

Investing in Commingled Funds: Potential Negative Implications for Pension Funds

By: Guillaume Buell and Domenico “Nico” Minerva, Partner, Labaton Keller Sucharow LLP

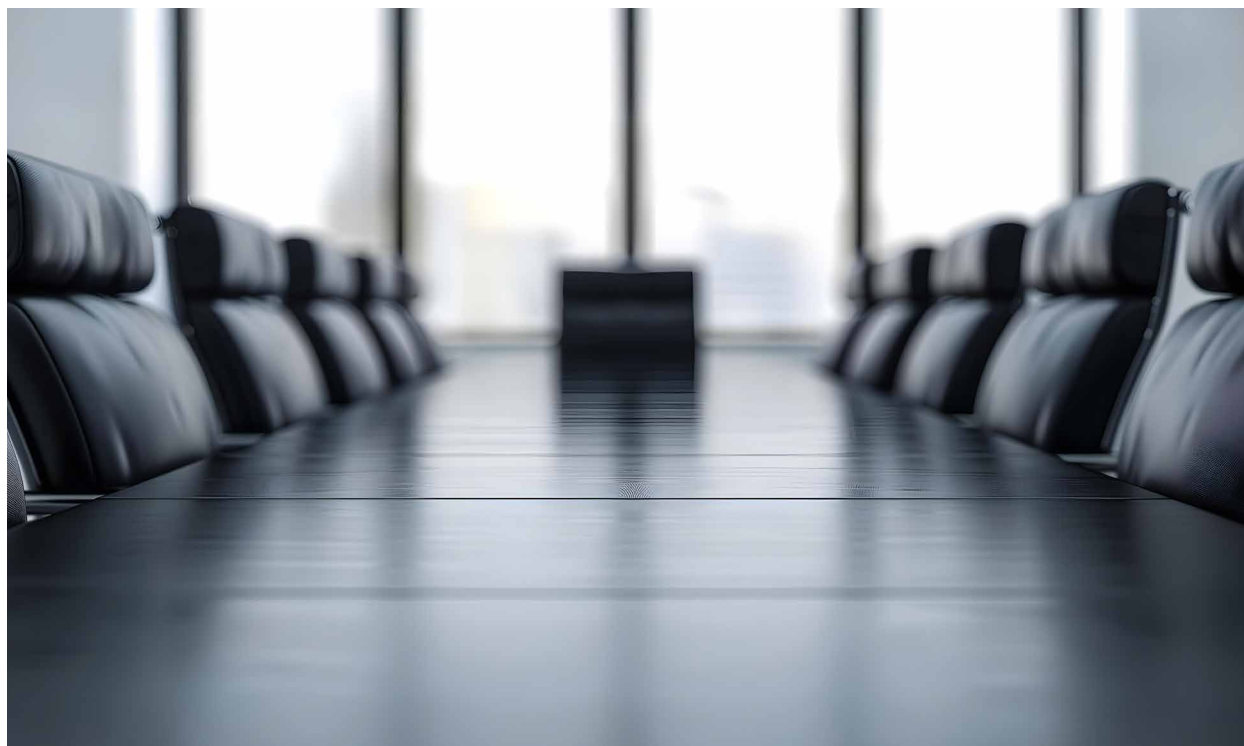


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Pension funds are frequently debating whether to invest in equities via either active management and separately managed accounts, or passive management and commingled funds. The pitch to investors for passive commingled accounts is often simple: reduced investment costs because investors don't need to pay someone to actively manage the related securities. Some pension funds have jumped at this opportunity for low-cost exposure to the stock market.

However, the shift to Commingled Funds comes with notable drawbacks.

When a pension fund invests in a Commingled Fund, it not only loses the right to direct where its investments go, it also loses the legal rights associated with the direct ownership of stock. This includes important rights such as (i) voting in corporate elections; (ii) initiating governance actions; (iii) obtaining information about the corporation; and (iv) suing to enforce fiduciary duties and investor rights. Historically, these have been useful tools for pension funds and other institutional investors to wield when advocating for corporate change.

a. Voting in Corporate Elections

One of the most significant rights that comes from direct ownership is the ability to directly participate in voting on corporate elections. Through direct participation, pension funds can elect nominees to a board of directors, approve mergers or acquisitions, and influence significant policy changes in a corporation's structure and governance. [🔗](#)

Direct participation allows a pension fund to vote for positive change in a corporation while simultaneously bolstering its own interests. This aligns with American tradition and institutional investors' historical role as advocates for proper corporate governance policies. Pension funds have used the corporate voting process to advocate for caps on executive pay, amend corporate bylaws, and strengthen labor union's collective-bargaining position.

b. Initiating Corporate Governance Actions

Another significant right of direct ownership is the ability to initiate corporate governance actions such as submitting shareholder proposals to be considered at annual meetings, nominating directors, and engaging in dialogue with boards of directors. Shareholder proposals sponsored by pension funds often address important issues such as labor practices, workplace safety, and employee rights.

By initiating a proxy contest, a pension fund can submit its director nominee to be elected to the board of directors at an annual shareholder meeting. In 2024, approximately 45 shareholder nominees were elected to boards of directors through proxy contests.

Additionally, pension funds can facilitate engagement through dialogue with board members on various corporate governance issues. This is a powerful tool. For example, in 2020, California Public Employees' Retirement System reported its private engagement led to 20 corporations agreeing to change their voting standards.

c. Recovering Losses

Securities litigation is a powerful and important shareholder tool to recover losses when corporate insiders violate the securities laws. Acting as lead plaintiff allows a pension fund to steer the litigation. The lead plaintiff chooses and sets terms with class counsel, oversees the litigation process, and ultimately has the final say on a settlement's monetary recovery and any corporate governance reform requirements.

Since the adoption of the Private Securities Litigation Reform Act ("PSLRA") in 1995, pension funds, which generally experience the largest losses, are frequently called upon to act as lead plaintiffs—not only for the financial incentives but also due to their experience, expertise, and sophistication. When a pension fund acts as lead plaintiff, they not only benefit themselves, but other class members as well. Statistically, in recent securities class actions led by institutional investors, the median settlement was over five times larger than without an institutional investor lead plaintiff. Moreover, where institutional investors and pension funds served as lead plaintiff, the median settlement recovered 18.6% more of the damages in the case.

Pension funds specifically have seen some of the largest recoveries on behalf of investors. For example, a union pension fund served as the lead plaintiff in stockholder litigation against Dell Technologies and they secured a record-breaking \$1 billion cash settlement for the class. This represented the largest recovery prior to judgment ever achieved in a fiduciary duty action in the Delaware Court of Chancery and the largest shareholder settlement in any U.S. state court at the time.

d. Achieving Corporate Governance Reform

Beyond monetary recoveries, corporate governance reforms obtained through securities litigation settlements are vital tools as well. These reforms can be wide ranging and take on a variety of issues.

For example, in Massey Energy Securities Litigation, Massey Energy's lack of safety culture and protocols led to the deaths of 29 miners in a mine explosion in West Virginia. As lead plaintiff, the Massachusetts Pension Reserves Investment Trust held the company accountable to the tune of \$265 million in connection with the tragedy, and Massey was forced to revamp its corporate governance structure to better protect its workers.

Additionally, in *Employees' Retirement System of Rhode Island v. Marciano et al.*, the Employees' Retirement System of Rhode Island secured a \$30 million settlement on behalf of the class and robust corporate governance reforms to provide a safe and fair work environment at Guess?, Inc. Along with heavy regulations on the company's co-founder, the reforms included appointment of an independent director to the board and prohibited tactics to silence whistleblowers. ☺

Although Commingled Funds offer an appealing, low-cost solution, at what cost? The trade-offs cannot be understated. Relinquishing shareholder rights that have historically paved the way for pension funds to effect labor and corporate governance reforms is detrimental to institutional investors' ultimate goals that the companies they invest in conduct themselves legally and appropriately and always seek to maximize shareholder and worker rights. Internal and external governance action by shareholders is a crucial aspect of corporate governance and should be exercised by all investors. However, due to the traditional role of pension funds in America, this topic especially calls for more scrutiny from pension funds across the country. ♦

Domenico “Nico” Minerva is a Partner in the New York office of Labaton Keller Sucharow LLP. A former financial advisor, his work focuses on securities and shareholder derivative litigation, representing Taft-Hartley, public pension funds, hedge funds, asset managers, insurance companies, and banks across the world. Nico advises leading pension funds and other institutional investors on issues related to corporate fraud in the U.S. securities markets. Nico is described by clients as “always there for us” and known to provide “an honest answer and describe all the parameters and/or pitfalls of each and every case.” As a result of his work, the Firm has received a Tier 2 ranking in Class Actions from The Legal 500. Lawdragon has recognized Nico as one of the country’s “Leading Plaintiff Financial Lawyers” and “Leading Global Litigators.”