funds' own explanations for their activity level (or lack thereof). Many funds in our sample responded that they were reluctant to engage in activism because of their small size and limited staff and resources. They also cited their desire to avoid confrontational behavior. Yet despite the fact that litigation is openly confrontational, is a distraction of staff time and resources, and fails to provide lead plaintiffs with greater returns than those available

9. *See, e.g.*, Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1024-42, 1062-72 (2007) (describing hedge fund activism).

10. *See, e.g.*, Roberta Romano, *Does Confidential Proxy Voting Matter?*, 32 J. LEGAL STUD. 465, 477 (2003) ("[B]y the mid-1990s, labor unions had replaced public pension funds as the dominant institutional investors submitting shareholder proposals."); Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998) (describing union fund activism and use of shareholder proposals).

11. *See, e.g.*, James D. Cox & Randall S. Thomas with the assistance of Dana Kiku, *Does the Plaintiff Matter?: An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1609 (2006) ("[O]ur data contains no settlement where a bank, mutual fund, or insurance company has served as a lead plaintiff in a securities class action."); Michael Perino, *Institutional Activism through Litigation: An Empirical Analysis of Public Pension Fund Participation in Securities Class Actions* 11 n.5 (St. John's Legal Studies Research, Working Paper No. 06-0055, 2006), *available at* http://ssrn.com/abstract=938722 (describing large mutual funds as "entirely absent from the ranks of lead plaintiffs").

through free-riding, funds are surprisingly willing to participate—even funds that are unwilling to engage in non-litigation related activity. This willingness to participate in litigation-related activity undermines the notion that cost and a general preference against activism fully explain fund passivity.

There are several possible explanations for the widespread participation of public pension funds in litigation. One possibility is that public pension funds are responding directly to Congress's invitation for greater litigation participation, as embodied in the lead plaintiff provision of the Private Securities Litigation Reform Act of 1995 ("PSLRA").[12] Public pension funds in particular may be concerned about the legitimacy of shareholder activism. Such funds may view the PSLRA as explicitly endorsing their service as lead plaintiffs in a way that distinguishes that role from other types of activism. Another possibility is that the legislation has mobilized plaintiffs' law firms to encourage and facilitate fund involvement in litigation and that these entrepreneurial efforts have spurred fund participation. A third possibility is that litigation decisions are subject to a different decisionmaking structure within the fund. Our interviews suggest that litigation decisions may, in particular, be subject to greater influence by the state Attorney General.

The Article proceeds as follows. Part I explains our methodology. Part II offers summary statistics about the responding funds, a description of the types and levels of fund activism, and summary statistics about fund voting structure and participation in litigation. Part III describes our analysis of the data, including the relationship between fund-specific characteristics and the level of shareholder activism. We focus on testing the correlation between two fund characteristics—fund size and fund passivity/delegation—and activism levels, looking at both litigation and non-litigation activism. Part IV considers the significance of our findings with respect to current policy debates and offers some preliminary suggestions about the manner in which our data may influence the design of corporate governance structures.

I. METHODOLOGY

Data collection for this project took place in three stages. The first stage consisted of intensive multi-day interviews with two large institutional investors. We conducted these interviews in the spring of

12. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).

2005. Their purpose was to gain an understanding of the range of institutional players, the types of activism in which those players participated, the primary reasons for participation, and recent developments and trends that have influenced the role of the institutional investor.

Following these interviews, we developed a set of interview questions designed for an in-person or telephone interview. Using these questions, we conducted interviews with approximately twenty institutional investors during the academic year 2005-06. The institutions interviewed reflected a range of institution types, including public pension funds, investment companies (mutual funds), union funds, foundations, a university endowment, and a non-U.S. institutional investor. Despite the use of a standard set of questions, these interviews were relatively free-ranging, as we sought to learn more about institutional practices as well as the extent to which variations in activism were a function of institution type, as opposed to other factors such as size, staff, and investment portfolio. We collected information on fund practices, fund awareness of governance issues and developments, and fund attitudes about corporate governance.

The interviews rapidly demonstrated to us significant differences between types of institutional investors. Our responders identified several factors contributing to this variation, including differences in regulation, market competition and constraints, staff size and structure, and compensation structure. As a result, we decided to focus the research reported in this Article on a single institution type: public pension funds.

Using the results of our interviews, we constructed a new survey designed specifically for public pension funds. The survey collected information on a variety of general fund characteristics such as size, portfolio composition, investment management structure, and decisionmaking structure. It then collected detailed data on the funds' participation in a total of twenty-seven types of non-litigation activism activities and eleven types of litigation activism. We identified the specific types of activism from activities described by our interviewees as important for their institutions. The survey asked the funds to identify their primary reasons for engaging in activism and the primary reasons for their decision not to participate. The survey also sought additional information on a variety of governance practices including proxy voting and litigation claims processing.

We distributed the survey to 124 public pension funds by regular mail and e-mail during the summer of 2006. Our sample consisted of all the public pension funds whose attorney

representatives were members of the National Association of Public Pension Fund Attorneys ("NAPPA"). NAPPA is a membership organization, limited to attorneys of public pension funds. Its "purpose is to provide educational opportunities and informational resources for its member attorneys."[13] Specifically, NAPPA is not a shareholder activism or corporate governance organization. We selected the NAPPA sample, in part, to reduce the risk of selection bias.

Of the 124 surveys we sent, we received responses from forty public pension funds, giving us a response rate of approximately 32%. Responding funds ranged in size from less than $1 billion in assets under management to approximately $150 billion in assets. Our funds came from twenty-five states plus the U.S. Virgin Islands. We closed data collection in early December 2006 in order to avoid the risk that differences in responses would be the result of developments associated with the start of the 2007 proxy season. To test how representative our responding funds were of the original set of 124 funds, we compared publicly available data on the fund assets of the responding funds against the eighty-four non-responding funds from our original sample.[14] For consistency, assets under management were determined as of the end of the fund's prior fiscal year, which was generally 2006. The mean asset size for responding funds was $25.4 billion, compared with $15.8 billion for non-responding funds. This difference in the mean asset sizes was not statistically significant. The lack of a statistically significant difference in fund asset size between responding and non-responding funds supports the view that our responding funds were representative of the entire set of surveyed funds.

II. INITIAL OBSERVATIONS

In this Part, we survey the evidence from our funds and make some tentative observations about the nature of fund activism we observe.

A. General Summary Statistics

Table 1(a) provides summary statistics on firm size and investment structure. As indicated above, our responding sample includes a representative range of the entire NAAPA set of funds with

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13. NAPPA Home Page, http://www.nappa.org/ (follow "Please Enter" link) (last visited Jan. 7, 2008).

14. Publicly available data were taken from annual reports and comparable documents, which were generally available on the Internet.

respect to fund size. CalPERS, which is currently the public pension fund with the most assets under management, reported total assets under management of $232 billion as of January 31, 2007.[15]

Table 1(a): General Summary Statistics

Firm Size

Assets	**Number of Funds**	**Percent**
< $1 billion	2	5.1%
1-10 billion	14	35.9%
10-50 billion	17	43.6%
50-100 billion	4	10.3%
100-250 billion	2	5.1%
Total	**39**[16]	**100.0%**

Investment Structure

Allocation of Assets	**Mean**	**25%**	**50%**	**75%**	**Std. Dev.**
Fraction of Assets Managed by External Managers	0.842	0.710	0.995	1.000	0.250
Fraction of Assets Indexed	0.292	0.110	0.300	0.390	0.200
Fraction of Assets in U.S. Publicly Traded Equity	0.435	0.397	0.435	0.482	0.082
Fraction of Assets in U.S. Debt	0.247	0.204	0.250	0.300	0.083
Fraction of Assets in International (Non-U.S.)	0.203	0.163	0.200	0.232	0.075

A large percentage of public pension fund assets are managed externally. As a result, the public pension fund represents a multi-layered agency relationship in which the external managers, themselves often institutional investors such as hedge funds or mutual funds, are accountable to fund executives. The fund

15. CalPERS Investment Facts at a Glance, http://www.calpers.ca.gov/eip-docs/about/facts/investme.pdf (last visited Jan. 7, 2008).

16. One fund is excluded from this table due to inconsistent data on reported assets.

executives, in turn, owe their ultimate fiduciary obligations to the fund's beneficiaries. This multi-level relationship has received relatively little attention from commentators. We find that, on average, 84.2% of fund assets are managed externally. More significantly, a substantial number of funds delegate corporate governance responsibility, including voting authority, to their external portfolio managers.[17] Table 1(b) illustrates this delegation.

Table 1(b): Reliance on Agents

Voting Methodology	**Number of Funds**	**Percent**
Vote Own Proxies	6	15.0%
Delegate Authority to Proxy Advisor (Using Proxy Advisor's Recommendation)	8	20.0%
Delegate Authority to Proxy Advisor (Using Fund's Guidelines)	15	37.5%
Delegate Authority to External Portfolio Manager	11	27.5%
Total	**40**	**100.0%**

Preparation of Voting Guidelines	**Number of Funds**	**Percent**
Voting Guidelines Prepared In-House	23	57.5%
Voting Guidelines Outsourced (to Proxy Advisor, External Fund Manager, or Other Outside Party)	17	42.5%
Total	**40**	**100.0%**

Claims Filing	**Number of Funds**	**Percent**
Claims Filing Done In-House	6	15.0%
Claims Filed by Custodian Bank or Claims Processing Service	34	85.0%
Total	**40**	**100.0%**

17. We note that 69% of our funds retain ISS as their proxy advisor, a statistic that may raise concerns about the extent of ISS's influence over institutional voting decisions.

Primary Mechanism to Become Aware of Litigation	**Number of Funds**	**Percent**
Outside Law Firm/Retained Counsel/Outside Monitoring Law Firm	15	62.5%
Litigation Monitoring Service/Investor Responsibility Support Services ("IRSS")	6	25.0%
Internal Monitoring	2	8.3%
Other	1	4.2%
Total	**24**	**100.0%**

Public pension fund reliance on agents extends beyond external fund managers. As reported in Table 1(b), we find that pension funds rely heavily on a variety of agents for services ranging from proxy voting and the preparation of voting guidelines to claims filing and securities litigation screening. Significantly, we find that funds devote limited internal resources to corporate governance, including, as is detailed further below, oversight of their agents. Our interviews revealed that many funds do not dedicate even a single full-time staff position to corporate governance. Similarly, of the funds in our survey, only 17.5% have a separate budget for funding participation in corporate governance.

Another interesting fact revealed by our data is that public pension funds engage in indexed investing to a lesser degree than is sometimes assumed. We find that the average fund indexes only 29.2% of its assets. This is in marked contrast to TIAA-CREF, for example, which indexes 80% of its assets.[18] The argument that an indexed institution has a greater incentive to focus on monitoring because it is locked into the market and cannot discipline issuers through exit[19] would seem to apply to our sample of public pension funds only to a limited extent. Moreover, the failure to index means that fund resources are devoted to attempting to improve returns through investment rather than governance decisions.

18. TIAA-CREF, Life Funds Prospectus 47 (May 1, 2007), http://www.tiaa-cref.org/pdf/prospectuses/spia.pdf.

19. *See, e.g.*, John C. Coffee, Jr., *Liquidity versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1366 (1991) (explaining why monitoring might be rational for indexed institutional investors, namely because they are locked into the market).

B. Non-Litigation Activism

Observing non-litigation related fund activity is often difficult. Some activities, such as publicly announcing a fund's votes prior to a shareholder meeting, are public. Others are less visible, such as when a fund writes a letter to management or informally suggests candidates for the board of directors to a company's nominating committee. Our survey method allows us to obtain information on both more public and less visible forms of non-litigation activism.

Table 2 contains the core of our survey results—statistics about fund participation in twenty-seven categories of non-litigation activism. We identified the activities contained in Table 2 through our interviews of institutional investors. They include the universe of non-litigation forms of corporate governance activism in which various types of institutional investors, including public pension funds and other institutions, described themselves as participating. In our survey, funds were asked to indicate whether they participated in that activity and, if so, to characterize their activity level as done either "occasionally" or "frequently."

Table 2: Non-Litigation Related Activism Summary Statistics

Activity	Never Done	Occasionally	Frequently
Writing Letters to Management	53.9%	30.8%	15.4%
Meeting with Management	64.1%	20.5%	15.4%
Communicating with Other Institutions Regarding Corporate Governance	25.0%	50.0%	25.0%
Soliciting Support for Activities from Other Institutions (Building Coalitions)	47.5%	35.0%	17.5%
Participating in Corporate Governance Organizations	30.0%	27.5%	42.5%
Participating in Corporate Governance Programs	37.5%	27.5%	35.0%

Sponsoring Corporate Governance Programs	75.0%	17.5%	7.5%
Sponsoring Shareholder Proposal	82.5%	15.0%	2.5%
Soliciting Votes on Shareholder Proposal	85.0%	10.0%	5.0%
Formally Nominating Director Candidate in Opposition to Management	100.0%	0.0%	0.0%
Participating in Proxy Contest in Support of Other Non-Management Nominees	71.8%	28.2%	0.0%
Submitting Names of Director Candidates to Nominating Committee	90.0%	10.0%	0.0%
Informally Suggesting Director Candidates to CEO or Other Board Members	87.5%	12.5%	0.0%
Withholding Votes from Management Director Candidate	42.5%	22.5%	35.0%
Publicly Announcing Vote Prior to Shareholder Meeting	85.0%	10.0%	5.0%
Recalling Loaned Stock for Voting	57.5%	27.5%	15.0%
Requesting SEC Rulemaking	75.0%	17.5%	7.5%
Writing Comment Letter to SEC	50.0%	35.0%	15.0%
Signing Comment Letter to SEC (as Part of Group)	42.5%	47.5%	10.0%
Participating in SEC Hearing or Roundtable	75.0%	22.5%	2.5%

Lobbying Congress (Formally or Informally) with Respect to Corporate Governance	72.5%	27.5%	0.0%
Lobbying State Legislature(s) with Respect to Corporate Governance	80.0%	20.0%	0.0%
Participating in Bar Association Activities with Respect to Corporate Governance	67.5%	30.0%	2.5%
Targeted Investing	76.9%	20.5%	2.6%
Creating Focus Lists for Activism	87.5%	2.5%	10.0%
Submitting Amicus Brief on Corporate or Securities Issue	71.8%	25.6%	2.6%
Issuing Press Release with Respect to Any Corporate Governance Activities	72.5%	22.5%	5.0%

The results show substantial variation among activities. As Table 2 indicates, there are seven activities in which 50% or more of our funds reported participating. Several of these activities involve interacting with other institutional investors through coalition building, participation in corporate governance organizations and programs, and communicating with fellow institutional investors. More than half of our funds report writing or signing comment letters to the Securities and Exchange Commission ("SEC"). Additionally, 57.5% of our funds reported withholding votes from director elections.

It is worth noting that all of these activities are relatively low cost, making them feasible options for institutions that do not have resources expressly devoted to corporate governance. In addition, these activities do not involve the funds in visible public confrontations with management. Because public pension funds do not have to report their votes publicly, for example, it is difficult for management to identify and challenge specific funds for withholding

votes against a director candidate.[20] In addition, the widespread use of director withhold votes among institutional investors and their frequent recommendation by proxy advisory firms have made withhold votes relatively common and reduced the political or media risk associated with this form of investor activism.[21]

Activism addressed to specific companies is far less common. Despite media reports that institutional investors engage in frequent direct communication with company management, we find that 53.9% of our funds never submitted a letter to management, and 64.1% never met with management.[22] More openly confrontational activity is even less frequent; fewer than 20% of funds had submitted a shareholder proposal or actively engaged in the solicitation of proxies. Fewer than 15% of our funds had followed the CalPERS model of identifying activism targets through the use of focus lists.[23] And, importantly, funds almost never are involved in actively challenging management control over the nomination and election of directors. None of our funds reported nominating a director candidate, and fewer than 15% had even submitted the name of a potential director candidate to a board member, CEO, or nominating committee.

Finally, funds reported relatively little involvement in policymaking. Only 20% of funds had lobbied their state legislatures with respect to corporate governance even occasionally, and only 27.5% had lobbied Congress. To the extent that funds are concerned with policymaking, they are more likely to engage with the SEC; as indicated above, more than half the funds reported communicating with the SEC through comment letters or testimony. This is consistent with our interview findings in which the majority of institutional investors identified the SEC as the government agency most responsive to the needs of institutional investors. Finally, only 28.1% of funds reported submitting an amicus brief on a corporate or securities issue, although that number may have increased, as a

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20. Nonetheless, some public pension funds voluntarily disclose their votes. For example, CalPERS provides its proxy voting on the web at Proxy Voting Decisions, http://www.calpers-governance.org/alert/proxy/ (last visited Jan. 7, 2007). In addition, management sometimes can track withhold votes based on broker voting.

21. *See* Patrick G. Quick, John K. Wilson & Jessica S. Lochmann, *Recent Developments Regarding Majority Voting in Director Elections*, WALL ST. LAW., Jan. 2006, *available at* http://www.realcorporatelawyer.com/wsl/wsl0106.html (describing the significance of withhold votes among institutional investors).

22. One explanation for this is the fact that many public pension funds delegate responsibility for corporate governance to their external portfolio managers. It is possible, even likely, that those portfolio managers engage in meetings with corporate management or write letters in connection with their investment decision-making.

23. *See* Press Release, CalPERS, *supra* note 2 (describing CalPERS's focus list strategy).

number of public pension funds signed on to amicus briefs in recent Supreme Court cases addressing securities fraud litigation.[24]

C. Litigation Activism

With the adoption of the PSLRA and the creation of the lead plaintiff provision, institutional investors and public pension funds in particular have become increasingly active, serving as lead plaintiffs in a higher percentage of cases every year and, on occasion, taking a visible role in selecting counsel and negotiating aggressive fee agreements. In some cases, institutions exert even more control.[25] For example, the New York State public pension funds, under the leadership of state comptroller Alan Hevesi, were the driving force behind requiring individual outside directors to contribute personal funds to the settlement of the WorldCom litigation.[26] The University of California negotiated a similar provision in the Enron settlement.[27]

At the same time, concerns about delay, procedural obstacles, and, in some cases, lack of control over the selection of lead counsel have led some institutional investors to opt out of class litigation in favor of pursuing individual cases.[28] Institutional investors also

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24. *See, e.g.*, Brief of the N.Y. State Common Retirement Fund et al. as Amici Curiae in Support of Respondents, Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499 (2007) (No. 06-484), 2007 U.S. S. Ct. Briefs LEXIS 226 (providing an example of public pension funds signing onto amicus briefs in cases addressing securities fraud litigation).

25. We both have written extensively about the participation of institutional investors in litigation, particularly in securities fraud class action litigation. *See, e.g.*, Stephen J. Choi, Jill E. Fisch & A.C. Pritchard, *Do Institutions Matter? The Impact of the Lead Plaintiff Provision of the Private Securities Litigation Reform Act*, 83 WASH. U. L.Q. 869, 888-89 (2005) (analyzing the participation of institutional investors in litigation over a ten-year period); Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Era After the PSLRA*, 106 COLUM. L. REV. 1489, 1503-07, 1518-30 (2006) (assessing the effects of the PSLRA on institutional investors as lead plaintiffs in class actions); Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 COLUM. L. REV. 650, 654-55 (2002) (describing the role and selection of lead counsel in class action litigation).

26. *See The Director's Cut*, WALL ST. J., Jan. 13, 2005, at A12 (reporting a statement by Hevesi that he "felt personally that this would be unfair and not a deterrent for future failures on the part of directors if they weren't held personally liable").

27. Press Release, Univ. of Cal., UC Reaches $168-Million Settlement with Enron Directors in Securities Fraud Case (Jan. 7, 2005), *available at* http://www.universityofcalifornia.edu/news/2005/jan07.html.

28. *See, e.g.*, Lorraine Woellert, *Fractured Class Actions: "Opt-Outs" Are a Growing Headache for Companies*, BUS. WK., Feb. 27, 2006, at 31 (describing pension fund opt-outs in several major cases). In some cases, institutional investors have recovered substantially more through individual litigation. *See, e.g.*, Gilbert Chan, *CalPERS' Time Strategy Pays Off: The State Pension Fund Gets $117.7 Million After Opting Out of Class-Action Suit Against Media Giant*, SACRAMENTO BEE, Mar. 15, 2007, at D4 (reporting that by opting out CalPERS received a recovery in Time-Warner litigation that was seventeen times what it would have received by remaining as a member of the class action).

occasionally participate in other types of litigation, such as state court derivative suits and appraisal proceedings.[29]

We sought to obtain information about public pension fund participation in various types of litigation. For those funds that participated, we sought to gain a greater understanding of the nature of their involvement. Table 3 contains summary statistics for litigation activism. As the table shows, activism levels are significantly higher for litigation than for non-litigation activity. Fifty-five percent of responding funds, for example, reported that they had served as lead plaintiff. These findings are consistent with data showing increasing involvement by institutional investors in shareholder litigation. Cornerstone Research, for example, reported that more than half of all suits settled in 2006 had institutional investors as lead plaintiffs.[30]

Table 3: Litigation Activism Summary Statistics

Activity	**Percent of Funds That Engaged in Activity at Least Once**
Served as Lead Plaintiff in Securities Litigation	55.0%
Served as Lead Plaintiff in Derivative Litigation	15.0%
Opted out of Class Action and Pursued Individual Securities Fraud or Derivative Suit	60.0%
Competed with Another Institution for Lead Plaintiff Role	55.0%
Informally Participated in Litigation	32.5%
Attempted Unsuccessfully to Serve as Lead Plaintiff	35.0%
Participated in Litigation over Shareholder Proposals	2.5%
Sought Appraisal Remedy	2.5%
Other Corporate/Securities Litigation	10.0%

29. *See* Fisch, *supra* note 25, at 724 (noting that institutions have participated actively in some derivative suits).

30. *See* Beth Barr, *Securities Class Action Settlements Reach Record Level*, N.Y. L.J., Mar. 29, 2007, *available at* http://www.law.com/jsp/article.jsp?id=1175159036321 (reporting results of Cornerstone study).

Objected to Proposed Settlement	5.0%
Objected to Proposed/Requested Attorney Fee Award	25.0%

As media reports indicate, opting out of shareholder litigation to pursue an individual claim is relatively common.[31] Table 3 reports that 60% of funds reported opting out of representative litigation. Funds appear to believe that they will recover more money and receive payment more quickly when they opt out.[32] The media report that opting out has been a successful strategy in several high profile cases.[33] Nonetheless, in the interviews, some institutions reported frustration with opting out.

Funds are much less active in other types of litigation. Only a small fraction of funds reported participating in derivative suits, appraisal proceedings, and litigation over shareholder proposals. Lower participation levels in these forms of litigation activism may be driven, in part, by the fact that legal fees may not be available out of the resulting common fund as they are in class actions.

We also asked funds about the manner in which they processed securities litigation claims. Our questioning on this topic was motivated by highly publicized research by James Cox and Randall Thomas reporting that institutional investors failed to file claim forms in securities litigation at an alarmingly high rate, leaving billions of dollars "on the table."[34] When Cox and Thomas's research was released, more than forty mutual fund managers were sued for failing to file claims forms on behalf of their funds.[35] It appears that public pension funds have responded to the Cox and Thomas research and

31. *See* Woellert, *supra* note 28 (describing a number of pension fund opt-outs).

32. *See, e.g.*, Neil L. Selinger, *Why Funds Opt Out of Class Action*, PENSIONS & INVESTMENTS, Feb. 20, 2006, at 12 (explaining that opting out can result in "substantial premiums over the class recovery" as well as "an expeditious payment").

33. *See, e.g.*, Woellert, *supra* note 28 (reporting recoveries by opt outs in *Time Warner*, *WorldCom*, and other big securities fraud cases).

34. James D. Cox & Randall S. Thomas, *Leaving Money on the Table: Do Institutional Investors Fail To File Claims in Securities Class Actions?*, 80 WASH. U. L.Q. 855, 856-60 (2002); James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 425 (2005) [hereinafter Cox & Thomas, *Letting Billions*]. Cox and Thomas researched filings by "financial institutions," which they defined to include "private and public pension funds, life and casualty insurance companies, mutual funds, bank trust departments, and various endowments," but did not focus specifically on public pension funds. Cox & Thomas, *Letting Billions*, *supra* at 415.

35. *See* Securities Litigation Watch, http://slw.riskmetrics.com/ (Jan. 25, 2005) (under Archives, select "January 2005") (describing litigation against mutual funds).

the admonition that filing claims is one of their fiduciary obligations. However, the procedures by which funds handle claims submission varies; as reported above in Table 1(b), 85% outsource the process, either to their securities custodian or to a claims processing firm, and 15% handle claims processing internally.[36]

An important question is whether the recoveries in investor litigation are significant.[37] We find that funds in our sample reported recovering an average of $6.75 million in the prior fiscal year, an amount that represents 0.035% of the average fund's total assets (although the recovery obviously may have a more substantial effect on returns). There is considerable variation in fund recoveries, ranging from 0.209% of fund assets down to 0.003% of assets. In addition, recoveries in securities fraud class actions have grown substantially in the past 5 years. Nonetheless, for many funds, it remains an open question as to whether litigation recoveries are economically significant. Interestingly, 25% of funds reported that they do not maintain information on their litigation recoveries. One can question whether a fund is meeting its fiduciary obligations if it does not even keep track of whether and to what extent it is recovering money on its securities claims.

D. Measuring Activism

In order to measure activism levels and to test those levels against fund-specific factors such as size, we constructed three activism indices. The first index, which measures non-litigation activism, is based on the information contained in Table 2. For each sample fund, we assigned a value of 1 for occasional participation in each non-litigation activity and a value of 2 for frequent participation in that activity. Summing those numbers for each sample fund gives

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36. An increasing number of firms are offering funds the opportunity to outsource their claims processing. One of the best known is Securities Class Action Services (SCAS), a subsidiary of ISS. For a description of services provided by SCAS, see Institutional Shareholder Services, Securities Class Action Services: Recover Your Clients' Eligible Assets with Securities Class Action Services, *available at* http://www.issproxy.com/pdf/securitiesclass.pdf (last visited Feb. 14, 2008). SCAS reported that, in the year 2006, it filed more than 160,000 claims on behalf of its clients. *Id.* Claims filing is also offered by IRSS. Investor Responsibility Support Services, Inc., About IRSS, https://www.irss.ws/about.html (last visited Jan. 3, 2008). Plaintiffs' law firms are also offering claims processing. *See, e.g.*, Coughlin Stoia, News, Lerach Coughlin takes on Securities Claims Filing (Mar. 3, 2007) http://www.csgrr.com/csgrr-cgi-bin/mil?templ=news/articles/securities_claims_filing.html (highlighting the claims filing services for institutional clients Coughlin Stoia (formerly Lerach Coughlin) introduced last year).

37. *See* Adam C. Pritchard, *Who Cares?*, 80 WASH. U. L.Q. 883, 883-84 (2002) (raising this question in the context of the Cox and Thomas research).

us the non-litigation index, which can range from 0 to a maximum of 54.

The second index measures litigation activism. For each litigation activity listed in Table 4, we assigned a value of 1 if the fund indicated that it participated in the specific activity at least once. The litigation index for each sample fund is the sum across all the various litigation activity categories, which can range from 0 to 11.

Lastly, to measure overall activism, we constructed a combined activism index. To give equal weight to each non-litigation and litigation activity, we assigned a value of 1 for each activity that a fund indicated that it had performed at least once. Thus, unlike for the Non-Litigation Sum variable, where each activity can range from 0 to 2, we treat each activity for purposes of constructing the Activism index as ranging from 0 to 1. The activism index is the sum of the values assigned to each activity—both non-litigation and litigation—for each fund and can range from 0 to 38. Table 4 reports summary statistics on our three measures of fund activity. We use these measures of activism in the next Part to test the extent to which fund-specific characteristics correlate with activism levels.

Table 4

Measures of Activity	**Mean**	**25%**	**50%**	**75%**	**Std. Dev.**
Non-Litigation Sum	11.675	4.500	8.500	16.500	10.866
Litigation Sum	2.975	1.000	3.000	4.000	2.166
Activism	12.000	6.000	11.500	17.000	8.735

III. FUND-SPECIFIC CHARACTERISTICS AND LEVELS OF ACTIVISM

We test the relationship between various characteristics of a fund and the level of activism in which a fund engages. Our tests focus on two hypotheses on how fund characteristics may relate to activism.

First, we test the relationship of fund size with activism. We hypothesize that size will correlate with a greater inclination to engage in activism. Larger funds are better able to spread the fixed costs of researching corporate governance issues, participating in proxy contests, and so on. Specifically, we test whether size is equally important for both non-litigation and litigation-related activism.

Second, we hypothesize that funds that delegate more of their functions will engage in less activism. Funds that delegate more functions will have fewer in-house resources with which to engage in activism. Similarly, delegation may reflect a structural preference against outside actions, including activism. We test in particular whether the delegation of functions correlates with levels of litigation and non-litigation activism.

A. Fund Size and Activism

The costs of engaging in activism are largely fixed. The costs of serving as lead plaintiff in a securities class action are roughly the same whether the plaintiff is a small or large fund. The costs of soliciting proxies for a shareholder proposal do not vary with the size of the fund. Given the mostly fixed costs of activism, larger funds have an economic advantage in pursuing activism. Large funds are able to spread the cost of activism across this larger asset base. In addition, large funds are likely to have larger staffs and budgets, making it easier for the funds to devote a portion of both to activism. Even relatively small activism costs may overwhelm the operating budget of smaller funds.

Because of the cost advantage accruing to larger funds, we predict that larger funds will engage in more activism. We define "Small Funds" as funds with assets less than $10 billion. Large Funds" are defined as funds with $10 billion or more in assets. Table 5 explores in more detail the relationship between fund size and activism. We report the p-value from a t-test of the difference in the means between small funds and large funds.

Table 5: Fund Size and Activism

Non-Litigation Activity	**Small Funds**	**Large Funds**	**p-value**
Writing Letters to Management	0.133	0.917	0.001
Meeting with Management	0.400	0.583	0.469
Communicating with other Institutions Regarding Corporate Governance	0.688	1.208	0.022
Soliciting Support from Other Institutions (Building Coalitions)	0.438	0.875	0.073
Participating in Corporate Governance Organizations	0.625	1.458	0.002

Participating in Corporate Governance Programs	0.563	1.250	0.012
Sponsoring Corporate Governance Programs	0.000	0.542	0.005
Sponsoring Shareholder Proposal	0.000	0.333	0.024
Soliciting Votes on Shareholder Proposal	0.125	0.250	0.460
Formally Nominating Director Candidate in Opposition to Management	0.000	0.000	—
Participating in Proxy Contest in Support of Other Non-Management Nominees	0.200	0.333	0.381
Submitting Names of Director Candidates to Nominating Committee	0.000	0.167	0.089
Informally Suggesting Director Candidates to CEO or Other Board Members	0.000	0.208	0.053
Withholding Votes from Management Director Candidate	0.563	1.167	0.033
Publicly Announcing Vote Prior to Shareholders' Meeting	0.188	0.208	0.902
Recalling Loaned Stock for Voting	0.188	0.833	0.006
Requesting SEC Rulemaking	0.000	0.542	0.005
Writing Comment Letter to SEC	0.250	0.917	0.004
Signing Comment Letter to SEC (as Part of a Group)	0.438	0.833	0.061
Participating in SEC Hearing or Roundtable	0.000	0.458	0.004
Lobbying Congress (Formally or Informally) on Corporate Governance	0.188	0.333	0.324
Lobbying State Legislature(s) on Corporate Governance	0.125	0.250	0.345
Participating in Bar Association Activities with Respect to Corporate Governance	0.188	0.458	0.117
Targeted Investing	0.067	0.375	0.059
Creating Focus Lists for Activism	0.000	0.375	0.060
Submitting Amicus Brief on Corporate or Securities Issue	0.200	0.375	0.314
Issuing Press Release with Respect to Any of Your Corporate Governance Activities	0.125	0.458	0.071
Non-litigation sum	**5.625**	**15.708**	**0.003**

We find that, for virtually every type of non-litigation activism, large funds are significantly more active than small funds. In addition, the Non-Litigation Sum measure is significantly greater for large funds as compared with small funds.

What drove fund participation in non-litigation activism? Table 6 gives a breakdown of the primary reasons for participation and non-participation as indicated by our responding funds.

Table 6: Reasons for Non-Litigation Activism

Reason for Participating	**Number of Funds**	**Percentage**
Improved Returns	14	38.9%
Fiduciary Duties	4	11.1%
Significant Public Interest	4	11.1%
Other	6	16.7%
Did Not Participate	8	22.2%
Total	**36**	**100.0%**

Note: "Other" includes the fund board required more activity to become aware of corporate governance issues, among others.

Reason for Not Participating	**Number of Funds**	**Percentage**
Lack of Resources	16	44.4%
Cost-Benefit Analysis Against Participation	11	30.6%
Lack of Authority; Not Authorized by Trustee or Board; Reluctance of Trustee or Board to Become Active	6	16.7%
Other	3	8.3%
Total	**36**	**100.0%**

Note: "Other" includes delegation of participation decisions to external managers, the desire to avoid potentially contentious issues, and the desire to avoid getting entangled in openly public "headline" activism.

Note that 38.9% of funds gave "improved returns" as their primary reason, constituting 50% of those funds that reported some form of participation. Lack of resources was the most common reason for not participating.

In contrast to the difference in non-litigation activism based on the size of the fund, we find no such size difference for litigation-related activism. Table 7 reports the fund responses to several categories of litigation-related activism. We report the p-value from a t-test of the difference in the fraction of small funds and large funds.

Table 7

Litigation Activity	**Fraction of Small Funds**	**Fraction of Large Funds**	**p-value**
Served as Lead Plaintiff in Securities Litigation	0.500	0.583	0.615
Served as Lead Plaintiff in Derivative Litigation	0.063	0.208	0.216
Opted out of Class Action and Pursued Individual Securities Fraud or Derivative Suit	0.438	0.708	0.091
Competed with Another Institution for Lead Plaintiff Role	0.625	0.500	0.449
Informally Participated in Litigation	0.313	0.333	0.894
Attempted Unsuccessfully to Serve as Lead Plaintiff	0.313	0.375	0.694
Participated in Litigation over Shareholder Proposal	0.000	0.042	0.421
Sought Appraisal Remedy	0.000	0.043	0.412
Other Corporate/Securities Litigation	0.000	0.167	0.089
Objected to Proposed Settlement	0.000	0.083	0.247
Objected to Proposed/Requested Attorney Fee Award	0.188	0.292	0.469
Litigation Sum	**2.438**	**3.333**	**0.204**

Large funds opted out of class actions to pursue their own individual securities fraud or derivative suits more often than small

funds.[38] Large funds also responded that they engaged in other forms of corporate or securities litigation more frequently than small funds. Both differences, however, are significant at only the 10% confidence level. Outside of these two areas, none of the differences in the other litigation activity categories are significant. Moreover, the overall Litigation Sum score for small funds is not significantly different than the score for large funds.

What explained a fund's decision to become active in litigation? We asked our sample funds why they sought appointment as lead plaintiffs. Among those funds that responded that they had sought the lead plaintiff position, Table 8 gives a breakdown of their primary reasons for participation. Table 8 also delineates the primary reasons for non-participation among funds that did not seek lead plaintiff status.

Table 8

Reason Sought Lead Plaintiff Position	**Number of Funds**	**Percentage**
Large Losses; Large Size of Recovery	17	65.4%
To Increase Recovery Amount; Affect Settlement; Deter Misconduct	4	15.4%
Particularly Egregious Fraud on the Merits	2	7.7%
Fiduciary Responsibility	1	3.9%
Other	2	7.7%
Total	**26**	**100.0%**

Note: "Other" includes the recommendation of the state Attorney General to pursue lead plaintiff appointment, among other reasons.

Reason Did Not Seek Lead Plaintiff Position	**Number of Funds**	**Percentage**
Insufficient Resources; Drain on Resources	7	43.8%
Other Funds with Larger Losses	6	37.5%
No Merit; No Worthwhile Suit	2	12.5%
Other	1	6.3%
Total	**16**	**100.0%**

Note: "Other" includes opposition from fund trustees, among other reasons given from the same fund.

38. Given that opting out of a class action is economically rational only for a class member with a relatively large stake, this finding is not surprising.

By far the most important reason for the decision to seek lead plaintiff status is the size of the loss and corresponding size of the potential litigation recovery. Funds are concerned with the bottom line in pursuing litigation activism.

Importantly, our findings reveal that litigation is not dominated by a subset of only the larger funds. Given the focus on the bottom line, what explains this lack of size differential for litigation-related activism? One possible explanation is that litigation tends to generate a large amount of publicity. Regardless of size, public pension funds may engage in litigation-related activism precisely because of this publicity. Specifically, pension funds that face political pressure from external sources, such as the state Attorney General, may decide to engage in litigation activism even if they normally eschew non-litigation activism.

A second possibility is that litigation activism, particularly service as lead plaintiff in a securities fraud class action, does not impose substantial costs on a fund. Despite the common response of insufficient resources on the part of funds that did not seek lead plaintiff status, plaintiffs' firms typically bring these cases on a contingency fee basis, and funds incur no out-of-pocket costs other than the expenditure of time by fund personnel to monitor the case. Indeed, plaintiffs' firms typically screen cases and identify pension funds with substantial stakes, so that funds need not incur investigation costs. The lower cost of litigation activism may make it accessible to firms that lack the resources for other types of governance.

A third possibility is that participation in litigation may not always constitute activism. Although some public pension funds take an active role when they serve as lead plaintiff—monitoring counsel, negotiating a fee agreement, overseeing litigation strategy, and so forth[39]—others may not. One of the criticisms of securities fraud class representatives prior to the adoption of the PSLRA was their relative passivity in overseeing the litigation.[40] The mere fact that a lead plaintiff is a public pension fund rather than an individual is not a guarantee of greater oversight. Recent studies suggest that public

39. *See* Fisch, *supra* note 25, at 704-10 (describing the active involvement of institutional investors in selecting lead counsel, negotiating fee agreements, and monitoring litigation); R. Randall Roche, *My Experience as a Lead Plaintiff*, INSTITUTIONAL INVESTOR ADVOCATE, at 1 (2000), http://www.blbglaw.com/advocate/adv2000Q4.pdf (describing the author's role as general counsel for the Louisiana Retirement Systems in monitoring the litigation against 3Com).

40. *See* Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053, 2054 (1995) (describing such plaintiffs as "figurehead" plaintiffs).

pension fund involvement as lead plaintiff is correlated with greater settlement amounts and lower attorneys' fees,[41] but those studies cannot determine the frequency with which funds participate actively. Moreover, it is possible that public pension funds simply cherry pick the stronger securities suits; the higher recovery amounts may not be due to any added value from fund participation, but may reflect the ability of funds to select higher value suits with which to become involved.[42]

A fourth explanation is that fund losses may not be correlated with fund size. A small fund may have a substantial loss in a particular issuer, justifying its involvement in litigation.[43] Indeed, such a fund may have a greater incentive to participate in the litigation than a larger fund to the extent that its losses are, relative to its overall portfolio, economically significant.

B. Delegation and Activism

We hypothesize that funds that delegate more of their functions have fewer resources in-house to devote to activism. Delegating may indicate a preference for greater passivity that corresponds to lower levels of activism. Importantly, however, delegation also exposes funds to an agency problem: outside parties assisting funds in investment decisions (i.e., active portfolio managers) and voting decisions (i.e., ISS) may not necessarily make decisions in the best interests of the fund. Active portfolio managers, for example, simply may prefer to exit from poorly performing investments rather than attempt to improve corporate governance. Because, as suggested above, the factors that seem to drive litigation activism differ from non-litigation activism, we also hypothesize that a fund that delegates will not necessarily display the same lack of activity for litigation as for non-litigation related activity.

As discussed above, funds choose to delegate many of their activities (see Table 1(b) above). We focus on three specific acts of delegation: (1) voting, (2) the preparation of voting guidelines, and (3) the processing of claims in securities litigation. We do not include the decision to delegate litigation screening because the significance of this variable is compromised by firms that do not participate in

41. Cox & Thomas, *supra* note 11, at 1636-39; Perino, *supra* note 11, at 24, 30-31.

42. *See* Choi, Fisch & Pritchard, *supra* note 25, at 892 (finding some empirical evidence consistent with the "cherry-picking" hypothesis).

43. The likelihood of this event is increased to the extent that funds are stock picking rather than indexing.

litigation. We focus only on those decisions to delegate that are not related directly to our measures of non-litigation and litigation activism in order to avoid endogeneity problems. Whether a fund is engaged in one of our areas of activism, the fund will make separate decisions about the development of its voting guidelines, whether to delegate its decision to vote, and whether to outsource its claims processing.

We take the decision to delegate in the areas of voting, development of voting guidelines, and claims processing as a proxy for the exogenous preference of the fund to outsource those activities as opposed to undertaking them in-house (with a corresponding commitment to fund them. "Delegation" is defined as follows: a score of 1 is given for each of the three delegations described above, and the sum is Delegation (so the score can range from 0 to 3).

(1) The fund describes its method of voting as (a) delegate voting authority to a proxy advisor in accordance with its recommendations, (b) do not vote, or (c) delegation to outside managers
(2) The fund outsources the preparation of voting guidelines
(3) The fund outsources the processing of its securities litigation claims

Our hypothesis is that a fund with a preference to delegate (as proxied through our Delegation variable) will choose not to engage in activism. Table 9 reports summary statistics on the Delegation measure.

Table 9: Passive and Active Funds Summary Statistics

Measures of Activity	**Mean**	**25%**	**50%**	**75%**	**Std. Dev.**
Delegation	1.7	0.0	1.5	3.0	1.027

Relationship with Activism

	Delegation ≤ Median	**Delegation > Median**	**p-value**
Activism	15.55	8.48	0.008
Non-Litigation Activism	16.35	7.00	0.005
Litigation Activism	3.30	2.65	0.349

Note: p-value is for a t-test of the difference in means between the Delegation ≤ Median group and the Delegation > Median group.

Funds that choose to delegate more functions are likely to devote less effort and fewer resources to developing in-house knowledge and expertise about corporate governance. We find that funds that choose to delegate engage in far less non-litigation activity as compared with other funds (difference significant at the 1% significance level). Funds that delegate also engage in less non-litigation activity, but the difference is not statistically significant.

C. Multivariate Tests

Our tests above examine the correlation between fund activism and (a) size and (b) a preference for passivity. To further test the differences between litigation and non-litigation activism, we perform a series of multivariate models to control for other factors that may affect a fund's level of activism.

Our models use one of two dependent variables based on our measures of fund activism: Non-Litigation Sum or Litigation Sum. Because both dependent variables are discrete and ordinal, we use an ordered logit model.

In each of our models, we include three control variables. The first control is the fraction of the fund's portfolio that is externally managed (Fraction Externally Managed). Funds with external managers may not take as close an interest in the corporate governance of the corporations in which they invest. The second control is the fraction of the fund's portfolio in the form of U.S. publicly traded equity (Fraction Equity U.S.). Funds with more assets in U.S. publicly traded equity may have a greater incentive to engage in activism within the United States to boost the value of this equity. Our third control is the fraction of a fund's assets that is indexed, as opposed to actively managed (Fraction Equity Index). The greater the fraction of indexed funds, the less incentive a fund may have to improve the corporate governance at any one particular company. On the other hand, indexed funds may be more active because they cannot respond to poor governance through exit.

To test the impact of size, we include fund assets in each regression. To test the relationship between delegation and activism, we include the Delegation variable. Lastly, we include an indicator variable, Public Official Decisionmaker, to test whether having a public official in direct decisionmaking authority for a fund results in

greater activism.[44] Public Official Decisionmaker is defined as equal to 1 if a fund responded that decisionmaking authority is vested in an elected or appointed public official and 0 otherwise.[45]

Table 10 reports the results from our multivariate tests.

Table 10

	Model 1	**Model 2**
Dependent Variable	Non-Litigation Sum	Litigation Sum
Independent Variables		
Assets	0.075*** (3.860)	0.012 (1.000)
Delegation	-0.781** (-1.990)	-0.125 (-0.330)
Public Official Decisionmaker	2.949* (1.780)	0.701 (0.550)
Fraction Externally Managed	-2.235 (-1.130)	-2.497 (-1.510)
Fraction Equity U.S.	-3.939 (-0.890)	-10.031** (-2.190)
Fraction Equity Index	-4.476** (-2.260)	0.388 (0.230)
N	38	38
Log Likelihood	-87.981	-71.282

***1%, **5%, *10% significance level. z-statistic in parentheses.

44. The degree of oversight exercised by a public official may differ from that official's legal authority. Because we are concerned with actual involvement rather than the legal right to exercise oversight, we code based on the official's involvement as reported by our sample funds.

45. Most of our funds did not report a public official as the decisionmaker. Instead, we found that 90% of our funds were governed by a board of governors, trustees, or directors. This finding is consistent with Schneider, who states that the majority of public pension funds are administered by a board. Schneider, *supra* note 8, at 110. Our interview data revealed that board composition varies significantly. Some boards contain a number of public officials, some contain primarily current or retired plan members, and some contain a number of independent members similar to the outside directors of corporations. Our survey, however, did not request information on the board composition of responding funds; nor did it allow us to determine the extent to which boards are likely to be influenced by local politics.

Note from Table 10 the lack of correlation between fund size and litigation activism.[46] Unlike non-litigation activism, litigation draws equally from large and small firms. This finding is noteworthy in light of the fact that the funds most commonly explain their lack of activism (both litigation and non-litigation) as the result of their small size and limited resources. Our results are consistent with the recent report by Cornerstone Research, indicating that the funds most active in litigation in 2006, by number of lawsuits, were Teachers' Retirement System of Louisiana ($14 billion in assets), Local 144 Nursing Home Pension Fund ($8.2 billion including several other funds), Plumbers & Pipefitters National Pension Fund ($4.3 billion), Louisiana School Employees Retirement System ($1.5 billion), and the Louisiana State Employees Retirement System ($7.8 billion).

Similar to our univariate results, Delegation correlates with a lesser degree of Non-Litigation activism (at the 1% significance level). In contrast, Delegation does not correlate with a lesser degree of litigation activism. Funds appear to distinguish between non-litigation and litigation-related activities. Funds that perform fewer functions in-house are not more limited in their litigation-related activities.

Table 10 reports that funds with an appointed or elected public official as the decisionmaker engage in greater non-litigation activism (significant at the 10% level). It is unclear whether such public decisionmakers are motivated by shareholder or public welfare or simply seeking to increase their personal visibility, possibly to further the goal of attaining higher office. Under the civic republicanism view of the political process, the involvement of public officials should increase accountability and lead to socially desirable levels of participation in corporate governance.[47] On the other hand, some commentators have accused public officials of using pension fund activism to pursue political objectives that are inconsistent with the

46. Despite this finding, there remains a substantial degree of correlation between non-litigation activism and litigation activism. The correlation coefficient was equal to 0.6598.

47. *See, e.g.*, Jill E. Fisch, *The "Bad Man" Goes to Washington: The Effect of Political Influence on Corporate Duty*, 75 FORDHAM L. REV. 1593, 1611 (2006) (describing civic republicanism); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 562 (2000) (explaining that "civic republicanism portrays government as a moral force for the common good").

financial interests of fund beneficiaries.[48] Our data provide no bases for testing between those competing hypotheses.[49]

Table 10 also reports that funds with more of their assets held in an equity index are significantly less likely to engage in non-litigation activism. Indexed funds generally are less active. This finding is surprising, in that it counters the argument that indexed investors will be more active because they cannot sell poorly performing portfolio companies.[50] It suggests, however, that activism may be driven largely by a fund's available resources and that highly indexed funds may seek to maximize their returns by minimizing operating costs. On the other hand, more heavily indexed funds are no less likely to engage in litigation activism, suggesting that litigation activism does not involve substantial out-of-pocket costs.

Lastly, Table 10 reports that there is no correlation between a public decisionmaker and higher levels of litigation activism. This finding casts some question on the claim that officials participate in litigation in an effort to attract political contributions from plaintiffs' firms—so-called "pay to play."[51] We find no evidence that the involvement of public officials correlates with greater litigation activism.

IV. POLICY IMPLICATIONS

The funds that we talked to were extremely interested in the amount of activism engaged in by their peer firms. Despite the fairly high visibility of much fund activism, we found that funds are largely unaware of each others' activities. In part, limited awareness may reflect the fact that state and local government actors, particularly at smaller funds, have limited opportunities to interact with their peer institutions unless they seek out those activities through corporate governance organizations and other networking.

Regardless of activity level, all funds described their reasons for activism in terms of improving returns for their beneficiaries and increasing shareholder value. Yet in our more detailed interviews,

48. *See, e.g.*, Mary Williams Walsh, *California Pension Activist Expects to Be Ousted*, N.Y. TIMES, Dec. 1, 2004, at C1 (describing claims that "the Calpers board had begun to range far away from its fiduciary duty of protecting the retirement fund and had begun to engage in political activism").

49. *See* Roberta Romano, *The Politics of Public Pension Funds*, PUB. INT., Spring 1995, at 42, 47-49 (identifying potential effect of political pressure on public funds' involvement in corporate governance, and describing two examples of such pressure).

50. *See, e.g.*, Coffee, *supra* note 19 (making this argument).

51. *See* Fisch, *supra* note 25, at 715-16 (describing claims of pay to play).

fund officials exhibited very little familiarity with existing empirical evidence on corporate governance, such as studies analyzing the value of poison pills, independent boards, or shareholder litigation. It appears that, although public pension funds have, as a group, bought into the claim that shareholder activism improves corporate performance, they have little basis for ascertaining the truth of that claim. A possible reason for this is the fairly widespread participation of public pension funds in corporate governance organizations and programs. The conceptual relationship between good governance and corporate performance is heavily featured in these programs, but the underlying empirical studies are not.

At the same time, the limited expertise of public pension funds probably explains both their choice of non-governance activities and their limited overall activism. As we noted above, public funds make relatively little use of company-specific forms of activism such as shareholder proposals and director nominations. One possible reason may be the perception that fund officials are not well positioned to determine weaknesses in individual firm governance structures and to propose appropriate reforms.[52] In contrast, union funds, which are far more active, tend to focus their proposals most heavily on employment-related topics, on which they presumably believe that they have particular expertise.[53] Similarly, social responsibility funds and religious organizations can make effective use of shareholder proposals because of their developed knowledge about topics within their mission.[54]

Lack of expertise is even more likely to explain the failure of public pension funds to become involved in the process of identifying

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52. This perception is consistent with empirical evidence failing to demonstrate that public pension fund use of shareholder proposals improves corporate performance. *See, e.g.*, Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 177 (2001) (summarizing the empirical literature). It is also consistent with our finding that many funds do not have voting guidelines and have never recalled loaned stock in order to vote it. These actions suggest a lack of willingness or ability to evaluate governance policies at specific firms.

53. *See, e.g.*, Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 879-81 (S.D.N.Y. 1993) (addressing union's shareholder proposals concerning Wal-Mart's Equal Employment Opportunity policies and programs); *see also* Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97, 113-21 (2000) (describing labor unions' use of shareholder proposals to promote workers' as well as investors' interests); Randall S. Thomas & Kenneth J. Martin, *Should Labor Be Allowed to Make Shareholder Proposals?*, 73 WASH. L. REV. 41, 47-52 (1998) (describing history of labor unions' use of shareholder proposals).

54. *See, e.g.*, Aaron A. Dhir, *Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability*, 43 AM. BUS. L.J. 365, 382-85 (2006) (describing the use of human rights social policy proposals by religious investors, socially responsible funds, and social justice organizations).

director candidates. As noted in Table 2 above, none of our sample funds either submitted the names of director candidates to nominating committees or formally nominated a director candidate in opposition to management. It is likely that public pension funds simply lack the capacity to identify suitable candidates. Public fund officials do not have specialized knowledge about director qualifications or regular contact with the types of people who might make good nominees, such as current or retired business leaders. Nor do public pension funds have relationships with intermediaries who can assist them in identifying potential directors; funds do not, for example, have director search firms on retainer.[55]

A second obvious consideration is cost. Of the firms that responded to our survey, only seven (fewer than 20%) had a separate budget for corporate governance activities. As government agencies, public funds are subject to substantial financial constraints, and, in responding to our survey, virtually every fund identified cost as a substantial consideration in determining the extent of its activism. In addition, the payoff for shareholder activism is relatively opaque, making it difficult for public officials to justify expenditures in terms of an identifiable return. It is therefore unsurprising that the highest levels of participation were focused on extremely low cost activities, including communicating with other institutions, participating in corporate governance organizations, voting no, and serving as lead plaintiff.

It may be the case, however, that this attempted fiscal prudence is somewhat short-sighted. Arguably, pension funds pay for shareholder activism indirectly through their investments in hedge funds and private equity (which do participate in extensive activism) and through their use of external fund managers who may engage in various levels of activism, ranging from full-scale proxy contests to behind-the-scenes meetings with management. Although the funding for this type of activism is not politically transparent in the pension fund's budget, it ultimately may cost funds more in higher management fees than if funds engaged in activism directly.

Funds also appear concerned about the perceived legitimacy of their actions. Several funds reported that their trustees were uncomfortable with public demonstrations of activism. One fund also cited the "headline risk" associated with shareholder activism. These concerns may reflect, in part, the longstanding regulatory constraints

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55. Failure of funds to nominate director candidates may also be motivated by a fear that such actions could result in the application of the short swing trading restrictions of section 16(b) of the Securities Exchange Act.

on some types of shareholder activism. Institutions may perceive more recent efforts to encourage institutional activism, such as the SEC's relaxation of its proxy rules as equivocal, especially in light of opposition efforts to characterize activism as politically motivated or driven by special interests.

Finally, public funds make extensive use of intermediaries. The availability of services or agents who provide expertise and manpower is a substantial factor in determining whether funds will become involved, especially if those services are available at little or no additional cost to the fund. Thus, funds are willing to exercise their voting power, but rely heavily on the assistance of proxy advisors to formulate guidelines, make case-specific voting decisions, and submit proxies. Funds file claim forms, but primarily through outside services or custodians. Funds screen securities fraud claims and participate as lead plaintiffs, but largely in response to the entrepreneurial efforts of plaintiffs' counsel. Funds submit amicus briefs—an effort largely controlled by the same lawyer-entrepreneurs—but do not otherwise seek broad-based market improvements through lobbying, petitions for rulemaking, or similar initiatives.

The foregoing factors likely explain the substantial difference between public pension fund participation in securities litigation and other forms of activism—both the greater overall level of involvement by public pension funds in litigation activism and the lack of correlation between litigation activism and fund size. Service as lead plaintiff does not require funds to incur out-of-pocket costs other than the relatively low visibility cost of staff time. Indeed, regular fund staff may not face that burden because, for many public funds, their litigation activism is carried out largely through the state Attorney General's office. Although litigation might seem to require some expertise in evaluating claims, outside services and lawyers provide this expertise—preparing damage models, evaluating claim strength, and outlining litigation strategy. These resources allow even small funds without the resources for active participation in corporate governance to serve as lead plaintiffs. Finally, the adoption of the lead plaintiff provision and the legislative history of the PSLRA send a strong message that litigation activism is desirable from a public policy perspective. This message has been enhanced by the highly publicized corporate scandals of the late 1990s and by the success of institutional investors in cases such as Cendant and WorldCom in recovering significant settlements and holding wrongdoers

accountable.[56] Fund decisionmakers—from elected officials, to trustees, to staffers—are government actors for whom public and congressional opinions are of substantial importance.

What are the implications of our findings? They may be particularly relevant with respect to the potential effect of ongoing efforts to reform the federal proxy rules to increase the role of institutional investors. The SEC, in response to requests that it facilitate the exercise of shareholder power through the voting process,[57] substantially amended the proxy rules in 1992 to enable institutional investors to communicate more easily in proxy solicitations. Several years ago, the SEC proposed, but did not adopt, Rule 14a-11, which would have increased the ability of shareholders—particularly institutional investors—to nominate director candidates directly.[58] More recently, the SEC considered but failed to adopt rule changes that would have increased the ability of shareholders to introduce bylaw amendments through the shareholder proposal process.[59]

Our survey results cast doubt on the extent to which public pension funds are likely to engage in these types of initiatives. The introduction of shareholder proposals, participation in proxy solicitations, and nomination of director candidates are all costly. While larger funds may have the resources to justify these costs, small funds lack both the dollars and the manpower to engage in this type of activism. In addition, these activities require funds to make a judgment that the governance structure of their portfolio companies is inadequate. Public pension funds appear unwilling or perhaps unable to make that judgment, in part because they lack the expertise and in

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56. *See, e.g.*, Kara Scannell, *Settlements Totaled $5.4 Billion For Securities Class Actions in '04*, WALL ST. J., Mar. 2, 2005, at C4 (describing record settlements in *Cendant* and *WorldCom*).

57. *See, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 677 (2007) (advocating increasing shareholder voting power through mandatory contested elections); Letter from Richard H. Koppes, Gen. Counsel, CalPERS, to Linda C. Quinn, Dir., Div. of Corp. Fin., SEC 3 (Nov. 3, 1989) (requesting SEC rule-making to revise federal proxy rules).

58. Security Holder Director Nominations, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,206, 68 Fed. Reg. 60784 (proposed Oct. 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274).

59. *See* Shareholder Proposals, Exchange Act Release No. 56,160 (July 27, 2007) (describing history of SEC's consideration of increased shareholder power to nominate directors through access to the corporate proxy); Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,914 (Dec. 7, 2007) (amending federal proxy rules to limit shareholder access). In connection with its most recent rule change, Chairman Cox stated that the SEC would continue to study proxy access and revisit the issue of shareholder access. Christopher Cox, Chairman, SEC, Speech at the SEC Open Meeting: Electronic Shareholder Forum Rules; Codification of Interpretation of Rule 14(a)(8)(i)(8), (Nov. 28, 2007), *available at* http://www.sec.gov/news/speech/2007/spch112807cc.htm.

part because such judgments are inconsistent with their delegation of investment authority to external portfolio managers, who implicitly make that judgment in connection with their investment decisions.

On the other hand, public funds might view SEC rulemaking as legitimizing or even demanding greater participation in the director nomination process. The experience with the lead plaintiff provision suggests that such a statement may outweigh the general desire among funds to remain passive and non-confrontational. It is, of course, unclear whether funds would respond to such a determination by the SEC in the same manner as they would to a statement by the democratically elected Congress. In our interviews, funds reported respect for the SEC and its role in protecting investors' rights, suggesting that they would view SEC action as significant.

Our survey also offers guidance for the SEC in its rulemaking approach. The common assumption that public pension funds will be willing to spend more than retail investors on voting, shareholder proposals, lobbying, and so forth because of the larger size of funds' holdings[60] may be misplaced. Because cost is a substantial concern, shareholder initiatives that do not require substantial expenditures are likely to generate greater public pension fund involvement. Regulatory changes that enable public pension funds to exercise greater influence at relatively low cost—such as majority voting and bylaw amendments—are particularly promising. Regulatory changes that allow institutional investors to recover the costs of sponsoring successful initiatives also should be considered. In addition, proposals that generate some sort of reimbursement or subsidization might create an economic incentive for intermediaries to mobilize pension funds in the same way that entrepreneurial lawyers have spurred litigation activism.

Finally, public pension funds' extensive reliance on intermediaries should be acknowledged. Our research shows that public pension funds engage in very limited internal decisionmaking; they rely heavily on outside lawyers, services, proxy advisors, and so forth. The plaintiffs' bar appears to play a critical role in determining public fund involvement in securities litigation, and the lack of intermediaries with the economic incentive to mobilize non-litigation activism is likely a substantial factor explaining the limited levels of participation in such activism.

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60. *See, e.g.*, Jill Fisch, *Relationship Investing: Will It Happen? Will It Work?*, 55 OHIO ST. L.J. 1009, 1010 (1994) (describing claim that larger institutional stakes will lead to more common and more efficient monitoring).

The reliance of pension funds on intermediaries further suggests that the structure and incentives of those intermediaries warrant further study. Reliance on intermediaries creates an additional layer of agency costs that is likely to depend critically on the incentives of proxy advisor, such as ISS, and active portfolio managers, incentives that may differ substantially from those of the funds themselves. These agency costs are of particular concern in light of recent developments in shareholder voting power. Majority voting, for example, offers institutional investors potentially new power over director elections.[61] "Say on pay" provisions have been considered at a number of issuers, and Congress is considering legislation that would mandate a non-binding vote on executive compensation.[62] In debating the desirability of increased shareholder voting rights, policymakers should consider the extent to which public pension funds and, potentially, other institutional investors may rely on agents, such as proxy advisors, in deciding how to exercise these rights.[63]

CONCLUSION

We report results from a unique survey of public pension funds gauging the participation of these funds in a wide range of corporate governance-related activities. While some highly visible funds, such as CalPERS, engage in a number of different governance activities, most funds in our study engage in only a limited subset of activities. Moreover, the precise activities selected by different funds vary substantially.

Our results demonstrate that size is strongly correlated with non-litigation activism. Larger funds have a greater ability to spread the fixed cost of engaging in activism across their greater asset base. Surprisingly, however, size is not correlated with the incidence of litigation activism. Instead, funds of all sizes engage in litigation

61. *See, e.g.*, Louis Lavelle, *Commentary: A Simple Way to Make Boards Behave*, BUS. WK., Jan. 31, 2005, at 38 (advocating a switch from plurality to majority voting). According to CLAUDIA H. ALLEN, STUDY OF MAJORITY VOTING IN DIRECTOR ELECTIONS 1 (Nov. 2007), http://www.ngelaw.com/files/upload/majoritystudy111207.pdf, 57% of Fortune 500 companies had adopted some form of majority voting by November 2007.

62. *See* Marlene Kennedy, *Getting a Say on Pay for Execs*, TIMESUNION.COM, Apr. 20, 2007, http://timesunion.com/AspStories/story.asp?storyID=582473&category=BUSINESS&newsdate=4/20/2007 (describing the progress of H.R. 1257, sponsored by Barney Frank, in Congress).

63. We note that although ISS has dominated the market for proxy advisory services for many years, several other firms recently have begun issuing proxy recommendations including Proxy Governance, Glass Lewis, and Egan-Jones. Thus far, public pension funds are relying heavily on ISS, but when other advisors begin to penetrate the market, the information available to funds will increase dramatically.

activism. Funds appear to treat non-litigation and litigation activism separately. Funds that structure themselves to delegate more functions and consequently have fewer in-house resources, as reflected in our Delegation variable, do not engage in significantly lower levels of litigation activism (although they report significantly lower levels of non-litigation activism). One possible explanation for the difference is cost. The subsidization of private securities litigation through the class action mechanism combined with contingency fee awards appears to affect the ability of state governmental actors—particularly small pension funds that otherwise are not active in corporate governance—to participate.

Several questions remain unanswered from our study. One important question is the extent to which our findings extend to other types of institutions. Hedge funds, mutual funds, and other institutions are subject to dramatically different funding structures and market constraints. At the same time, other institutions may lack the political influence that simultaneously gives public pension funds greater autonomy from portfolio companies and greater reason to be motivated by non-financial considerations in their choice of activism.

A second question is the degree to which public pension fund activism is evolving and will continue to evolve. In the twelve years since the adoption of the PSLRA, public pension funds have increased their involvement in securities fraud litigation dramatically, primarily through service as lead plaintiffs, but also through direct lawsuits and objecting to proposed settlements. Studies show that such activism is correlated with higher settlements and lower attorneys' fees. It remains to be seen whether corporate governance scandals like those at Enron and WorldCom, stock options backdating, and the continued explosive growth of executive compensation will spur funds to extend their involvement to other forms of activism. The potential is particularly great for public funds to add their voice, through their vote, to the more entrepreneurial activism of hedge funds.

Finally, public pension fund activism seems to be, in part, a function of the applicable regulatory environment. Public pension funds began to participate in litigation in response to the lead plaintiff provision of the PSLRA.[64] Public pension funds are paying increased attention to voting, through the adoption of voting guidelines and increased disclosure of their votes, in response to recent regulatory

64. *See* Choi, Fisch & Pritchard, *supra* note 25 (reporting little participation by institutional investors as lead plaintiffs prior to the adoption of the PSLRA and increased involvement following the adoption of the statute).

requirements focusing on mutual fund voting.[65] Although public pension funds may display conservatism in their governance activities, as government actors they are likely to be highly responsive to the public policy judgments reflected in legislation and SEC rules concerning the appropriate level and extent of their participation in corporate governance.

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65. *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188, Exchange Act Release No. 47, 304, Investment Company Act Release No. 25,922 (Jan. 31, 2003) (requiring mutual funds to disclose their voting policies as well as their actual proxy votes).