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Commodifying Marginalization

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71 DUKE L.J. __ (forthcoming 2022)

ABSTRACT:

Once pillars of American social provision, public pension funds now rely significantly on private investment to meet their chronically underfunded promises to America's workers. Moreover, desperate for returns, pension funds are increasingly investing in marginalized debt, namely the array of high-interest-rate, subprime, risky debt—including small-dollar installment loans and other forms of subprime debt—that tends to concentrate in and among historically marginalized communities. Notwithstanding its often-catastrophic effects on communities, marginalized debt is a valuable investment because its characteristically high interest rates and myriad fees engender higher returns. In turn, higher returns ostensibly mean greater retirement security for ordinary workers who are themselves economically vulnerable in the current atmosphere of public welfare retrenchment. They must increasingly fend for themselves if they hope to retire at a decent age and with dignity, if at all.

This Article surfaces this debt-centered connection between two economically vulnerable groups: workers on the one hand and marginalized borrowers on the other. It argues that the current public-private welfare regime has thoroughly shifted retirement security into the hands of private financial markets, whose fiduciary duties and profit-sensitive incentives eschew broader moral considerations of the source of profits or the subsequent consequences of wealth extraction. Consequently, the rise of marginalized debt as a source of

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retiree wealth maximization shows how the tenuous socio-economic condition of one community is now openly a source of wealth accumulation for another vulnerable community. Moreover, this incursion of private entities into the arena of public welfare is pernicious because it commodifies and reinforces the subordinate socioeconomic conditions that make the persistence of marginalized debt predictable.

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"[O]ne day we must come to see that an edifice which produces beggars needs restructuring."
- Martin Luther King, Jr., 1967[1]

INTRODUCTION

The ability to borrow money is an important aspect of the American public-private welfare regime.[2] Indeed, "credit/debt"[3] lies at the center of social provision policy for low-income Americans[4] and for other socially-marginalized Americans, like women and African Americans.[5] This credit deployed as social provision, however, often comes in the form of "marginalized debt," the array of high-interest-rate, subprime, risky debt that tends to concentrate in and among historically marginalized communities.[6] Even so, social provision policies have conceived of credit/debt as an institution that, when fairly priced, can function to smooth consumption and to serve as a catalyst for social mobility for marginalized borrowers.[7]

Marginalized borrowers, however, are not the only ones for whom social welfare policy invokes the power of credit/debt as a valid means of social provision. Social provision policy has also conceived of credit/debt as a valid

[1] Martin Luther King, Jr., *Where Do We Go From Here?*, Address Delivered at the Eleventh Annual Southern Christian Leadership Conference Convention, Atlanta, GA, Aug. 16, 1967, https://kinginstitute.stanford.edu/king-papers/documents/where-do-we-go-here-address-delivered-eleventh-annual-sclc-convention.

[2] *See* Jacob Hacker, THE DIVIDED WELFARE STATE: THE BATTLE OVER PUBLIC AND PRIVATE SOCIAL BENEFITS IN THE UNITED STATES 11-12 (2002). Political scientist Jacob Hacker defines the public-private welfare regime as a combination of: (1) "direct pension social programs" like Social Security, (2) "the constellation of more indirect or 'hidden' government interventions," like tax breaks and government subsidies, "that are designed to provide similar social benefits or shape their private provision," and (3) "publicly-regulated and subsidized private benefits."

[3] Gustav Peebles, *The Anthropology of Credit and Debt*, 39 ANN. REV. ANTHROPOLOGY 225, 226 (2010) (noting that "credit and debt stand as an inseparable, dyadic unit" and adopting the term "credit/debt" because "debt is always already a dyadic relation that requires its opposite[, credit]").

[4] Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1095, 1108-1112(2019) (hereinafter Atkinson *Rethinking*) (describing debates about how to regulate the cost of payday loans).

[5] Abbye Atkinson, *Borrowing Equality*, 120 COLUM. L. REV. 1403, 1419-1424 (2020) (hereinafter Atkinson *Borrowing*) (describing 1960s and 1970s advocacy for increased access to credit as a means of greater socioeconomic equality for women and African Americans).

[6] *E.g.*, Taz George, Robin Neuberger, & Mark O'Dell, *The Geography of Subprime Credit*, FEDERAL RESERVE BANK OF CHICAGO, Nov. 6, 2019, https://www.chicagofed.org/publications/profitwise-news-and-views/2019/the-georgraphy-of-subprime-credit.

[7] Atkinson *Rethinking*, *supra* n. 4 at 1101.

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means of wealth extraction in service of increased retirement security for workers. Specifically, public pension funds—which rely heavily on investment returns to meet their obligations to retirees[8]—have increasingly moved their gargantuan pools of "labor's capital"[9] into "alternative" investments, like marginalized debt, that promise higher yields crucial to fund pension obligations even as they portend greater risk of loss.[10]

Consequently, marginalized debt is increasingly an asset that rounds out the diversified portfolios of the nation's public pension funds. In this context, marginalized debt serves as a mechanism of social welfare because it furnishes a basis from which working people might, at least nominally, shore up their often-precarious retirement prospects.[11] Yet, in this iteration of credit/debt as social

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[8] *E.g.*, Pew Charitable Trusts, *State Pension Funds Reduce Rates of Return* at 5 (Dec. 2019) (hereinafter *Pew Report*) (observing that "[i]nvestment returns make up more than 60 percent of public pension plan revenues [while] employer and employee contributions make up the rest")

[9] *E.g.*, David Webber, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON 8 (2018) [hereinafter THE RISE OF THE WORKING-CLASS SHAREHOLDER] (defining "labor's capital" as "the trillions of dollars held in public pension funds"); Teresa Ghilarducci, LABOR'S CAPITALISM: THE ECONOMICS AND POLITICS OF PRIVATE PENSIONS 50 (1992) (observing that "[p]ensions may not be labor's wages, but labor's capital" in part because they function "as an insurance fund in which every [worker] holds a share").

[10] Ben Christopher, *Riskier Bet: Why Calpers, the Country's Largest Pension Fund, is Getting into Banking*, O.C. REG., Jul. 9, 2020, https://www.ocregister.com/2020/07/09/why-calpers-the-countrys-largest-pension-fund-is-getting-into-banking/, (observing that in the search for investment returns, "pensions [have] ventured further into the Wild West of 'alternative investments' — private equity, one-off infrastructure projects and real estate, with e]ach step t[aking] the funds into potentially more profitable, but also more perilous, terrain"); *see also* Gordon L. Clark, PENSION FUND CAPITALISM 28 (2000) (observing "the rise of pension fund capitalism and the world of finance with which it is intimately associated"); David F. Swensen, PIONEERING PORTFOLIO MANAGEMENT: AN UNCONVENTIONAL APPROACH TO INSTITUTIONAL INVESTMENT 55 (2009) (noting that "[f]inance theory posits that acceptance of greater risk leads to the reward of higher expected returns").

[11] *E.g.*, Jack M. Beermann, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 6 (2013) (observing that "many public pension plans are seriously underfunded either intentionally or due to unrealistic assumptions concerning investment performance and the amount that will be owed over time" and that one of the worries of the public pension crisis is the potential "consequences to public employees and retirees, especially those who did not participate in Social Security, who could be left with insufficient assets for a decent retirement"); David H. Webber, *The Use and Abuse of Labor's Capital*, 89 N.Y.U. L. REV. 2106, 2108–09 (2014), (observing that "pension reductions … can be particularly damaging to public employees because millions of them, including … forty percent of public school teachers across the country, and two-thirds of all public-safety employees, are ineligible for Social Security because of their public pensions," and that "[t]hose pensions are often all they have to sustain them in retirement"); *but see* Susan Soederberg, *Cannibalistic Capitalism: The Paradoxes of Neoliberal Pension Securitization* in Leo Panitch, Greg Albo, & Vivek Chibber , THE CRISIS THIS TIME in 224 (2010) (defining this process as "cannibalistic capitalism" because it "captures the processes by which workers' savings in the form of pension funds feed off both their own increased

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provision, it is the investor-pensioners who ostensibly benefit from the borrowing, not the borrowers themselves.

For example, the Kentucky Retirement Systems (KRS) is a public pension fund that has served the state's public employees, including Kentucky's teachers and police officers, since its inception in 1956.[12] KRS is currently in a deep fiscal crisis with just 32.8% of its liabilities to Kentucky's public employees funded.[13] Like most public pension funds,[14] KRS depends heavily on investment in private markets to meet its goals.[15] Its investment holdings are numerous and diversified to include a mix of low-risk, low-yield investments and high-risk alternative" investments.[16] As to the latter, as of September 2020, KRS invests significantly in marginalized debt, including in subprime lenders like Flagship Credit Auto,[17] Freedom Mortgage Corporation,[18] and Santander Consumer

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indebtedness and that of other workers, a condition driven largely by stagnant real wages and unemployment."),

[12] Kentucky Retirement Systems, *About KRS*, https://kyret.ky.gov/About/Pages/default.aspx.

[13] By contrast, a pension plan is sufficiently funded "if the plan has sufficient assets to meet its emerging benefit obligations in a timely fashion, given reasonable assumptions about future contributions and investment income." Jonathan Barry Forman, *Fully Funded Pensions*, 103 MARQ. L. REV. 1205, 1231 (2020). Thus, according to one local observer, "KRS is one of the nation's worst-funded public pensions systems, with more than $25 billion in unfunded pension liabilities, due primarily to the failures of state leaders over two decades." John Cheves, *'A Cloud Hanging Over All of Us.' NKU Plans To Exit Kentucky's State Pension System*, LEXINGTON HERALD LEDGER, Dec. 14, 2020, https://www.kentucky.com/news/politics-government/article247828680.html; *see also* Elizabeth S. Goldman & Stewart E. Sterk, *The Impact of Law on the State Pension Crisis*, 54 WAKE FOREST L. REV. 105, 106 (2019) ("At the close of the 2016 fiscal year, Kentucky's primary pension plan for civilian state employees was only 16% funded.").

[14] *Pew Report*, *supra* n. 8 (observing that "[i]nvestment returns make up more than 60 percent of public pension plan revenues [while] employer and employee contributions make up the rest"); *see also* CalPERS, *How is Your CalPERS Pension Funded?*, Feb. 25 2020, (hereinafter CalPERS Video), https://www.youtube.com/watch?v=Bl-7HZsChU8, ("If you were to break down each dollar we pay in pension benefits it looks like this: 13 cents comes [sic] from CalPERS members, 29 cents comes [sic] CalPERS employers, and 58 cents comes [sic] from what we earn on the money we invest.").

[15] *Id.*

[16] *See* Kentucky Retirement Systems, *Internal Asset Holdings Report*, Sept. 30, 2020, https://kyret.ky.gov/Investments/Investments%20Holdings/KTYALL%20Holdings%20as%20of%2031%20September%202020.pdf.

[17] Flagship Credit, *Our Services*, https://www.flagshipcredit.com/our-services/. By its own account, "Flagship's programs are designed to serve customers who have limited access to automobile financing through traditional lending sources. Many of our customers have experienced prior credit difficulties or have limited credit histories and generally have FICO® scores ranging from 500 to 675."

[18] Freedom Mortgage Corporation, *About Freedom Mortgage Corporation*, https://www.freedommortgage.com/about. In similar tones, Freedom Mortgage Corporation write that: "[O]ur mission is to foster homeownership across the United States. We specialize in mortgages that can help you buy or refinance a home regardless of your unique

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Bank USA, an auto lender well-known for its predatory auto loans.[19] Thus, even as KRS struggles to right itself, it does so, at least in part, on the backs of marginalized borrowers who find themselves, for example, prey to predatory subprime lenders like Santander.[20]

As exemplified by KRS, the rise of marginalized debt reveals the advance of debt-focused privatization in social welfare policy in two particular aspects. First, it shows how the current public-private welfare regime has largely shifted retirement security into the hands of private financial actors, whose fiduciary duties and profit-sensitive incentives eschew broader moral considerations of the externalities of retiree wealth maximization.[21] Second, the rise of marginalized debt as a source of retiree wealth maximization shows how in the financialized economy, the tenuous socio-economic condition of one community[22] is now openly a source of wealth accumulation for another vulnerable community, retirement-insecure workers.[23] To that end, credit/debt

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circumstances. We are particularly focused on helping our service men and women realize the American dream of home ownership."

[19] Santander Consumer USA, *Auto Financing*, https://santanderconsumerusa.com/auto-financing, (purporting to "[h]elp[] drivers reach their destinations, regardless of credit.") Santander is no stranger to regulatory sanction for questionable behavior. For example, as recently as December 2020, the Consumer Financial Protection Bureau fined Santander Consumer $4.7 million for fair lending violations. Laura Alix, *CFPB Fines Santander Consumer $4.7M for Fair-Lending Violations*, AMERICAN BANKER, Dec. 22, 2020, https://www.americanbanker.com/news/cfpb-fines-santander-consumer-4-7m-for-fair-lending-violations. It has previously been sanctioned for predatory behavior. *E.g.*, David Shepardson, *Santander Agrees to $550 Million U.S. Settlement Over Suprime Auto Loans*, REUTERS, May, 19, 2020, https://www.reuters.com/article/us-usa-autos-lending/santander-agrees-to-550-million-u-s-settlement-over-subprime-auto-loans-idUSKBN22V2GS#:~:text=The%20states%20said%20Santander%20violated,on%20loans%20worth%20%24478%20million.

[20] In its most recent posted Holdings Statement (September 2020), KRS lists each of these companies among its fixed asset investments. https://kyret.ky.gov/Investments/Investments%20Holdings/KTYALL%20Holdings%20as%20of%2031%20September%202020.pdf; *see also*, Patrick Rucker, *CFPB Fines Spain's Santander $11.8 Million Over Misleading Loans, Insurance*, FORBES, Nov. 20, 2018, https://www.reuters.com/article/us-santander-cons-cfpb-settlement/cfpb-fines-spains-santander-11-8-million-over-misleading-loans-insurance-idUSKCN1NP2FY

[21] THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 9.

[22] *E.g.*, Peter Whoriskey, *'A way of monetizing poor people': How private equity firms make money offering loans to cash-strapped Americans*, WASH. POST, Jul. 1, 2018, https://www.washingtonpost.com/business/economy/a-way-of-monetizing-poor-people-how-private-equity-firms-make-money-offering-loans-to-cash-strapped-americans/2018/07/01/5f7e2670-5dee-11e8-9ee3-49d6d4814c4c_story.html, ("Private equity firms, with billions to invest, have taken significant stakes in the growing [small-dollar installment loan] field.").

[23] *E.g.*, THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 8 (observing that for many employees with public pensions, the "loss of their jobs and pensions would leave them on the knife's edge of poverty, if not impoverished)".

reveals itself both as a politically expedient and versatile means of financing a decent standard of living for low-income and other economically-vulnerable groups, without the burden of solving for "persistent wage stagnation and other entrenched social pathologies,"[24] *and* as also a politically expedient means of financing a decent standard of living for older people, without the burden of solving for the real failures of retirement security, like overpromising.[25]

The Great Recession of 2008 brought to the surface the facets of this modern, financialized and marginalized-debt-infused retirement system. Before the economic crisis gripped the global economy, marginalized debt, in the form of subprime mortgages, was a valuable, if ultimately volatile, commodity for a range institutional investors including pension funds, [26] notwithstanding its broader destructive effects on the communities targeted for such marginalized debt.[27] Specifically, with its characteristically elevated interest rates, subprime mortgages attracted pension funds who were interested in the accelerated accumulation of assets.[28] Familiarly, when the bubble burst, both retirees *and* marginalized communities were devastated by the ensuing subprime mortgage crisis that spawned the global Great Recession.[29]

Nevertheless, more than a decade after the debacle of the Great Recession, marginalized debt continues to draw the interest of pension funds trying to supplement their more stable, long-term returns with the higher returns

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[24] Atkinson *Rethinking*, *supra* n. 34 at 1101.

[25] G. Alan Tarr, *No Exit: The Financial Crisis Facing State Courts*, 100 KY. L.J. 785, 803 (2012) ("Some states have in the past balanced their budgets in part by inducing public employee unions to accept lower wage increases with the promise of future benefits payments, and the effects of this short-term gimmick are now being felt."); *cf.* Beermann, *supra* n. 11 at 27. Beermann argues that "[u]nfunded pension promises benefit politicians" by "allow[ing] for current officials to provide services without requiring taxpayers to pay for them until much later, when they may be out of office." *Id.*
Second, pension promises help politicians shore up support among government workers, or at least avoid opposition from government workers, which would be substantial if significant reductions in pension benefits were proposed. *Id.*

[26] *See* Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 BROOK. L. REV. 1, 7 (1991) ("Institutional investment vehicles generally are grouped in five categories: foundations and endowments, bank (non-pension) trusts, insurance companies, investment companies, and private and public pension funds.").

[27] Kathleen C. Engel & Patricia A. McCoy, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS (2011).

[28] *Id.*

[29] *E.g.*, T. Leigh Anenson, Alex Slabaugh, & Karen Eilers Lahey, *Reforming Public Pensions*, 33 YALE L. & POL'Y REV. 1, 11 (2014) ("Pension reform has taken center stage in the public policy debate as states struggle to deal with the fallout from the Great Recession."); G. Alan Tarr, *No Exit: The Financial Crisis Facing State Courts*, 100 KY. L.J. 785, 803 (2012) (noting that following the Great Recession, "state pension obligations have been tied to stock market investments, and the decline in stock prices has meant that these obligations are significantly underfunded").

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that such risky investment promises.[30] Notwithstanding the tough lessons of the subprime mortgage crisis, pension fund managers remain willing to gamble for high returns by filling out pension fund portfolios with various forms of marginalized debt, including investment in private equity funds that target marginalized-debt-based businesses like for-profit education[31] and subprime small-dollar installment lenders [32].

In this light, this Article makes both a descriptive and a normative contribution. Descriptively, it surfaces the phenomenon of public pension investment in marginalized debt as a source of retirement security. It shows how the American public-private welfare regime has driven ordinary workers, through their representatives, to secure their retirement wellbeing on the backs of vulnerable borrowers' use of marginalized debt. It highlights how, more broadly, marginalized debt has become central in the late-capitalist framework as means of wealth accumulation. This characterization of marginalized debt is distinctly different, however, from the existing academic and policy discussions of the value of marginalized debt. The latter tend to focus merely on internal considerations like non-discriminatory pricing[33] or its ability to engender social mobility,[34] without reference to the broader instrumentality of this credit/debt in the economy.

Normatively, it argues that this drift into market-based, debt-funded social provision is wrong because it commodifies the *condition* of socioeconomic marginalization. This is because the value of investing in this kind of debt depends entirely on a steady pool of marginalized borrowers who consistently have to pay more in interest rates and fees in order to borrow. In other words, retirement investment in marginalized debt capitalizes on the persistence of socioeconomic inequality. This reliance, in turn, incentivizes and even perversely justifies continued inequality and marginalization if one considers the significance of pensions, and particularly public pensions, to ordinary workers, including those from historically marginalized groups.[35] At a minimum, in light

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[30] *E.g.*, James Estes & Janine Kremling, *Public Pension Issues and an Examination of CalPERS, the Largest of the Nation's Public Pension Programs*, J. OF FIN. SERV. PROFESSIONALS 76 (2018).

[31] *See infra* Part I.B.2 and attendant footnotes.

[32] *See infra* n. I.B.2 and attendant footnotes.

[33] *See, e.g.*, Atkinson *Rethinking, supra* n. 4.

[34] *See, e.g.*, Atkinson *Borrowing, supra* n. 5.

[35] *See, e.g.*, Robert Hiltonsmith, *Twin Threats: How Disappearing Public Pensions Hurt Black Workers*, Demos (2016) (arguing that "[d]espite decades of efforts to reduce employment discrimination in the private sector, public employment remains important to African American workers as a source of income security, helping to close the wage gap between" and that "[a]s important as public employment is to the black middle class, the pensions provided by public employment are perhaps even more crucial to the retirement security of black workers"); *Cf.* Angela P. Harris, *Theorizing Class, Gender, and the Law: Three Approaches*, 72 L. & CONTEMP. PROBS. 37, 39 (2009) (noting that "the politically loaded quality" of categories like race and gender "is obscured by a thick layer of justifying ideology…that serve[s] to make [their] existing social practices and relations seem natural, normal, and necessary").

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of their broader significance and public purpose, public pension funds should not participate in this form of regressive investment, at a minimum, for moral reasons. Yet, immersed as public pension funds now are in privatized, market-based investment, it is unsurprising that they too would reflect an enduring aspect of American capitalism; namely embracing marginalization as a valid source of wealth extraction.

The Article proceeds as follows. Part I describes the incidence of pension institutional investment in marginalized debt, both pre- and post-Great Recession. It shows how, for pension funds as big institutional investors, marginalized debt bears significant instrumental value as a means of retiree wealth maximization. Part II contextualizes this phenomenon in the increasing privatization of retirement security of the American public-private welfare regime. It describes two significant pressures on retirement security that have pushed public pension plans and retirees more broadly into the "Wild West" of financial markets.[36] First, it explains the shifting burden and risk of pension funding from employers to workers. Second, it shows how the burden and risk of adequate retirement funding have caused retirement funds to depend significantly on investment in the private financial markets, including investment in marginalized debt.

Part III argues that we should worry about public pension funding that relies on marginalized debt for profits because it, along with other institutional investment, commodifies and incentivizes the persistence of marginalization more generally. Indeed, marginalized debt as an investment strategy is dependent on a steady supply of borrowers whose life conditions relegate them to payday loans, small-dollar installment loans, student loans to attend for-profit colleges, and the like. Consequently, from the investor's perspective, the value of a marginalized-debt investment derives from the proposition that there will be a reliably steady stream of people in society who are relegated to risky debt because of their subordinate socio-economic status and conditions. In the case of public pension funds, this profit motivation is inconsistent with their public-oriented social welfare purpose.

Part IV considers the plausibility of regulatory reform as a resolution to the problems engendered by public pension fund investment in marginalized debt. It examines both whether pension funds as pillars of social welfare should have a more public-regarding mission that precludes this sort of extractive investment in marginalization, and whether the undue influence of financial intermediaries, on such an important aspect of social provision should justify closer scrutiny and regulation of their involvement in transactions that have such close impact on the public interest. It concludes that although increased regulation of these sectors would provide some measure of harm-reduction, it

[36] Christopher, *supra* n. 9.

would nevertheless skirt the larger, structural problems that engender this pitting on one vulnerable group against another in the name of wealth extraction.[37] It posits that debt-based regressive wealth extraction is merely "a shadow cast by"[38] our American capitalist approach to welfare that includes reliance on the market, such as it is, to "do the choosing" in the difficult task of redistribution.[39] The market is ill-equipped to perform this function, however, as long as wealth maximization remains a guiding principle independent of the social consequences of sourcing wealth for extraction within vulnerable communities. Instead it leaves financial intermediaries tasked with securing the welfare of ordinary Americans free to commodify and profit from the distress of others.[40]

I. FEEDING ON MARGINALIZED DEBT

Pension funds, alternatively known as "labor's capital," are an important aspect of the American public-private welfare regime.[41] They are tasked with securing the retirement income of workers and their beneficiaries.[42] Maintaining sufficient assets to meet this tremendous burden, however, is a perennial challenge for pension funds, rendering the investment returns on employer and employee contributions absolutely crucial.[43] For example, public pension systems rely on investment returns to fund 60 cents of every dollar promised to

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[37] *See* Robert J. MacCoun, *Moral Outrage and Opposition to Harm Reduction*, 7 CRIM. L. & PHIL. 83, 85 (2013) (defining harm reduction as "making an objectionable behavior safer" and observing that a harm reduction policy "take[s] for granted that people will engage in the [harmful] behavior" and consequently takes "steps … to make it less risky"). For example, a needle exchange program is a harm reductive policy aimed at addressing heroin use. *Id.* at 92. MacCoun reports that support for harm reduction as a policy approach varies across the political spectrum and hypothesizes that this may depend on the "sacred' domains where the cold calculus of harm reduction… is unpalatable." *Id.* at 95.

[38] Martin Luther King Jr., *The Man Who Was a Fool*, Sermon Delivered at the Detroit Council of Churches' Noon Lenten Services, Mar. 6, 1961, [Hereinafter *King Sermon*] https://kinginstitute.stanford.edu/king-papers/documents/man-who-was-fool-sermon-delivered-detroit-council-churches-noon-lenten.

[39] *See* Greta M. Krippner, CAPITALIZING ON CRISIS: THE POLITICAL ORIGINS OF THE RISE OF FINANCE 59 (2011). Economic sociologist Greta Krippner argues that the deregulation of credit in the wake of 1970s economic upheaval offered an expedient, if short-term, solution for policymakers plagued by the likely political consequences of having to determine "the rational distribution of scarce capital between sectors." *Id.*

[40] Rachel E. Dwyer, *Credit, Debt, and Inequality*, 44 ANN. REV. SOCIOL. 237, 247 (2016).

[41] *E.g.*, THE DIVIDED WELFARE STATE *supra* n. 2 at 72 (noting the "centrality" of retirement pensions "to modern social policy").

[42] Paul Rose, *Public Wealth Maximization: A New Framework for Fiduciary Duties in Public Funds*, 2018 U. ILL. L. REV. 891, 892 (2018).

[43] Jeffrey B. Ellman & Daniel J. Merrett, *Pensions and Chapter 9: Can Municipalities Use Bankruptcy to Solve Their Pension Woes?*, 27 EMORY BANKR. DEV. J. 365, 375 (2011) (describing the taxpayer liability for unfunded pension obligations and noting that as a consequence, municipalities invest heavily).

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pensioners.[44] In this context, the necessity for sufficient returns is particularly heightened in the public pension context where fiscally-vulnerable states and municipalities struggle to keep up with the promises of retirement income made to their employees, whose life expectancy keeps rising.[45]

When Detroit filed for bankruptcy, its overwhelming pension liabilities were front and center.[46] In addition to other structural problems that affected its financial health, at the time of its bankruptcy filing in 2013, Detroit's public pensions were woefully underfunded, and "its post-employment benefits and underfunded pension liabilities accounted for over half of Detroit's debt."[47] The city emerged successfully from bankruptcy following the implementation of the so-called "Grand Bargain"—a multi-party deal in which pension holders agreed

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[44] *Pew Report*, *supra* n. 8 (observing that "[i]nvestment returns make up more than 60 percent of public pension plan revenues [while] employer and employee contributions make up the rest"); *see also* CalPERS Video, *supra* n. 13 ("If you were to break down each dollar we pay in pension benefits it looks like this: 13 cents comes [sic] from CalPERS members, 29 cents comes [sic] CalPERS employers, and 58 cents comes [sic] from what we earn on the money we invest.").

[45] Ellman & Merrett, *supra* n. 45 at 366. Ellman and Merrett observe that "[f]aced with unsustainable and deepening budgetary shortfalls, municipalities are being forced to consider every option to extricate themselves from their difficult financial positions," *id.* at 366, and that "perhaps the single largest problem facing municipalities today is the dramatic and growing shortfall in public pension funds, *id.* at 367.

[46] *See id.* (observing that "municipalities have looked to Chapter 9 of the Bankruptcy Code as a means to adjust their pension obligations" and that "the City of Detroit's bankruptcy filing has brought this issue to the forefront"); Christine Sgarlata Chung, *Zombieland / the Detroit Bankruptcy: Why Debts Associated with Pensions, Benefits, and Municipal Securities Never Die ... and How They Are Killing Cities Like Detroit*, 41 FORDHAM URB. L.J. 771, 818 (2014) (describing "[p]ension impairment []as been a hot button issue in the Detroit bankruptcy"). Other notable municipal bankruptcies have reflected the immense financial burdens that pension obligations place on the public purse. *E.g.*, C. Scott Pryor, *Municipal Bankruptcy: When Doing Less Is Doing Best*, 88 AM. BANKR. L.J. 85, 85 (2014) (observing that "[t]he recent narrative of municipal bankruptcies focuses on the power of insolvent cities to reduce burdensome retiree benefit obligations," and that "[f]rom Orange County to the cities of San Bernardino and Vallejo as well as Detroit, a principal focus has been the power of cities to cut retirement benefits free of the procedural and substantive roadblocks faced by non-municipal debtors"); Hannah Heck, Comment, *Solving Insolvent Public Pensions: The Limitations of the Current Bankruptcy Option*, 28 EMORY BANKR. DEV. J. 89, 89 (2011) (describing Prichard, Alabama's pension liability-motivated municipal bankruptcy filing); Chris Megerian & Melody Petersen, *Stockton Bankruptcy Ruling a Blow To Pensions*, L.A. TIMES, Oct. 1, 2014, https://www.latimes.com/business/la-fi-stockton-bankruptcy-20141002-story.html#:~:text=The%20decision%20came%20after%20a,nation's%20largest%20public%20pension%20fund.&text=Stockton%20owes%20the%20pension%20agency%20more%20than%20%2415%20million%20this%20year, (describing the bankruptcy court's ruling that the City of Stockton, California could reduce pension obligations in its bankruptcy filing).

[47] *Id.* at 782-785. Of its then-approximately 18-billion-dollar debt, Detroit listed 6.4 billion dollars in "other post-employment benefits" and 3.5 billion in "underfunded pension liabilities based on [then-]current actuarial estimates"). *Id.* at 776.

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to a plan of reorganization that cut their benefits.[48] The Grand Bargain was "nothing short of miraculous," given the complexities of Detroit's fiscal distress and the competing claims upon the city's limited funds.[49] Nevertheless, Detroit's bankruptcy has become a cautionary tale for public pension fund managers. Indeed, by one account, "the real lesson" from Detroit was that municipalities could not address their broader problems in funding by shortchanging their longer-term obligations to pensioners.[50]

In this regard, pension fund managers are expected to engage in modern-day acts of veritable alchemy, taking an existing pool of employer and employee contributions, namely labor's capital, and increasing its quantity in order to maximize participant wealth.[51] Maximizing investment returns is crucial to success. Yet in performing this duty, pension fund managers are at least nominally hemmed in by their fiduciary duty to plan participants and their beneficiaries.[52] This duty is rooted in the tenets of trust doctrine in which trustees, in the management of trust assets, are required to act with prudence, due care, and "solely in the interest of the beneficiaries."[53]

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[48] Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 YALE J. ON REG. 55, 71 (2016) (describing the Grand Bargain which "reduced the [expected] cuts to pensions for public workers and retirees"); ; *also* Andrew B. Dawson, *Pensioners, Bondholders, and Unfair Discrimination in Municipal Bankruptcy*, 17 U. PA. J. BUS. L. 1, 18(2014) (describing "the two most controversial aspects of the [Detroit bankruptcy proceedings]" as being "the treatment of pensioners and the treatment of Detroit's world-class art collection at the Detroit Institute of Arts (DIA)");.Goldman & Sterk, *supra* n. 13 at 108 ("At the municipal level, pension default has already become a reality: Detroit's bankruptcy resulted in a cut in pension benefits promised to retired workers."); *also* Lester Graham, *Detroit Bankruptcy Lesson: Underfunded Pension Funds could Trip Up Other Municipalities*, MICHIGAN WATCH, Dec. 1 2015, https://www.michiganradio.org/post/detroit-bankruptcy-lesson-underfunded-pension-funds-could-trip-other-municipalities (opining that "[i]f the city's retirees had not agreed to cuts and had the so-called "Grand Bargain" not minimized those cuts, the city's bankruptcy could still be in the courts").

[49] *Id.* (opining that the Grand Bargain "is not a feat that other cities facing bankruptcy are likely to pull off").

[50] *Id.* ("Shorting the pension fund is kicking the can down a road that leads to financial disaster."); *see also* Jun Peng, *Public Pension Funds and Operating Budgets: A Tale of Three States*, 24 PUB. BUDGETING & FINANCE 59, 61-62 (2004) (observing that "a chronic underfunding of pension plans in the past can be explained by the willingness of current residents in the community to shift pension obligations to future residents").

[51] Rose, *supra* n. 44 at 893 ("Public trustees have long been held to a strict duty of loyalty that, by design, limits their ability to direct the fund in ways that would not serve the interests of the pension plan participants and their beneficiaries."); *also* Eileen Appelbaum & Rosemary Batt, DILEMMAS FOR PENSION FUNDS AS LIMITED PARTNERS IN PRIVATE EQUITY AT WORK: WHEN WALL STREET MANAGES MAIN STREET 242 (2014).

[52] Rose, *supra* n. 44 at 893.

[53] *Id.* at 896 ("fiduciary duties of pension fund officials are based in long-standing trust doctrines").

This fiduciary duty extends to private and public pensions alike,[54] and "modern portfolio theory" governs whether the investment strategy of pension fund managers comports with this fiduciary duty.[55] Whereas traditional limits on prudent behavior prohibited speculative investment as unduly risky,[56] modern portfolio theory rejects such a categorical limitation and instead dictates that "the prudent investor should seek to diversify risk, not to avoid risk altogether."[57] Thus, rather than a focus on risk relative to any individual investment, pension fund managers should manage risk attendant to their investment decisions through diversification of investment.[58] As described by Stewart Sterk:

> Modern portfolio theory teaches that in determining the content of an investor's portfolio the investor must assess the level of market risk he or she is willing or able to bear. The investor then should hold a mixture with two components— (1) a diversified portfolio of high-risk, high-expected-return investments and (2) a risk-free investment—proportioned in accordance with the investor's risk tolerance.[59]

Bolstered by this relatively expansive standard of prudent investment, and coupled with consistent decreases in returns from more traditionally safe investments like U.S. Treasury Bonds,[60] pension fund managers have

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[54] Webber, *supra* n. 11 at 2119.
[55] Appelbaum & Batt, *supra* n. 53 at 249 (observing that "modern portfolio theory [has become] the dominant approach for allocating pension fund assets").
[56] Stewart E. Sterk, *Rethinking Trust Law Reform: How Prudent Is Modern Prudent Investor Doctrine?*, 95 CORNELL L. REV. 851, 856-857 (2010) (noting that traditional approaches to prudent investment "mandated conservative investment strategies for trustees" and "excluded investment in 'speculative' enterprises").
[57] *Id.* at 854; *also* Olivia S. Mitchell, David McCarthy, Stanley C. Wisniewski, & Paul Zorn, *Developments in State and Local Pension Plans* in Olivia S. Mitchell & Edwin C. Hustead, PENSIONS IN THE PUBLIC SECTOR 14 (2010) (noting that, in an effort "to expand the investment options available to state and local retirement plans," state legislatures began in the 1980s to relax the more restrictive limits on the prudence standard).
[58] Sterk, *supra* n. 58 at 854; *see also* Webber, *supra* n. 10 at 2153 (observing that under modern portfolio theory, "MPT the prudent investor standard requires fiduciaries to analyze investments [by focusing] not on any particular asset's individual risk-- as was the case under the prudent person rule--but rather on how the asset's risk contributes to the portfolio's risk").
[59] Sterk, *supra* n. 58 at 859; *see also* David F. Swensen, *supra* n. 10 at 97 ("Creating a diversified portfolio with a range of equity-oriented asset classes that respond to drivers of returns in fundamentally different fashion provides important underpinning to the investment process.").
[60] Appelbaum & Batt, *supra* n. 53 at 242; *also* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 80 (observing that U.S. Treasury bills are "widely considered the safest and most conservative investments in the world"); Sondra Albert, *The Subprime Crisis' Impact on Fixed-Income Funds*, AFL-CIO Housing Investment Trust, Nov. 13, 2007,

increasingly looked to risky, short-term investments to round out their portfolios.[61] Indeed, one recent study observes that, 75% of pension fund assets "are held in what are often called risky assets—stocks and alternative investments including private equities, hedge funds, real estate, and commodities."[62]

This risk-tolerant diversification strategy has led public pension fund managers to invest in private equity funds, whose investment strategy includes capitalizing on the high interest rates and fees that characterize accessible credit for marginalized borrowers. This reliance on marginalized debt is perhaps most clear in light of public pension fund losses following the Great Recession. But even after the lessons offered by the Great Recession, pension funds continue to entrust their dollars to private equity firms that make forays into marginalized debt-based income enterprises like for profit colleges[63] and small-dollar installment lending[64]

A. Pension Fund Investment in Pre-Great Recession Marginalized Debt

In mid-July of 2007, the early days of the financial crisis that spawned the Great Recession, the California Public Employee Retirement System (CalPERS), the country's largest public pension fund,[65] told the *Wall Street Journal* that it had been minimally exposed to toxic collateralized debt obligations (CDOs), the investment bonds that were backed by consumer debt, including

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https://www.sec.gov/Archives/edgar/data/225030/000116923207004677/d73205_40-24b2.htm, (noting that "[f]ixed-income instruments include bonds issued by governments, government-backed agencies and companies to raise capital to cover their spending requirements," but that "with interest rates at historically low rates, investors have increased their taste for risk in order to gain higher returns").

[61] Jean-Pierre Aubry, Anq Chen, & Alicia Munnell, *A First Look at Alternative Investments and Public Pensions*, CENTER FOR RETIREMENT RESEARCH, Jul. 2017, https://crr.bc.edu/wp-content/uploads/2017/06/slp_55.pdf ("Public pension plans have boosted their holdings in alternative assets, defined as private equity, hedge funds, real estate, and commodities. This shift reflects a search for higher returns, a hedge for other investment risks, and diversification."); Appelbaum & Batt, *supra* n. 53 at 239 ("Allocations to higher-risk alternative investments, such as private equity, have been attractive when funds need to be shored up or meet retiree payments.").

[62] *Pew Report*, *supra* n. 8 at 1; *see also*, Sondra Albert, *The Subprime Crisis' Impact on Fixed-Income Funds*, AFL-CIO Housing Investment Trust, Nov. 13, 2007, https://www.sec.gov/Archives/edgar/data/225030/000116923207004677/d73205_40-24b2.htm, (observing that "public pension funds have also increased their investments in hedge funds in an attempt to boost their returns due to larger funding requirements").

[63] Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns & The Billionaire Factory* 24-25, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3623820.

[64] Whoriskey, *supra* n. 24.

[65] THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 9.

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subprime mortgages.[66] A CalPERS spokesperson told the *Journal* that the pension behemoth's investments in collateralized toxic mortgages amounted to just $140 million of its then-total $245 billion in assets.[67] Moreover, the spokesperson averred that CalPERS intended to continue to invest in consumer mortgage debt in the next two years, pending the addition of "personnel and building an analytical infrastructure to support that effort."[68] Consistent with modern portfolio theory, the spokesperson justified these investments in ordinary consumers' abilities to pay their mortgages, and the attendant elevated risks, as being "just part of diversification."[69] Yet, a mere two years later, once the enormity of the crisis became apparent, CalPERS revealed in a lawsuit filed against three credit ratings agencies, that it had in fact invested $1.3 billion in three structured investment vehicles[70] based on mortgage-backed securities, and that it expected losses of over $1 billion.[71]

Like CalPERS, many pension funds invested in consumer mortgage-backed securities in the years leading up to the Great Recession.[72] The origin story of these mortgage-backed securities is a now a relatively familiar one. Following years of federal deregulation of lending practices and attendant to a federal policy that encouraged homeownership for all, loan originators "developed innovative loan products to make mortgage credit more readily available to lower income, but often higher risk, consumers."[73] These

[66] Stan Rosenberg, *Public Pension Funds Avoid the Subprime Meltdown*, WALL STREET JOURNAL, Jul. 14, 2007, https://www.wsj.com/articles/SB118433634548665952.
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] William W. Bratton and Adam J. Levitin provide an excellent definition of the now-defunct Structured Investment Vehicle. William W. Bratton & Adam J. Levitin, *A Tale of Two Markets: Regulation and Innovation in Post-Crisis Mortgage and Structured Finance Markets*, 2020 U. ILL. L. REV. 47, 115 (2020). They explain that: "Structured Investment Vehicles or 'SIVs,' were the shadow banks par excellence of the pre-crisis era, combining aspects of a bank, a securitization, and a hedge fund. The banks created and advised them initially as unregulated, off-balance sheet alter egos holding assets that suffered unfavorable treatment under the bank capital rules. With a SIV, such investment could be financed with an all-debt capital structure. The banks' SIVs went on to become holders of diversified portfolios of actively managed, highly-rated (mostly securitized) assets funded through the issuance of medium-term notes and commercial paper. Like a bank, a SIV arbitraged the spread in yields between long-term debt investments and short-term liabilities. Like a hedge fund, there was an advisory relationship and an absence of deposit-based funding. Like a securitization, there was an SPE and tranched debt." *Id.*
[71] Rick Brooks, *Raters Sued by CalPERS Over Losses*, WALL STREET JOURNAL, Jul. 15, 2009, https://www.wsj.com/articles/SB124763258772743653.
[72] Engel & McCoy, *supra* n. 29 at 102.
[73] A. Mechele Dickerson, *Consumer Over-Indebtedness: A U.S. Perspective*, 43 TEX. INT'L L.J. 135, 140 (2008).

products—often high-risk, subprime mortgages[74]—were bundled together to form pooled income streams that were then transformed into securities and offered for sale.[75] Pension funds invested significantly in these consumer debt-based income streams.[76]

In theory, as long as subprime borrowers continued to pay their relatively-high-interest mortgage debt as expected, institutional investors of all stripes could have realized the expected higher return on these subprime debt-laced investments. In other words, they would have benefited from the higher prices that marginalized borrowers had to pay to buy a home. Yet, neither did this "democratized credit" bear out its promise of greater socio-economic inclusion for marginalized borrowers,[77] nor did it yield the tantalizingly high-interest-rate-fueled gains that pension funds and other institutional investors expected.[78] Rather, built as they were on a foundation of sand, many subprime mortgages quickly proved too good to be true, and the ensuing tsunami of

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[74] The Consumer Financial Protection Bureau describes a subprime mortgage loan as "a [higher interest rate] loan that is meant to be offered to prospective borrowers with impaired credit records." Consumer Financial Protection Bureau, *What is a subprime mortgage?*, Feb. 24, 2017, https://www.consumerfinance.gov/ask-cfpb/what-is-a-subprime-mortgage-en-110/ (explaining that "[t]he higher interest rate is intended to compensate the lender for accepting the greater risk in lending to such borrowers" and that "[t]he interest rate on subprime and prime ARMs can rise significantly over time").

[75] *See, e.g.*, J. David Cummins & Christopher M. Lewis, *Securitized Risk Instruments as Alternative Pension Fund Instruments* in Olivia S. Mitchell & Kent Smetters, THE PENSION CHALLENGE: RISK TRANSFERS AND RETIREMENT INCOME SECURITY 268 (2003) (observing that "securities have been introduced to trade the risk in 'exotic underlyings").

[76] *E.g.*, Engel & McCoy, *supra* n. 29 at 102 (noting that "[p]ension funds were big investors in mortgage-backed securities" including those built on subprime mortgages); Bruce I. Jacobs, *Tumbling Tower of Babel: Subprime Securitization and the Credit Crisis*, 65 FIN. ANALYSTS J. 17, 23 (2009) ("Securitization also allowed the expansion of funding for subprime mortgages to move beyond the leveraged financial sector to such traditionally unleveraged investors as insurance companies, pension funds, and mutual funds."); Maria Teresa Cometto, *"Toxic Waste" in Pension Funds*, INVESTMENTS AND PENSIONS EUROPE, Sept. 2007, https://www.ipe.com/toxic-waste-in-pension-funds/25155.article, ("US public pension funds - the ones sponsored by states and other public administrations - have bought more than $500m in CDO equity tranches, which are the bottom and riskier slice of a bundle of bonds backed by debt, including home loans such as subprime mortgages, issued to households with a very poor credit history or to those termed 'NINJA' (No Jobs No Income No Assets)"; *see also* Kristopher Gerardi, Stephen L. Ross, & Paul Willen, *Understanding the Foreclosure Crisis*, 30 J. POL. ANAL.& MANAGEMENT 382, 385 (2011) ("the credit enhancements offered by AIG and other market players allowed much of this debt to be securitized as AAA-rated securities and therefore sold to pensions funds, the Government Sponsored Enterprises (GSEs), and other regulated investors").

[77] *See* Atkinson *Borrowing*, *supra* n. 5.

[78] Dickerson, *supra* n. 75 at 140 (observing that the "push for a greater democratization of credit generally resulted in lenders giving higher risk borrowers, a group generally characterized as "subprime" borrowers, greater access to credit in the form of non-traditional mortgage products").

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defaults that washed onto the shores of the global economy left pension funds in tatters.[79] If anything, the attempt to feed pension funds from a diet rich in marginalized debt left both vulnerable groups at the bookends of these transactions—namely workers and marginalized borrowers—in deep distress.[80]

B. *Pension Fund Investment in Post-Great Recession Marginalized Debt*

Although securitized mortgages as fodder for investment fell from grace following the Great Recession, public pension funds and other institutional investors have continued to seek out other similar alternative investments whose value as a source of participant wealth maximization is similarly rooted in marginalized debt. For example, pension funds have turned in significant numbers to a different source of returns, namely those acquired from equity investment— "money that is invested in a company by purchasing shares of that company in the stock market."[81]

Before the rise of modern portfolio theory, equity investment was "disfavored" as a prudent means of trust wealth maximization in light of its elevated risk.[82] Instead risk-limited investments like government bonds, including U.S. Treasury bonds, were deemed more prudent sources of wealth accumulation.[83] Yet with the rise of modern portfolio theory, with its sanction of increased risk relative to portfolio diversification, "equities now represent a larger share of trust portfolios, just as modern portfolio theory suggests they should."[84] Consequently, in their quest to maximize retiree wealth, pension

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[79] Kenneth Glenn Dau-Schmidt, *Promises to Keep: Ensuring the Payment of Americans' Pension Benefits in the Wake of the Great Recession*, 52 WASHBURN L.J. 393 (2013) (noting also that private and public pensions each lost 1 trillion dollars in asset value in 2008 alone); *see also* Appelbaum & Batt, *supra* n. 53 at 250, ("Given their investment in risky assets and their economic power to influence global markets, pension funds are implicated in the financial crisis.").

[80] Atkinson *Rethinking*, *supra* n. 4 at 1155; *also* Scott N. Marley, Taylor J. Haley, Coleman A. Allums, Steven R. Holloway, & Hee Cheol Chung, *The Limits of Homeownership: Racial Capitalism, Black Wealth, and the Appreciation Gap in Atlanta*, 44 INT'L J. OF URB. & REGIONAL RESEARCH 310, 311-312 (2020) (observing that "[d]uring the housing boom, mortgage lenders targeted Black spaces with subprime and predatory mortgage products, including adjustable-rate mortgages and balloon loans that had high default rates" and that "[f]oreclosures and attendant home price depreciation, then, combined to erase over 50% of the Black wealth in the US during the financial crisis").

[81] *E.g.*, BlackRock, Inc., *What are Equity Investments?*, https://www.blackrock.com/us/individual/education/equities#:~:text=An%20equity%20investment%20is%20money,traded%20on%20a%20stock%20exchange.

[82] *E.g.*, Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?*, 50 J.L. & ECON. 681, 692 (2007) ("First, the old prudent-man rule disfavored broad classes of equity holdings.").

[83] *Id.* at 683-685; Sterk, *supra* n. 58 at 877 (equity is riskier than fixed-income bonds).

[84] *Id.*

funds have turned to private equity funds, providing "the largest source of equity capital for [private equity] funds."[85] In turn, private equity funds have sought to capitalize on the borrowing needs and habits of the most vulnerable borrowers by taking relatively short-term equity stakes in businesses whose profit margins depend on marginalized debt, including small-dollar installment lenders and other non-mortgage "alternative" debt-based securities.[86]

1. A Primer on Private Equity Funds

Private equity firms make money by serving as a financial intermediary between large capital holders, like pension funds, mutual funds, university endowments, and other institutional investors, and target operating companies.[87] Private equity firms will open up a discrete fund structured as a partnership, in which the private equity firm will serve as general partner in charge of active management, and the investors will become limited partners, relegated to a passive role in the fund's decision-making.[88] As general partner, the private equity firm has principal discretion in selecting a target for acquisition. Once determined, the private equity firm generally contributes a small fraction of the partnership's equity contribution to the purchase price, while the limited partner-investors supply the bulk of the partnership's equity sunk into the purchase price.[89] Finally, the lion's share of the purchase price is usually paid with debt that is often secured by the assets of the target operating

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[85] Appelbaum & Batt, *supra* n. 53 at 43.

[86] *See, e.g.*, Nikou Asgari & Joe Rennison, *Private-Equity Backed Companies Dominate Lowest Depths of Junk*, FIN. TIMES, May 7, 2020, https://www.ft.com/content/30e3ba95-617e-4ef6-a2b4-ca2a32b7cf94; Joy Wiltermuth, *Cracks in the $1.3 Trillion Auto-Finance Market Aren't Curbing Investor Demand For Risky Debt*, MARKETWATCH, Feb. 20, 2020, https://www.marketwatch.com/story/cracks-in-the-13-trillion-auto-finance-market-arent-curbing-investor-demand-for-risky-debt-2020-02-19; Robert Armstrong, *Yield-Crazed Investors Pile Into US Subprime Car Loans*, FIN. TIMES, Nov. 25, 2019, https://www.ft.com/content/59f3a084-0d80-11ea-bb52-34c8d9dc6d84.

[87] Appelbaum & Batt, *supra* n. 53 at 43.

[88] *Id.*

[89] *Id.*

company.[90] Notwithstanding its relatively small equity outlay, however the private equity firm is generally entitled to "a major share of fund gains."[91]

Once the acquisition closes, the private equity firm is both an investor in and a manager of the operating company, while the institutional investors maintain a largely silent equity stake in the company.[92] Ideally, the private equity firm will deploy its purported managerial expertise and capital advantages to "unlock the untapped potential in good companies or to turn around poorly performing or failing ones," thus benefitting both the investors in the private equity fund as well as the various stakeholders in the operating company.[93] Yet, in practice, commentators have observed that with its primary concern in extracting value for the benefit of itself and the institutional investors in the fund,[94] private equity firms often manage the operating company so as to squeeze as much value out of the company during the typical three-to-five year life[95] of the fund, without reference to any negative consequences on the operating company itself or the stakeholders in the operating company's vitality.[96] For example, the private equity firm-as-manager might layoff more workers than necessary in order to increase the short-term revenues for the fund's investors.[97] Moreover, once the fund is finished with ownership and sells the target operating company, it often leaves the target operating company saddled with debt.[98]

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[90] *Id.* at 41-43 (noting that the private equity firm "sponsor[s] investment funds that buy out operating companies using high levels of debt"); Charlie Eaton, Sabrina Howell, & Constantine Yannelis, *When Investor Incentives and Consumer Interest Diverge: Private Equity in Higher Education* 7 (2018), National Bureau of Economic Research, https://www.nber.org/papers/w24976.pdf ("Private equity buyouts can affect target firm operations and finances, and are often accomplished using debt, which increases the target's leverage." (internal citation omitted.).

[91] Appelbaum & Batt, *supra* n. 53 at 4; *also* Sanford M. Jacoby, 30 COMP. LAB. L. & POL'Y J. 17, 57 (2008) (describing "PE's modus operandi [a]s to leverage its assets via debt, buy companies or their subsidiaries, take them private, dispose of corporate assets to pay off debt and to pay themselves, and sell out.").

[92] William A. Birdthistle & M. Todd Henderson, *One Hat Too Many? Investment Desegregation in Private Equity*, 76 U. CHI. L. REV. 45, 49–50 (2009) ("Investors … contribute only money, not management [and are] almost always large institutional investors, such as university endowments, public pension funds, and other substantial pools of money").

[93] *Id.* ("Private-equity investment typically begins with a group of individuals deciding to offer their labor (and often their money) as asset managers through an investment advisory entity that will raise funds, identify investment opportunities, and subsequently oversee equity investments in target firms.").

[94] *See* Eaton, Howell, & Yannelis, *supra* n. 92 ("private equity-owned firms have particularly high-powered incentives to maximize profits").

[95] Appelbaum & Batt, *supra* n. 53 at 43.

[96] *Id.* at 42 & 73.

[97] *Id.* at 73

[98] *Id.* at 42.

2. Private Equity and "Subprime Higher Education"[99]

In September 2019, Senator Elizabeth Warren (D-MA) and Representative Mark Pocan (D-WI) wrote to Andrew Sheiner, the Founder and Managing Partner of Atlas Partners, a large private equity firm.[100] They wanted to know more about Atlas's structure and finances as they related to their investment in for-profit colleges, 80% of whose revenues come from federal student aid, including student loans.[101] Senator Warren and Representative Pocan's letter—which they sent to eight other PE firms—arrived in the wake of Charlie Eaton, Sabrina Howell, and Constantine Yannelis' 2018 study of private equity buyouts in the for-profit higher education sector. Their findings suggested that private equity firms were targeting for-profit educational firms to capture guaranteed profits generated from federal subsidy of student loans and grants.[102]

For-profit schools are educational institutions that operate under a business model that depends on marginalized debt as the main source of profit. A form of "tax-payed financed capitalism,"[103] they rely primarily on federal student aid, including loans and grants, for their revenue.[104] The demographic of students is disproportionately "minority and disadvantaged,"[105] and most of the students who attend for-profit schools have to borrow money in order to do so. These borrowers are largely culled from socio-economically marginalized communities, i.e., "disproportionately poor, minority, single parents, and military personnel."[106] Because of these attributes, Jean Braucher observed that, "the label 'subprime higher education' accurately captures the nature of the risk to individual students" particularly those who borrow money to attend.[107]

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[99] Jean Braucher, *Mortgaging Human Capital: Federally Funded Subprime Higher Education*, 69 WASH. & LEE L. REV. 439, 441 (2012) (describing for-profit education).
[100] Letter to Andrew Sheiner, https://www.warren.senate.gov/imo/media/doc/2019-09-10%20Letters%20to%20PE%20Firms%20re%20For%20Profit%20Colleges.pdf
[101] *Id.*
[102] Eaton, Howell, & Yannelis, *supra* n. 92.
[103] Appelbaum & Batt, supra n. at 53 (observing that "another source of private equity gains is a transfer from taxpayers to private equity").
[104] Braucher, *supra* n. 101 at 440.
[105] David Deming, Claudia Goldin, & Lawrence Katz, *For-Profit Colleges*, 23 at 138 (2013), ("During the past fifteen years, youth from minority and disadvantaged backgrounds and those ill-prepared for college increasingly and disproportionately have enrolled in programs at for-profit colleges.");
[106] Braucher, *supra* n. 101 at 441-442; *also* Vasanth Sridharan, Note, *The Debt Crisis in for-Profit Education: How the Industry Has Used Federal Dollars to Send Thousands of Students into Default*, 19 GEO. J. ON POVERTY L. & POL'Y 331, 334 (2012) ("For-profit colleges and universities tend to draw a lower-income, older population.).
[107] Braucher, *supra* n. 101 at 441.

Against this backdrop, Eaton, Howell, and Yannelis studied whether "high-powered maximizing incentives induce focus on subsidy capture."[108] To test this inquiry, they examined 88 private equity buyout deals involving for-profit schools, which encompassed "557 school-level ownership changes" and "[acqui[sition] or establish[ment of] an additional 437 schools."[109] They observed that following the private equity buyout, "reliance on federal aid and guaranteed loans increases" even as "student outcomes deteriorate."[110] In other words, their evidence suggest that private equity firms enter into the for-profit education business to extract value for themselves and their investors through "federal aid capture" before leaving its cohort of marginalized student borrowers holding the proverbial bag.[111] Moreover, private equity funds need not concern themselves with student outcomes. Instead, because funds and their institutional investors take their value when student aid is first disbursed at the beginning of the teaching period, they profit whether or not the marginalized gains any benefit from the education.

3. Expanded Private Equity Investment in Marginalized Debt

On behalf of their institutional investor-partners and themselves, private equity firms continue to target a range of other businesses whose profits depend significantly on marginalized debt, including small-dollar installment lenders, who offer small amounts of unsecured money, at relatively high-interest rates, to a customer base that chronically struggles with income. [112] For example, in 2013, Warburg Pincus, "a leading global private equity firm focused on thesis-driven growth investing at scale," and whose president is Former Treasury Secretary Timothy Geithner, invested in Mariner Finance whose self-described mission is to "provide hard-working consumers responsible access to credit

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[108] Eaton, Howell, & Yannelis, *supra* n. 92 at 20.
[109] *Id.* at 1.
[110] *Id.* at 1.
[111] *Id.* at 9, 14-15. For example, Eaton, Howell, and Yannelis observed that in the wake of the buyout: class sizes increased; the instructor to student ratio increased; average loans per full-time student borrower increased; graduation rates dropped; student-in-repayment rate dropped; and default rates on student loans increased. *Id.* at 18-20; *see also* Kathleen Conn, *For-Profit School Management Corporations: Serving the Wrong Master*, 31 J.L. & EDUC. 129, 133 (2002) (noting that "when for-profit school management companies take over the functions of traditional public education[,…] non-shareholding constituencies, namely the students and parents, have little to no bargaining power vis-à-vis the corporate directors, and may be at their mercy in the absence of adequate regulatory safeguards").
[112] Whoriskey, *supra* n. 24 ("Private equity firms, with billions to invest, have taken significant stakes in the growing [small-dollar installment loan] field."); *also* James Rufus Koren, *Need A Loan? Forget the Corner Payday Lender — Your Boss Has You Covered*, L.A. TIMES, Aug. 5, 2018, ("Installment loans typically are made for at least $2,500 and are structured to be paid back over a year or more, causing borrowers to repay many times the loan amount.").

through respectful, compassionate, and efficient service."[113] Less euphemistically, however, Mariner merely sells small-dollar installment loans between $1,000 and $25,000 at high interest rates to people who need money, capitalizing on the financial distress of economically vulnerable people.[114]

Warburg Pincus offered investment in Mariner Finance as a part of a $2.3 billion private equity fund, "Warburg Pincus Financial Sector, L.P."[115] In trumpeting the closing of the fund, Warburg Pincus boasted that "[t]he Limited Partners who have committed to the Warburg Pincus Financial Sector Fund include existing investors in Warburg Pincus' funds and new investors to the firm, including leading public and private pension funds…"[116] Ultimately, "[d]ozens of other investment firms bought Mariner bonds …, allowing the company to raise an additional $550 million," with which it could continue to engage in questionable and predatory practices. For example, a recent report alleged that Mariner engaged in mass-mailing checks, permitting "customers to accept a high-interest loan on an impulse," extracted interest on loans as high as 36%, and engaged in "aggressive collection practices that include calling delinquent customers once a day and embarrassing them by calling their friends and relatives."[117]

Another marginalized debt-based investment included in the Warburg Pincus fund portfolio is Santander Consumer USA.[118] By its own description, Santander Consumer USA is in the business of "[h]elping drivers reach their destinations, regardless of credit."[119] Less euphemistically, however, Santander Consumer USA, is "the nation's largest subprime auto financing company," and it holds a reputation for preying on subprime consumers.[120] For example, in May 2020, following a multi-state investigation into its "subprime lending practices,"[121] Santander agreed to pay $550 million to settle a lawsuit brought by

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[113] https://www.marinerfinance.com/; https://www.warburgpincus.com/investments/mariner-finance/; *see also* Whoriskey, *supra* n. 24.
[114] *Id.*
[115] *Warburg Pincus Closes $2.3 Billion Financial Services Fund*, Dec. 18, 2017, (hereinafter Warburg Pincus Press Release] https://www.warburgpincus.com/content/uploads/2017/12/Financial-Sector-Fund-Close-Press-Release_FINAL-12.18.17.pdf
[116] *Id.*
[117] Whoriskey, *supra* n. 24.
[118] Warburg Press Release, *supra* n. 108.
[119]Santander Consumer USA, https://santanderconsumerusa.com/auto-financing.
[120] David Shepardson, *Santander Agrees to $550 Million U.S. Settlement Over Suprime Auto Loans*, REUTERS, May, 19, 2020, https://www.reuters.com/article/us-usa-autos-lending/santander-agrees-to-550-million-u-s-settlement-over-subprime-auto-loans-idUSKBN22V2GS#:~:text=The%20states%20said%20Santander%20violated,on%20loans%20worth%20%24478%20million.
[121] Illinois Office of the Attorney general, Press Release, *Attorney General Raoul Announces $550 Million Settlement With Nation's Largest Subprime Auto Financing Company*, May 19, 2020,

the Attorneys General of 33 states and the District of Columbia.[122] The states "accused Santander of extending loans that were too big relative to borrowers' incomes, charging excessive fees and failing to monitor dealership loan-approval practices."[123] In addition to monetary relief, Santander agreed to refrain from such predatory practices as: offering car loans to consumers whose car payment would exceed their monthly income and "requiring dealers to sell ancillary products, such as vehicle service contracts."[124] Similarly, in 2017, Santander Consumer USA agreed to pay $2.75 million to Delaware auto-buyers after an investigation by the Delaware and Massachusetts Attorneys General revealed that Santander engaged in predatory practices in the sale of its car loans to consumers.[125] Moreover, in 2015, the United States sued Santander, alleging that Santander violated the Service Members Civil Relief Act (SCRA) by illegally repossessing cars from military servicemembers and illegally assessing loan fees.[126] Santander settled the lawsuit, agreeing to pay $9.3 million in restitution and $2.5 million in fines.[127]

Warburg Pincus and its institutional investors, including pension funds, are not alone in feeding on marginalized debt as a source of wealth accumulation. Blackstone Group LP, one of the largest PE firms, sold its stake

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https://illinoisattorneygeneral.gov/pressroom/2020_05/20200519.html#:~:text=May%2019%2C%202020-,ATTORNEY%20GENERAL%20RAOUL%20ANNOUNCES%20%24550%20MILLION%20SETTLEMENT,LARGEST%20SUBPRIME%20AUTO%20FINANCING%20COMPANY&text=Chicago%20%E2%80%94%20Attorney%20General%20Kwame%20Raoul,with%20Santander%20Consumer%20USA%20Inc.

[122] Consent Judgement, *Illinois v. Santander Consumer U.S.A., Inc.*, https://illinoisattorneygeneral.gov/pressroom/2020_05/Santander-Final_Consent_Judgment_Illinois.pdf.

[123] Ben Eisen & AnnaMaria Andriotis, *Santander Settles Predatory Auto-Lending Claims for $550 Million*, WALL STREET JOURNAL, May 19, 2020, https://www.wsj.com/articles/santander-to-pay-states-550-million-to-settle-allegations-of-predatory-auto-lending-11589906880. For example, Similarly, California alleged that Santander violated the California Unfair Competition Law by, in part, "originating loans and purchasing installments contracts with a high likelihood of failure [and] exposing consumers to unnecessarily high levels of risk." Complaint, *California v. Santander Consumer U.S.A*, May 20, 2020, https://oag.ca.gov/system/files/attachments/press-docs/PPL%20v%20SCUSA%20Complaint.pdf.

[124] https://santandermultistateagsettlement.com/Home/portalid/0.

[125] Delaware Dep't of Justice, Press Release, *Santander Consumer USA Holdings, Inc. to Pay $2.875 Million to Delaware Consumers Over Sub-Prime Auto Loans*, Mar. 29, 2017, https://news.delaware.gov/2017/03/29/sc-2/?mod=article_inline.

[126] Complaint, *United States v. Santander Consumer U.S.A.*, 3:15-cv-00633-B (N.D. TX), https://www.justice.gov/file/674311/download.

[127] Consumer Financial Protection Bureau, Press Release, *Bureau of Consumer Financial Protection Settles with Santander Consumer USA Inc.*, Nov. 20, 2018, https://www.consumerfinance.gov/about-us/newsroom/bureau-consumer-financial-protection-settles-santander-consumer-usa-inc/.

in Lendmark Financial Services LLC to another private equity firm, Lightyear Capital LLC, in 2019.[128] Lightyear partnered with the Ontario Teachers' Pension Plan (OTPP), Canada's largest single-profession pension plan, in the purchase.[129] Like Mariner Financial, Lendmark Financial Services sells subprime small-dollar installment loans to marginalized consumers. Nevertheless, in heralding the deal, an OTPP's Executive Managing Director proclaimed that: "Ontario Teachers' is delighted to partner with Lendmark's strong management team and investment partner Lightyear to work together to take the company into its next phase of growth."[130]

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In sum, as the largest contributors of capital to private equity, pension funds have indirectly joined in on the targeting of marginalized-debt-based investment as a source of wealth maximization. This is disturbing because, while other institutional investors might be adjudged as unduly profit-minded, pension funds arguably should be less mercenary in light of their social welfare mandate. Indeed, that pension funds—concerned as they are with securing the retirement income of ordinary workers—have increasingly diversified their portfolios with marginalized debt-backed investments reveals something important about the precarity of retirement saving in the American public-private welfare system. It reveals how far individual workers and their financial intermediaries must now go to engage in self-help retirement funding that now characterizes the American public-private welfare regime. Counterintuitively then, one way to think about marginalized debt is that, at least in the case of pension funds as institutional investors (and most likely in the near future for individualized retirement saving accounts), it serves a public good because it furnishes a means from which working people might increase their retirement security.[131]

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[128] David French, *Blackstone to Sell Lendmark Financial to Lightyear Capital: Sources*, Reuters, Jun. 24, 2019, https://www.reuters.com/article/us-lendmarkfinancial-m-a-lightyearcapita/blackstone-to-sell-lendmark-financial-to-lightyear-capital-sources-idUSKCN1TP2C7, (noting that Blackstone purchased Lendmark in 2013).

[129] *Lightyear Capital and Ontario Teachers' Pension Plan to Acquire Lendmark Financial Services*, BUSINESSWIRE, Jun. 27, 2019, https://www.businesswire.com/news/home/20190627005795/en/Lightyear-Capital-Ontario-Teachers%E2%80%99-Pension-Plan-Acquire.

[130] *Id.*

[131] *See* THE DIVIDED WELFARE STATE *supra* n. 2 at 74 ("Retirement pension can be justified on many grounds: as a means of pulling the elderly out of poverty, as a way to remove older employees from the workplace, as a spur to long and committed service with an employer, or as a mechanism for encouraging long-term savings.")

II. Retirement Insecurity in the Self-Help Welfare State

Retirement security in the US has become significantly tied to the ups and downs of financialized markets. It is in this context that one might best understand why public pension funds have increasingly looked to capitalize on the borrowing habits and misfortunes of the most marginalized borrowers. Beginning with its alignment with the tenets of New Deal Keynesianism, in which government-subsidized social insurance was deployed to "redistribute across risk and income groups in a way that private insurance under competitive conditions could not,"[132] modern retirement security has succumbed to the same privatization and retrenchment that now characterizes other aspects of the social welfare system.[133] Increasingly, individual workers have been required to fend for themselves in their golden years, and both individual retirement savers and more traditional pension funds must now rely on the investment market to meet their significant liabilities. Indeed, the public-private welfare regime has thoroughly shifted retirement security into the hands of private financial markets and strictly financial actors, like private equity firms, whose fiduciary duties and profit-sensitive incentives eschew any broader moral considerations of the source or consequences of their aim to accumulate wealth.[134]

A. A Brief History of Employment Pensions in the U.S.

Pensions originated as tools to incentivize and reward faithful and loyal military service.[135] In 13 B.C., Augustus Caesar first established a systematic pension regime funded by the state in order to "reward and mollify" soldiers who risked life and limb for the benefit of the empire.[136] This system was remarkable for its dedicated use of state funds to accomplish the broader social goal of "ensur[ing] that warriors had a vested interest in the perpetuation of the system and the state that funded it."[137] Since then, state-funded public pensions

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[132] *Id.* at 101.
[133] *Id.* at 163-164
[134] Whoriskey, *supra* n. 24 (quoting the general counsel of a subprime lender as follows: "We operate in a competitive environment on narrow margins, and are driven by that competition to offer exceptional service to our customers. . . . A responsible story on our industry would focus on this reality.").
[135] Robert L. Clark, Lee A. Craig, & Jack W. Wilson, A History of Public Sector Pensions in the United States 1, 24-26 (2003) (describing how the provision of a sum of state funds offered in exchange for completed military service traces its history at least back to Roman practices of rewarding soldiers for faithful service and allegiance to the Empire).
[136] *Id.* at 26.
[137] *Id.* at 26-27; *see also* Vauhini Vara, *The Real Reason for Pensions*, The New Yorker, Dec. 4, 2013, https://www.newyorker.com/business/currency/the-real-reason-for-pensions, ("Emperor Augustus's new pensions were expensive: he paid for them partly out of his own pocket, but also, to the disgruntlement of some subjects, with new taxes.").

have taken various forms to serve varying state and public interests, including to provide for injured soldiers and their families,[138] soldier's widows,[139] and needy or otherwise destitute citizens.[140] In these iterations of pensions, the state largely assumed primary responsibility for the provision of benefits in order "to serve deserving groups…or to provide occupational benefits to government workers," not because they were aged out of the workforce.[141] In other words, they were not focused on retirement.

Modern employment pensions, that is pensions provided by employers to workers upon the latter's retirement, evolved in the mid-to-late 19th century to serve a different purpose; namely to provide "insurance against the loss of earning during retirement."[142] These employment pensions were guided by a work-focused rationale. Specifically, they were meant to encourage "long and committed service" while simultaneously encouraging older workers, deemed to have long passed their employment prime, to vacate their positions and make way for younger and newer employees.[143]

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[138] *E.g.*, Maggie Blackhawk, *Petitioning and the Making of the Administrative State*, 127 YALE L.J. 1538, 1586-87 (2018) (describing the Continental Congress' passage of pension legislation for "soldiers whose injuries during Revolutionary War service left them unable to earn a livelihood" and the First Congress' assumption of those pension payments).

[139] Kristin A. Collins, *"Petitions Without Number": Widows' Petitions and the Early Nineteenth-Century Origins of Public Marriage-Based Entitlements*, 31 L. HIST. REV. 1, 5-8 (2013).

[140] *E.g.*, Clark, Craig, & Wilson, *supra* n. 138 at 2, 6 ("From their earliest days, the American colonies provided pensions to disabled men who were injured fighting colonists who were injured defending the colonists and their property from native uprisings."); *generally* Theda Skocpol, PROTECTING SOLDIERS AND MOTHERS (1992) (describing the deep history of pension provision, particularly to widows and their children, as a form of social provision in the 19th century).

[141] THE DIVIDED WELFARE STATE *supra* n. 2 at 73 & 85 (describing these "governmental" pensions as based in "service to community, church, or country" rather than rooted in the "modern concept" of retirement").

[142] *Id.* at 73, 79, & 92 ("none of the varied initiatives—public employee pensions, veterans' pensions and insurance, mothers' pension—was really public. Social insurance for the aged"); Clark, Craig, & Wilson, *supra* n. 138 at 5; *see also* Ellman & Merrett, *supra* n. 45 at 377–78 ("The medieval or even colonial concepts of a compassionate and generous sovereign rewarding his humble, devoted subjects is completely alien to our modern views of a democratic government's obligations to its citizens."); Ghilarducci, *supra* n. 9 at 53-54. Ghilarducci argues that: "Pensions are better described as insurance contracts and schemes, rather than a simple deferred wage. The former speaks of risk, and the distribution of premiums paid and benefits disbursed; the latter of the individual's optimal tradeoff between consumption now and consumption later." *Id.*

[143] THE DIVIDED WELFARE STATE *supra* n. 2 at 74; Ghilarducci, *supra* n. 9 at 66. Hacker further notes that thwarting unionization was also a "goal" for modern employment pensions, THE DIVIDED WELFARE STATE *supra* n. 2 at 103, while Ghilarducci describes another perspective that views public employment pensions "as patronage and not as rightful compensation," Ghilarducci, *supra* n. 44 at 11. At a theoretical level, Ghilarducci describes three broad normative rationales underpinning employment pension provision, namely: (1) the neoclassical economic view that "see[s] pensions as a convenient intermediary allowing

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Public employment pensions, in which the federal, state, or local government is the employer, first emerged in the mid-19th century when a small number of states and municipalities began to offer disability and retirement benefits to their police and fire department workers.[144] New York City proffered the first such municipal retirement pension plan in 1857 to police officers who were injured while performing their duties.[145] This plan was revised some twenty years later to include a retirement benefit for those police officers who has served on the force for at least 21 years.[146]

Similarly, throughout the end of the 19th century and into the 20th century, increasing numbers of municipalities and states began to extend employment pension benefits to a wider range of government workers, like teachers.[147] By one account: "By 1920, pension coverage in the public sector was relatively widespread, with all federal workers being covered by a pension and an increasing share of state and local employees included in pension plans."[148] Moreover, as described in greater detail below, state and local pension plans "gr[ew] in earnest" following the passage of the Social Security Act in 1935.[149]

Private employment pensions, in which a private entity is the employer, emerged in the late 19th century as "industrialization finally produced old workers with ties to their companies."[150] These early plans were rooted in "welfare capitalism" insofar as they functioned on the "benevolence" of private employers "rather than on labor empowerment or coercive state action."[151] American Express offered the first formal private pension plan in 1875.[152] Subsequently, private pension plans multiplied, and by the onset of the Great Depression in 1929, there were over 400 private pension plans covering almost

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individuals to make choices between consumption now and consumption later"; (2) the Marxist view that sees "pensions as control devices"; and (3) the institutionalist view that embraces a combination of both of the latter, seeing pensions as a form of "industrial feudalism." *Id.* at 3-5.

144 Clark, Craig, & Wilson*, supra* n. 138 at 4. Clark *et al.* clarify, however, that "these early public plans either were disability plans or, if they were retirement plans, were largely funded by the workers themselves." *Id.*

145 Mitchell, McCarthy, Wisniewski, & Zorn, *supra* n. 59 at 12.

146 *Id.*

147 Clark, Craig, & Wilson*, supra* n. 138 at 4-5.

148 *Id.* at 5.; *but see* THE DIVIDED WELFARE STATE *supra* n. 2 at 87 (arguing that "[t]he most striking feature of U.S. social policy before the New deal was the almost complete failure of the broad-based programs for social insurance that were tentatively taking root in other industrializing nations").

149 Mitchell, McCarthy, Wisniewski, & Zorn, *supra* n. 59 at 12.

150 Ghilarducci, *supra* n. 9 at 3-5.

151 THE DIVIDED WELFARE STATE *supra* n. 2 at 85-86.

152 Jacob S. Hacker, THE GREAT RISK SHIFT: THE NEW ECONOMIC INSECURITY AND THE DECLINE OF THE AMERICAN DREAM 116 (2008) (hereinafter THE GREAT RISK SHIFT).

three million workers.[153] Nevertheless, private pensions were relatively uncommon[154] until, perhaps counterintuitively, the nationalization of social provision engendered by the passage of the Social Security Act of 1935 helped spur the proliferation of pension plans more generally.[155]

The Social Security Act (SSA) of 1935 passed in the midst of the Great Depression spawned by the 1929 stock market crash.[156] For the first time, Congress authorized a national program of Old Age Insurance (OAI), rooted in Roosevelt's conviction that "social insurance against the cost of retirement was needed, and that it should be compulsory, contributory, and national in scope."[157] As a cornerstone of the New Deal progressivism,[158] OAI was "financed by mandatory contributions from employers and employees" and "pa[id] to covered earners, on their attainment of age sixty-five, benefits tied to their previous earnings."[159] Recipients were eligible upon retirement as a matter of right, without reference to individual need, unlike previous federal need-based pension provision exemplified by soldiers and mothers pensions.[160] Although conservatives worried that OAI would cause retirement provision to shift too far from the American ethos of self-reliance,[161] the advent of nationalized retirement insurance ultimately had the opposite effect.[162] It

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[153] THE DIVIDED WELFARE STATE *supra* n. 2 at 88; *see also* Ghilarducci, *supra* n. 9 at 23 (noting that most of those covered by private pensions in this period "were elite members of the work forces of large paternalistic firms"); THE GREAT RISK SHIFT, *supra* n. 155 at 116 (noting that "[a]lthough formal plans grew in number in the early twentieth century, most salaried and wage workers were still on their own when it came to retirement").

[154] THE DIVIDED WELFARE STATE *supra* n. 2 at 95 (noting the "inadequacy" of private pensions before the New Deal). Hacker explains that: "Behind the celebratory rhetoric of welfare capitalism, however, the reach of private pensions was exceedingly limited and uneven, and federal encouragement and regulation of private pensions was as minimal as was government support for all other forms of social protection during this period." *Id.*

[155] Ghilarducci, *supra* n. 9 at 20.

[156] *E.g.*, Karen M. Tani, STATES OF DEPENDENCE: WELFARE, RIGHTS, AND AMERICAN GOVERNANCE, 1937-1972 60 (2016); THE DIVIDED WELFARE STATE *supra* n. 2 at 96 (observing that "the economic needs of the 1930s made the sheer insufficiency of private pensions grossly manifest").

[157] THE DIVIDED WELFARE STATE *supra* n. 2 at 106; *id.* at 95 (observing that SSA "did what welfare capitalism could not: provide broad retirement protection"); *see also* Tani, *supra* n. 159 at 60-61; *see also id.* at 9 (2016) (noting that in addition to Old Age Insurance, the SSA also established need-based income support).

[158] *See, e.g.*, THE DIVIDED WELFARE STATE *supra* n. 2 at 108 (describing SSA as "unquestionable the single most important enactment in the history of U.S. social policy").

[159] Tani, *supra* n. 159 at 60-61.

[160] *Id.*

[161] *See, e.g.*, Eric Laursen, THE PEOPLE'S PENSION: THE STRUGGLE TO DEFEND SOCIAL SECURITY SINCE REAGAN 13 (2012) (noting that conservative politicians opposed the passage of the SSA for these reasons); THE DIVIDED WELFARE STATE *supra* n. 2 at 98 (observing that "business support [for OAI] was extremely limited).

[162] THE GREAT RISK SHIFT, *supra* n. 155 at 116-117.

encouraged the growth of employer-sponsored pensions, which, in the spirit of American self-reliance, linked benefits to work,[163] and, in some cases, even "buil[t] their plans on top of Social Security."[164]

In that regard, employment pensions, both public and private alike, proliferated in the years following World War II.[165] With respect to private pensions, a combination of forces, including the relative "stagnation" and lack of meaningful expansion of OAI in the 1940s, OAI-inspired political motivation "to expand private plans as a temporary substitute for public programs," pension-based tax advantages for employers, and increased demand by high-income workers for whom OAI was less advantageous prompted the "rapid growth" of private pensions between 1935 and 1950.[166] With respect to public pensions, the SSA initially excluded state and local government employees from coverage.[167] Nevertheless, public employment pensions similarly flourished in the years following the passage of the SSA.[168] Half of the largest public pension plans were established between 1931 and 1950, many forming themselves in the image of OAI insofar as they tethered benefits solely to years of service and age at retirement.[169]

In sum, employment pensions developed as mainstays of the American social provision system halfway through the 19th century. Beginning with welfare capitalism in the private sector, and state and municipal moves to provide retirement benefits to certain of their civil servants in the public sector, employment pensions have grown into an important and enduring pillar of the tri-partite public/private structure of American retirement social provision: namely, "Social Security, employer-sponsored pension plans, and personal savings."[170] Importantly, however, as they were developed in the shadow of Social Security, many public pensions function as an alternative to Social Security, leaving public employees to rely largely on public pensions for retirement security.[171]

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[163] THE DIVIDED WELFARE STATE *supra* n. 2 at 98; *id.* at 106 (noting Roosevelt's political strategy expressly included the link between employee contributions and benefits, which gave "'contributors a legal, moral, and political right to collect their pensions and employment benefits'").
[164] THE GREAT RISK SHIFT, *supra* n. 155 at 117.
[165] THE DIVIDED WELFARE STATE *supra* n. 2 at 112.
[166] *Id.* at 112-113.
[167] Mitchell, McCarthy, Wisniewski, & Zorn, *supra* n. 59 at 13.
[168] *Id.* at 12-13.
[169] *Id.* at 13.
[170] Laursen, *supra* n. 152 at 19.
[171] THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 8 (observing that "millions of public sector worker—40 percent of them—are not entitled to participate in Social Security" because of their public pensions); see *also*, Anenson, Slabaugh, & Lahey, *supra* n. 31 at 31 ("In the thirteen states where pensions are a substitute for federal Social Security benefits, we believe that [pension reform is] even more likely to be barred as a constitutional

B. The Shifting the Risk of Retirement Security

Retirement security is risky business. There is risk of insufficient funding given that accounting for a comfortable retirement can be an exercise in tea-leaf reading.[172] There are a multitude of unpredictable factors that must be considered like morbidity, mortality, and number of dependents, whose occurrence, magnitude, and cost only time can actually reveal.[173] Even when their occurrence, magnitude, and cost could be adequately predicted, funding those needs involves significant expense.[174]

Initially by design, these risks were borne largely by employers, both private and public, who developed "defined benefit" programs for which they largely assumed the responsibility to fund and which purported to ensure retirement income.[175] Over time, however, the ideal of a pension fund as a meaningful and reliable aspect of retirement security, whose risk was rightly borne largely by employers, has worn away. In its place has come a retirement security regime in which, by design, private employees increasingly bear the risk of realizing a fully-funded retirement and in which, at least indirectly as a result of political choices, public employees can no longer trust that they will see the retirement compensation promised by their public employers.[176]

1. Shifting Retirement Risk from Employers to Employees

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harm because public pension benefits are the one and only retirement payment from any government in these states.").

[172] *See* THE DIVIDED WELFARE STATE *supra* n. 2 at 113 (observing that retirement forecasting "involves a relatively complex set of calculations").

[173] *See* Goldman & Sterk, *supra* n. 13 at 112 ("A plan's funding ratio incorporates a variety of contestable actuarial assumptions: at what age and at what salary will beneficiaries retire, how long will they live, and what investment returns will the pension fund generate."); Ghilarducci, *supra* n. 9 at 72 ("the employer's cost of promising one dollar of a defined benefit promise is a function of various factors [including] length of job tenure, salary profiles, morbidity, and mortality").

[174] Sterk, *supra* n. 58 at 458-464 (describing various risks associated with retirement pensions including investment risk, funding risk, and longevity risk).

[175] Ghilarducci, *supra* n. 9 at 53-54; THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 90.

[176] *E.g.*, Adam Hayes, *The Social Meaning of Financial Wealth: Relational Accounting in the Context of 401(k) Retirement Accounts*, 5 FIN. & SOC. 61, 63 (2019) (observing that "changes in how Americans save for retirement since the 1980s – in particular, the shift from guaranteed pensions to individual retirement accounts – have fashioned a generation of self-responsible retirement savers" and that as a consequence, "individuals have nobody to blame but themselves for accumulating too small a nest egg").

Traditionally, many public and private employment pensions were structured as "defined benefit" programs.[177] Defined benefit programs entitle workers to a fixed amount as calculated by factors such as time of employment, salary history, and age at retirement.[178] Employer and employee contributions are put into a trust—the pension fund—from which, upon the worker's retirement, the employer must pay the agreed-upon fixed benefit over a period of time.[179] Consequently, employers administering a defined benefit pension plan bear the risk that the pension fund assets will be insufficient to meet the liabilities of the participants.[180] As summarized by one commentator:

> [T]raditional defined benefit pensions have four major characteristics as a matter of plan design. First, they provide income on a deferred basis at retirement and not before then. Second, [they] provide such retirement income as periodic, annuity-type payments rather than as single lump sums. Third, [they] are funded collectively, the employer's contributions being pooled in a common trust fund from which all participants receive their benefits. Finally, [they] place[] on the employer rather than the employee the obligation to fund the benefit promised to the participating employee. If the funds in the trust are inadequate to pay promised benefits, the employer is obligated to make up the shortfall.[181]

The risk of insufficient funding was quite significant for both public and private pensions.[182] Yet is was in the private pension context that pension reform came to the fore. In 1963, the Studebaker-Packard company became the "poster child" for the significant consequences of institutional pension fund failure when its automobile plant in South Bend, Indiana shutdown under the weight

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[177] THE DIVIDED WELFARE STATE *supra* n. 2 at 153.

[178] Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 455 (2004) ("for example, a prototypical defined benefit formula specifies that a participant is entitled at retirement to an annual income equal to a percentage of her average salary times the number of years of her employment with the sponsoring employer").

[179] *Id.* at 455-456.

[180] THE GREAT RISK SHIFT, *supra* n. 155 at 115 (noting that defined benefit plans overall shift the risk of uncertainty onto employers); James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683, 685 (2001) (noting that with respect to defined benefit plan pensions, "[o]ne source of risk was underfunding" and that "[United Auto Worker] retirement plans almost never had enough assets to pay all of their pension obligations").

[181] Zelinsky, *supra* n. 181 at 456.

[182] Wooten, *supra* n. 183 at 698 ("Virtually all defined-benefit pension plans came into being with benefit obligations that far outstripped the assets set aside to pay those obligations.").

of prohibitively high labor costs.[183] Importantly, Studebaker-Packard promptly defaulted on millions of dollars in pension obligations.[184]

Congress subsequently intervened in private pension provision by formally studying the problem and then passing[185] the Employee Retirement Income Security Act of 1974 (ERISA).[186] ERISA was intended to transfer the risk of insufficient funding directly onto employers by mandating that employers meet certain funding and disclosure requirements.[187] It imposed a duty of prudent and loyal investment onto private pension fund managers to manage the fund "in the sole interest of the pension plan participants."[188] Moreover, to provide a buffer against the kinds of massive losses the Studebaker-Packard plant workers experienced, ERISA established the Pension Benefit Guaranty Corporation to provide insurance to workers for pension promises.[189]

ERISA was a bit of an anachronism from its moment of birth. By 1974, private employment pensions were evolving from the then-familiar model of a defined benefit program that promised a fixed sum and that bore the burden of adequate funding and moving toward a more individualized conception of retirement security and its inherent risks.[190] As explained by Jacob Hacker: "the vision at the core of ERISA looked to the past, to the union-negotiated plans that had arisen in the 1940s and 1950s, even as the private pension system was rapidly moving away from this traditional organization."[191] Instead, by the time ERISA passed in 1974, amidst the widespread economic discord of the 1970's economy, the steady decline of the long-term employee, and the onset of significant changes to the Tax Code, emboldened private employers began to move away from the burdens of defined benefit programs and instead began to embrace defined contribution pension plans.[192]

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183 *Id.*
184 *Id.* (noting that "the liability of the Studebaker pension plan exceeded its assets by $15M," which in today's dollars is approximately $126M).
185 *Id.*
186 *Id.* at 739; *see also* THE DIVIDED WELFARE STATE *supra* n. 2 at 125 (describing ERISA as "at once a challenge to the autonomous operation of private plans and an affirmation of their central place in the American welfare regime").
187 Forman, *supra* n. 13 at 1218–19 ("ERISA protects the pension benefits of most private-sector workers through sweeping participation, coverage, vesting, benefit accrual, funding, and reporting rules."); Ghilarducci, *supra* n. 9 at 89-90.
188 *Id.* at 89-90; *also* Webber, *supra* n. 10 at 2122 ("ERISA codifies the traditional fiduciary duties of trust law, including the duties of loyalty and prudence.").
189 Ghilarducci, *supra* n. 9 at 89-90; THE GREAT RISK SHIFT, *supra* n. 155 at 111 (noting that "historically, nine out of ten workers get full benefits when their plans are taken over by the Pension Benefit guaranty Corporation").
190 *See* THE DIVIDED WELFARE STATE *supra* n. 2 at 125.
191 *Id.*
192 *Id.* at 153-156.

Unlike defined benefit plans, defined contribution plans impose a much smaller burden and very limited risk on employers.[193] Rather, the employer is obliged merely to contribute a fixed amount periodically to an employee's retirement account, often defined "as a percentage of the participant's salary for that year."[194] Once that contribution is made, the employer bears no further obligation to secure the retirement prospects of their employee.[195] Instead, it is the employee who bears the full weight of ensuring that the retirement savings will be sufficient upon retirement.[196] To that end, unlike in defined benefit programs in which the employer is responsible for managing the pension fund, "defined contribution plans commonly feature participant-directed accounts," which is to say that employees are directly responsible for maximizing investment to account for their financial needs during retirement.[197] Thus, as explained by Edward Zelinsky:

> Since the employee's entitlement under the plan is the balance of her individual account, good investment performance redounds to the employee's benefit (because her account balance is larger), while, symmetrically, poor investment performance hurts the employee (because her account balance is smaller and the employer has no obligation to fund a defined benefit).[198]

Perhaps, the most well-known defined contribution retirement plan is the 401(k) program.[199] Authorized by an amendment to the Tax Code in 1978,[200] 401(k) savings accounts most exemplify the rapid rise of defined contributions

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[193] Zelinsky, *supra* n. 181 at 455; *also* James J. Choi, David Laibson, & Brigitte C. Madrian, *Plan Design and 401(k) Savings Outcomes*, 57 NAT'L TAX J. 275 (2004) (noting that "defined contribution pension plans place the burden of ensuring adequate retirement savings squarely on the backs of individual employees" but also that "employers make many decisions about the design of 401(k) plans that can either facilitate or hinder their employees' retirement savings prospects").

[194] Zelinsky, *supra* n. 181 at 455 ("Having made that contribution, the employer's obligation to fund is over because the employee is not guaranteed a particular benefit, just a specified input.")

[195] *Id.*

[196] *Id.* ("In a defined contribution context, the participant's ultimate economic entitlement is the amount to which the defined contributions for her, plus earnings, grow or shrink.")

[197] Ghilarducci, *supra* n. 9 at 163; *also* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 942 (2013) (observing that in the context of defined contribution plans, "[t]he amount of funds available for retirement depends on investment success").

[198] Zelinsky, *supra* n. 181 at 457.

[199] *Id.*

[200] Revenue Act of 1978, 26 U.S.C. 201(k) (2020).

as the model private retirement security program.[201] Initially passed to address the problem of "elective salary reductions arrangements" that decreased tax liabilities for certain profit-sharing employer/employee relationships, 401(k) inadvertently spawned a new means of deferred compensation as retirement savings.[202] Under section 401(k), employees are authorized to redirect a percentage of untaxed earnings into an employer-sponsored account, in which the employer would also frequently match any amount that the employee redirects.[203] With the support of the incoming Reagan administration, 401(k) retirement accounts "burgeoned," and by the 1990s "rose from obscurity to become one of the most celebrated vehicles of private retirement savings."[204]

Importantly, 401(k) retirement plans give individual workers control over the management of accumulated funds in ways that traditional defined benefit pension plans restrict.[205] For example, up to a certain limit, workers are generally free to elect the amount of wages to be redirected to the accounts. When the worker leaves the employ of the account sponsor, they can take any accumulated amount as a lump-sum distribution or else roll it over into another similar retirement savings vehicle. Moreover, workers may borrow against those funds for certain sanctioned purchases, like home down payments.

While this greater control has been lauded as giving individual workers greater autonomy over their retirement futures,[206] the financial outcomes have generally been unfavorable for workers, particularly those with relatively lower incomes.[207] One important reason is that "many employees do not make optimal

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[201] Zelinsky, *supra* n. 181 at 457.
[202] *Id*. at 483-484; THE DIVIDED WELFARE STATE *supra* n. 2 at 165 (observing that "Section 401(k) passed completely beneath the radar screen of public debate," and that "no one in Congress recognized how significant it would become").
[203] Zelinsky, *supra* n. 181 at 484.
[204] THE DIVIDED WELFARE STATE *supra* n. 2 at 165.
[205] Adam Hayes, *supra* n. 179 at 68 (noting that "401(k) allocations are strictly self-selected by employees without any input or nudging from their employer; people choose their own portfolios").
[206] *E.g.*, Zelinsky, *supra* n. 181 at 485 (noting that "the financial services industry…has emphasized the investment autonomy of the individual 401(k) participant and IRA holder").
[207] Teresa Ghilarducci & Amanda Novello, *The Labor Consequences of Financializing Pensions* in Kevin Skerret, Johanna Westar, Simon Archer, & Chris Roberts, THE CONTRADICTIONS OF PENSION FUND CAPITALISM 47 (2017). Ghilarducci and Novello argue that: "The current system of 401(k)s generates low returns for most people after the regressive tax benefit, high fee, and risk adjustment made for undiversified liquid portfolios are taken into account. Because individuals in the bottom 60% or so of households (by income) get little tax relief as a result of their low marginal tax rate, the retirement accounts for these households can easily earn negative real returns after deductions for fees are taken into account." *Id. See also* David H. Webber, *The Other Janus and the Future of Labor's Capital*, 72 VAND. L. REV. 2087, 2096 (2019) (observing that "the greatest threat to labor's capital and labor's shareholder activism is the 401(k)").

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financial decisions,"[208] including regularly exhibiting a short-term bias in decision-making.[209] Consequently, greater autonomy in decision-making must be offset against the features of defined benefit plans, such as restriction of individual choice-making, that make them a better vehicle for long-term savings.[210]

In sum, defined contribution plans like 401(k) accounts, epitomize "an individualized conception of retirement savings," that aligned well with Reagan-Era, neoliberal thinking that prized and prioritized "private property and individual autonomy."[211] In this regard, the evolution of private pension funding from defined benefit to defined contribution reflects what Jacob Hacker has termed the "Personal Responsibility Crusade" that has characterized the "political drive to shift a growing amount of economic risk from government and the corporate sector onto ordinary Americans in the name of enhanced individual responsibility and control."[212] Exemplified in other contemporaneous welfare retrenchment reforms like the replacement of AFDC with TANF and work limits on the receipt of public assistance,[213] this move to self-help social provision in the employment pension space has left workers with tremendous responsibility and tremendous risk in managing what, if any, retirement savings they accumulate in the defined contribution pension world.[214]

2. Public Pensions and Risk

Public employees have not been immune from this shift into self-help retirement security. Rather, they too are succumbing under the weight of their obligations, shifting to incorporate defined contribution aspects into their traditional defined benefit regimes. Several public pension plans have begun to transform into hybrid programs that offer newer employees a combination of

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[208] James J. Choi, David Laibson, & Brigitte C. Madrian, *Are Empowerment and Education Enough? Underdiversification in 401(k) Plans*, 2005 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 151, 153 (2005).

[209] THE GREAT RISK SHIFT, *supra* n. 155 at 115.

[210] THE DIVIDED WELFARE STATE *supra* n. 2 at 115.

[211] Zelinsky, *supra* n. 181 at 469; THE DIVIDED WELFARE STATE *supra* n. 2 at 163.

[212] THE GREAT RISK SHIFT, *supra* n. 155 at 8.

[213] *See, e.g.*, Atkinson *Rethinking*, *supra* n. 4 at _ 1140-1144 (describing the general climate of welfare retrenchment under the Reagan, Bush, and Clinton administrations).

[214] *E.g.*, Zelinsky, *supra* n. 181 at 485 ("One way of describing the services provided to 401(k) plans and their participants is that these services are the diseconomies of scale that result from decentralized investing, the diseconomies avoided under the defined benefit format with its centralized investment of a common pool of capital."); Gelter, *supra* n. 200 at 942 ("with a [defined contribution] plan, potential retirees bear the investment risk because the employer does not have to jump in if the plan assets do not suffice to meet pension obligations").

the more secure defined benefit plans that fully covers their senior colleagues and a defined contribution component which public employees must manage.[215]

For example, in the wake of a funding crisis, the Board of Regents of the University of California (UC) approved a hybrid pension system that applied to all employees hired after 2016. The new plan limited future UC employees to one of two options.[216] They could select a hybrid retirement plan that included a defined benefit plan with an income salary limit (as determined by the California Public Employees' Pension Reform Act of 2013) combined with a "401k-style"[217] supplemental defined contribution benefit subject to IRS salary limits.[218] Alternatively, the employee could select a "pure defined contribution approach" which functions as "stand-alone defined contribution (DC) plan with benefits-eligible employee pay up to the Internal Revenue Code limit."[219]

The UC's pension reform is evidence that the driving motivation for the shift to hybrid public pension plans has been to "keep costs in check" in light of the increasing financial precarity of state and municipal budgets relative to their significant pension liabilities.[220] The UC's move to a hybrid pension plan grew out of tense budget negotiations between then-UC President Janet Napolitano and then-Governor Jerry Brown in 2015. Resistant to raising tuition to make up the shortfall, Brown agreed to a $436 million infusion to help the ailing UC system's pension burdens in exchange for UC's agreement to reform its pension system to help rein in its costs.[221] Thus, even public employment

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[215] Jean-Pierre Aubry and Kevin Wandrei, *Have Localities Shifted Away From Traditional Defined Benefit Plans?*, CENTER FOR RETIREMENT RESEARCH, Apr. 2020, https://crr.bc.edu/wp-content/uploads/2020/04/SLP70.pdf, (noting the "the shift away from standalone [defined benefit] plans at the state level"); Brief, *Hybrid Public Pensions Plans*, Pew Charitable Trusts, Apr. 2015, https://www.pewtrusts.org/~/media/assets/2015/04/hybrid-public-pension-plans_brief.pdf?la=en; Caroline Cournoyer, *Hybrid Pension Plans Attracting More States, Cities*, GOVERNING, Aug. 2012, https://www.governing.com/gov-hybrid-pension-plans-attracting-more-states-cities.html, (same).

[216] *Task force submits recommendations on new retirement benefits for future UC employees; final decisions expected from UC Regents in March following input from UC community*, UCNET, Jan. 15, 2016, https://ucnet.universityofcalifornia.edu/news/2016/01/task-force-submits-recommendations-on-new-retirement-benefits-for-future-uc-employees-final-decisions-expected-from-uc-regents-in-march-following-input-from-uc-community.html.

[217] R. Stickney, *Napolitano Proposes UC Pension Changes*, NBC, Mar. 11, 2016, https://www.nbcsandiego.com/news/california/uc-system-pension-proposed-changes-napolitano/123623/.

[218] *Id.*

[219] *Id.*

[220] *Id.*; Paul M. Secunda, *Litigating for the Future of Public Pensions*, 2014 MICH. ST. L. REV. 1353, 1363 (2014) ("the significant underfunding of pensions has had a major impact on state and local finances.").

[221] *E.g.*, Jennifer Medina*, In California Budget Plan, Brown Wins Deal on Tuition Freeze for In-State Students*, NY TIMES, May 14, 2015, https://www.nytimes.com/2015/05/15/us/in-california-budget-plan-brown-wins-deal-on-tuition-freeze-for-in-state-students.html.

pensions have succumbed to the allure of reduced risk and responsibility engendered by defined contribution pensions, increasingly leaving their employees with primary responsibility for retirement security.[222]

Private pension evolution has also circumscribed how public pensions may approach their ostensible mandate to provide for the retirement security of ordinary government workers. Although exempted from ERISA, many public pension funds rely on ERISA's management standards as a guide in administering their own plans.[223] Consequently, ERISA has had a significant effect on the development of public pensions, where it "operates as a type of shadow law, governing the funds' conduct even though it is both inapplicable and unenforceable against them."[224] Specifically, many state legislatures have chosen to incorporate ERISA's fiduciary duties into their own state-law-based regimes that govern their public pensions.[225] As a consequence: "the shared language governing public pension funds in states whose fiduciary duties mirror ERISA's makes [Department of Labor] or federal court interpretations persuasive, if not binding, and some state courts look to ERISA and federal cases construing fiduciary duties when there is a dearth of state case law on the subject.[226]

Yet, as Professor David Webber has argued, ERISA's duty of loyalty, as interpreted by its implementing agency, the U.S. Department of Labor (DOL), "is a particularly bad fit for public pension plans" because it "elevat[es] the interests of outside investment managers above fund participants and beneficiaries."[227] ERISA's "exclusive purpose rule," codified in Sections 403 and 404,[228] incorporates "the traditional fiduciary duties of trust law, including the duties of loyalty and prudence."[229] Official DOL interpretations of the exclusive purpose rule permits plan fiduciaries to prioritize fund performance even when this "fund first" approach diverges from the economic interests of plan

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[222] Caroline Cournoyer, *Hybrid Pension Plans Attracting More States, Cities*, GOVERNING, Aug. 2012, https://www.governing.com/gov-hybrid-pension-plans-attracting-more-states-cities.html, (noting that "[defined contribution] accounts may have the same pitfalls as 401(k) plans have had in the private sector" leaving individual employees "to navigate the perils of the investing world on their own and could end up retiring in a down market, losing a big chunk of their nest egg"); *see also* THE GREAT RISK SHIFT, *supra* n. 155 at 123 (arguing this shift also allocates blame to the employee when they fail to meet their retirement goals).

[223] 29 U.S.C. § 1003(b)(1) (2012); Ellman & Merrett, *supra* n. 45 at 373 (observing that "[n]either ERISA nor the PBGC have any role in the creation, administration, modification, enforcement, or termination of public pension plans").

[224] Webber, *supra* n. 11 at 2121.

[225] *Id.* at 2120-21.

[226] *Id.*

[227] *Id.*

[228] *See* 29 U.S.C. § 1103(c)(1) (2012) (duty of loyalty); 29 U.S.C. § 1104(a)(1)(B) (2012) (duty of prudence).

[229] Webber, *supra* n. 11 at 2122.

participants and beneficiaries.[230] For example, the "fund first" approach would permit a public pension fund to select investments in order to "undermine participant employment" as long as those investments were "are of equal economic value to a plan."[231]

For example, Webber describes the choice of the Florida Retirement System (FRS), which represents Florida's public-school teachers, to invest in a private company, EdisonLearning, Inc., that contracted to run public schools and which "attracted favorable recognition from those sympathetic to the school choice movement and for-profit education, including elected officials."[232] The state's public school teachers opposed Edison, challenging "its claims about improving test scores and assert[ing] that its business model relied on pushing out experienced teachers in favor of newer, lower-cost teachers while shifting other costs to the public sector."[233] The teachers also opposed the reelection of then-governor, Jeb Bush, who supported "privatization of public schools, promotion of school vouchers, and criticism of teachers unions," and who served "as [a] trustee on the Florida State Board of Administration, which directs investment for the [FRS]."[234]

Upon Bush's reelection, Liberty Partners, a private equity firm whose only client at the time was FRS, invested FRS's money in Edison, buying the company.[235] Edison was in direct competition with Florida's public-school teachers, and as reported by a consulting firm that FRS hired to conduct a review of Liberty Partners, "Liberty [was] responsible for 'negative' investment-picking skills, lack of diversification in its investment portfolio, sloppy record keeping and overcharging the pension fund to the tune of at least $88 million since inception in 1993."[236] Yet as Webber explains:

> Under DOL's investments of equal value rule, Bush and the State Board of Administration could have directed the Florida Retirement

[230] *Id.* at 2122-2125 (describing two DOL Interpretive Bulletins issued in 1994 and 2008).
[231] *Id.* at 2144-44.
[232] *Id.*; *see also For-Profit School Management Corporations: Serving the Wrong Master*, 31 J.L. & EDUC. 129, 139 (2002) ("Edison Schools, Inc. and its associated Edison Project are the creations of media entrepreneur Christopher Whittle, who legitimized the project by enlisting the former President of Yale University, Benno Schmidt, Jr., to head his education team.").
[233] Webber, *supra* n. 11 at 2145.
[234] *Id.* at 2145-46.
[235] *Id.*; *see also*, Vineeta Anand, Consultant *Gives Failing Grade to Florida's Private Equity Manager*, PENSIONS & INVESTMENTS, Nov. 10, 2003, https://www.pionline.com/article/20031110/PRINT/311100721/consultant-gives-failing-grade-to-florida-s-private-equity-manager, ("The American Federation of Teachers, the AFL-CIO, the Florida Education Board, the Service Employees International Union, and the American Federation of State, County and Municipal Employees all vehemently oppose[d] the proposed investment of the pension fund's assets in Edison.").
[236] *Id.*

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> System to purchase Edison Schools because it undermined participant employment and economic interests, so long as [the State Board of Administration] could show that the risk/return, liquidity, and diversification properties for the Florida retirement fund itself alone were equal to other potential investments. Whether the Edison investment might have been chosen for this reason is difficult to say, but the example points to the possibility that it could have been chosen for this reason, illustrating the problem.[237]

In other words, post-ERISA the public pension funds' fiduciary duty could validly encompass investment behavior that would undermine the overall welfare of the public employees it is supposed to protect. This is because what matters most is the fund's ability to make money, regardless of how that project of making money affects the employees' interests.

C. Delegating Retirement Security to Financialized Markets

The main challenge for both aggregated and individualized retirement security is persistently inadequate funding, making investment returns crucial.[238] A pension plan is sufficiently funded "if the plan has sufficient assets to meet its emerging benefit obligations in a timely fashion, given reasonable assumptions about future contributions and investment income."[239] In light of this threshold, the very real dilemma of underfunding is perhaps most clear with respect to public pension funds, where, for example, a recent report observes that "on average, state pensions are only 71 percent funded – amounting to more than $1 trillion dollars in debt."[240] Moreover, for public pensions, this massive shortfall has broader implications since "the significant underfunding of pensions has had a major impact on state and local finances."[241] Put simply, taxpayers are liable for pension promises on the occasion that the pension fund

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[237] Webber, *supra* n. 11 at 2146.
[238] Estes & Kremling, *supra* n. 32 at 76 (noting the "increasing focus on funding the rapidly growing deficit in public pension plans and on how to address the problem").
[239] Forman, *supra* n. 13 at 1231.
[240] Pew Charitable Trusts, *States are Struggling to Fund Pensions—Here's Why*, Aug. 5, 2019, https://www.pewtrusts.org/en/research-and-analysis/video/2019/states-are-struggling-to-fund-pensions-heres-why, (further observing that "[t]he bill for this debt has crowded out public spending on schools, roads, and public safety."); Beerman, *supra* n. 11 at 4 (observing that "many state and local governments are sitting on a fiscal time bomb—underfunded public employee pension and health care liabilities"); *but see*, Estes & Kremling, *supra* n. 32 at 76 (observing that "[t]here are wide discrepancies in these estimates depending on the actuarial assumptions on life span, benefits, rate of return and retirement ages" and speculating that "the total deficit in all states' pension funds at present range between $3.2 trillion and $6 trillion.").
[241] Secunda, *supra* n. 216 at 1363.

fails to meet its obligations.[242] Moreover, the task of raising taxes or drumming up other public revenue to meet this obligation "creates an increasingly bitter political pill for legislators."[243]

Consequently, pension funds have begun to diversify their investment strategies in an attempt to increase their actual rates of return,[244] and, in so doing, they are turning to equity investments in the hopes of higher yield.[245] For example, one study notes that 75% of pension fund assets "are held in what are often called risky assets—stocks and alternative investments including private equities, hedge funds, real estate, and commodities."[246] Meanwhile, although 401(k) funds have regularly invested in "mutual funds, bank collective investment trusts, and insurance company pooled accounts with portfolios focused on publicly traded stocks and bonds," the Trump Administration's recently proffered an Information Letter sanctions the investment of 401(k) funds in private equity funds.[247] This endorsement is likely to open the floodgates of private equity investment there as well.[248]

Equity investment in debt-centered industries itself is increasingly among the alternative investments that have captured the eyes of the financial

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242 Ellman & Merrett, *supra* n. 45 at 375 ("When a municipal government promises a future payment to a worker, it creates a financial liability for its taxpayers.").
243 Estes & Kremling, *supra* n. 32 at 77.
244 *E.g.*, *How Do Public Pension Funds Invest?: From Local to Global Assets*, State Street Global Advisors, April 2018, https://www.ssga.com/investment-topics/asset-allocation/2018/inst-how-do-ppfs-invest.pdf, (studying asset allocation data between 2008 and 2016, and observing that "in response to unconventional monetary policy after 2008, [public pension funds] universally undertook a definitive shift into higher risk assets, particularly away from fixed income," and into "equity and alternative allocations").
245 *Pew Report*, *supra* n. 8 at 1.
246 *Id.*
247 U.S. Department of Labor, Information Letter, Jun. 30, 2020. https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/information-letters/06-03-2020.pdf. Dep't of Labor Letter 6-30-20, https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/information-letters/06-03-2020.pdf. In this Information Letter, the Department of Labor has endorsed the "use of private equity investments in designated investment alternatives" for participants in individualized retirement accounts, like 401(k) plans, that require individual workers to secure their own retirement security away from the benefits of aggregation enjoyed by workers enrolled in public and private pension programs.
248 *See, e.g.*, David Kudla, *Private Equity in 401(k)s: Is it Right For You?*, FORBES, Jun. 26, 2020, https://www.forbes.com/sites/davidkudla/2020/06/26/private-equity-in-401ks-is-it-right-for-you/#37db09e5178a, (noting that with respect to 401(k) investment in private equity, "now employees have to be cognizant of these inherent risks [of private equity investment] now that the option is available in their 401(k)."); *also* Brent Arends, Private-Equity Crowd Wants Your 401(K) Money: 'Yikes!', MARKETWATCH, Jul. 24, 2020, https://www.marketwatch.com/story/yikes-the-private-equity-crowd-wants-your-401k-money-2020-06-11, (noting that private equity firms stand to make $180 billion in profits a year from 401(k) funds).

intermediaries tasked with managing the vast wealth of public pension funds. For example, the California Public Employees' Retirement System (CalPERS), the nation's largest public pension fund, decided to invest in the banking business in the summer of 2020.[249] When one imagines a bank, however, the image of a pension fund usually does not come to mind. Yet, by one account, CalPERS was in a "desperate" position relative to its underfunded pension obligations.[250] It faces "hundreds of billions in unfunded future pension debt, persistently basement-scraping interest rates and now a pandemic-ravaged economy."[251] Indeed, tasked with earning 58 cents of every dollar promised to California's "[r]etired DMV clerks, former firefighters and aging government bean-counters" from the investment market,[252] the ailing CalPERS needed a new source of returns to help meet its liabilities.[253] Consequently, in Spring 2020, CalPERS' Board of Administration approved a new investment strategy that authorizes the deeply underfunded pension giant to invest in "risky ventures" like direct lending.[254] Thus, like other big public pension funds, CalPERS decided to "wad[e] into the rollicking market for private debt"[255] in its search for higher returns. In this regard, CalPERS is representative of the consequences of ever-expanding privatization and financialization of American retirement security.[256] More specifically, CalPERS' choice to invest in banking reveals the deep significance of debt in the broader search for wealth accumulation in the American public-private welfare regime.[257]

In sum, retirement security has now come to depend heavily on successful investment in financial markets as the primary source of accumulation, as opposed to retirement security that is accomplished "collectively by the state."[258] Consequently, "financialized accumulation" now

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[249] Christopher, *supra* n. 10.
[250] *Id.*
[251] *Id.*
[252] CalPERS Video), *supra* n. 13 ("If you were to break down each dollar we pay in pension benefits it looks like this: 13 cents comes from CalPERS members, 29 cents comes CalPERS employers, and 58 cents comes from what we earn on the money we invest.").
[253] Christopher, *supra* n. 10.
[254] *Id.* (noting that CalPERS manages $400 billion in pension assets).
[255] *Id.* (reporting that CalPERS's deputy chief investment officer statement that, "We need every arrow in the quiver we can get, and private debt is one of the critical ones," and that for CalPERS, "[t]here isn't a no-risk choice.").
[256] THE DIVIDED WELFARE STATE, *supra* n. 2.
[257] Political scientist Jacob Hacker defines the public-private welfare regime as a combination of: (1) "direct pension social programs" like Social Security, (2) "the constellation of more indirect or 'hidden' government interventions," like tax breaks and government subsidies, "that are designed to provide similar social benefits or shape their private provision," and (3) "publicly-regulated and subsidized private benefits." THE DIVIDED WELFARE STATE *supra* n. 2 at 11-12.
[258] Skerret, Westar, Archer, & Roberts, *supra* n. 210 at 3; *see also* News Release, *U.S. Department of Labor Issues Information Letter on Private Equity Investments*, Employee Benefits Security

rests at the heart of successful retirement provision, firmly tethering retirement security to the fluctuations of private financial markets.[259] This shift is true at both ends of the spectrum; both traditional defined-benefit pension funds and individuals going it alone with a singular 401(k) account have little option but to invest their money in riskier financial markets in order to accumulate enough to meet their obligations.[260]

III. COMMODIFYING MARGINALIZATION

Because marginalized debt is a valuable asset, so too are the set of unfavorable socioeconomic conditions that steadily produce marginalized borrowers who must make use of this debt both for survival and opportunity.[261] Consequently, to the extent that private equity funds and their public pension partners (among other institutional investors) value marginalized debt as a source of wealth extraction, they have an implicit vested interest in the continued socio-economic subordination that maintains a steady supply of marginalized borrowers who have no option but to pay more to borrow. Indeed, marginalized "debt-power"—namely, the generative capacity of marginalized borrowing— is a valuable commodity from which pension funds and other institutional investors may extract wealth. This phenomenon reveals the familiar yet perverse value of marginalization and, more generally, how institutions continue to commodify and trade on the subordinate status of marginalized communities.[262]

Administration, Jun. 3, 2020, https://www.dol.gov/newsroom/releases/ebsa/ebsa20200603-0, ("Private equity investments have long been part of the investment portfolios used by defined benefit plans to fund retirement benefits for many American workers, but they generally have not been incorporated into investment funds used by defined contribution plans, such as 401(k) plans."). More generally, the rise of financialization— "a pattern of accumulation in which profits accrue through financial channels rather than through trade and commodity production"— in the U.S. (and indeed in the global economy more generally) has added another significant layer to the growing precarity of workers' retirement wellbeing in the public/private welfare state. Krippner, Greta R. Krippner, *The Financialization of the American Economy*, 3 SOCIOECONOMIC REV. 173 (2005).

[259] Dick Bryan & Mike Rafferty, *The Financial Responsibilities of Our Grandparents: Toward a Political Economy of Pension Restructuring* in Skerret, Westar, Archer, & Roberts, *supra* n. 210 at 92.

[260] *Id.*

[261] Chrystin Ondersma, *Borrowing Equality: Dispossession and the Need for an Abolitionist Approach to Survival Debt*, 120 COLUM. L. REV. F. 299, 301 (2020) (defining "survival debt" as "debt that individuals incur in order to survive and live a life of human dignity" and "opportunity debt" as " debt that enables an individual to acquire wealth, such as procuring or expanding a home or business"). Ondersma argues for "an abolitionist approach to survival debt and a reformist approach" to opportunity debt. *Id.*

[262] *See* Caitlin Rosenthal, *Capitalism When Labor was Capital: Slavery, power, and price in Antebellum American*, 1 Capitalism: A Journal of History and Economics 296, 302 (2020) (observing that "the crucial characteristic of capitalism us not commoditization itself but *the power to commoditize*") emphasis in original.

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A. Accumulating Wealth from "Debt-Power"

The familiar "labor-power" frame deployed in the capitalism discourse is a useful, if admittedly imperfect, means by which to consider the generative capacity embodied in a community of marginalized borrowers, namely their "debt-power."[263] Under traditional production-based theories of capitalism, the capital owner purchases the worker's "labor-power"—the generative capacity of the worker's labor, for use along with the other capital owner's control of other means of production, in order to extract surplus value (profits) and accumulate wealth.[264] There is an exploitative element in this arrangement insofar as traditionally, other than wages, the worker derives no additional value from any surplus realized by means of their labor-power. Thus, one critique of this arrangement is that the capitalist takes advantage of the worker's need to sell his labor for subsistence.[265]

The American economy has shifted from its principal basis in the production of goods to one rooted in finance. In a world of financialized capitalism, "profits accrue primarily through financial channels rather than through trade and commodity production."[266] Significant here, financialization at the household level is characterized by increasing levels of household debt.[267] Thus, the rise in

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[263] *E.g.*, Caitlin Rosenthal, *Capitalism When Labor was Capital: Slavery, power, and price in Antebellum American*, 1 Capitalism: A Journal of History and Economics 296, 301 (2020) (defining capitalism as "the commoditization of labor that results from the accumulation of capital").

[264] *E.g.*, Roemer, *supra* n. 266 at 4; Rosenthal at 298 (observing that "The centrality of wage labor to understanding capitalism has never been about the wage itself, but rather what this mode of compensation tells us about underlying capital relations.").

[265] *See* David Graeber, DEBT: THE FIRST 5000 YEARS 351 (2011) (observing that "Marxists have questioned whether wage labor is ultimately free in any sense (since someone with nothing to sell but his or her body cannot in any sense be considered a genuinely free agent, but they still tend to assume that free wage labor is the basis of capitalism.").

[266] Krippner at 174-176 (arguing that "financialization not only offers an apt characterization of the world in which we
live, but a productive one, clarifying key issues in current areas of debate in the social sciences"); at 216 (Observing that financialized capitalism "is observable at three levels: industry, firm, and household" and that globally, "the United States stands out as the most finalized economy").

[267] At 205 Indeed, by one account: "Owing to greater access to credit by the general population, accompanied by stagnant income, household consumption was increasingly maintained not by earnings but by accumulating debts." (The proportion of median household debt to income grew from 0.14 in 1983 to 0.61 in 2008, and the median debt service ratio (i.e., the percentage of income devoted to required debt payment) increased from 5% in 1983 to 13% in 2007.) Moreover, increased financialization has been associated with increased economic inequality and other adverse effects on consumers, particularly marginalized

consumer willingness to borrow money to fund their lives—which I refer to as their debt-power—is now a basis for wealth accumulation in a world of financialized capitalism, much like labor-power was the basis for wealth accumulation in production-based capitalism.[268] Specifically for institutional investors, including pension funds, consumer debt-power, and specifically marginalized debt-power, is increasingly the major source of profits and wealth accumulation as is "profits accrue increasingly through financial channels."[269] The increasing investment in marginalized debt by PE funds on behalf of their institutional investors, including pensions funds, bears this out. It helps to

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consumers. At 211 ("Increased debt, in turn, led to increased mental stress, and this association was
greatest among middle- and lower-class Americans who are forced to borrow but have the least
resources for repayment (Hodson et al. 2014). Simply put, whereas those who have extra assets
to invest enjoy increasing returns, those who cannot join such markets suffer more, enlarging the
wealth gap of the entire society.") Specifically, the increase in household debt was made possible, in part, by securitization, "the process of taking assets with cash flows, such as mortgages held by banks, and turning them into tradable securities (bonds)." Gerald F. Davis & Suntae Kim, *Financialization of the Economy*, 41 ANN. REV. OF SOCIOLOGY 203, 207 (2015); also Kathleen C. Engel & Patricia A. McCoy, The Subprime Virus: Reckless Credit, Regulatory Failure, and Next Steps 16 (2011) Securitization has transformed consumer debt into a powerful investment vehicle, through which lenders of all stripes can pass on the both the benefits and risks of lending to investors. Id at 40.

[268] *See* Roemer, *supra* n. 258 at 94-96 (describing the "capital market—labor market isomorphism" in which he posits that exploitation would appear in a capital market by the same process in which it appears in a labor market).

[269] *Id.* at 27-28 ; Krippner, *supra* n. 261 at 175-176 (noting that "changing patterns of profitability suggest[] that financialization is the key development in the US economy in recent decades"); Costas Lapavitsas & Ivan Mendieta-Munoz, *Explaining the Historic Rise in Financial Profits in the U.S. Economy* 3 (2017) (observing that "[o]ne of the most salient aspects of the financialisation of the US economy has been the rise of profits earned through financial activities, including lending and borrowing of money capital, managing money stocks, insurance, trading in financial assets, and even dealing in assets that are not directly financial but have acquired a strong financial dimension, such as housing and real estate"); *also* Christopher Witko, *How Wall Street Became a Big Chunk of the U.S. Economy — And When the Democrats Signed On*, WALL STREET JOURNAL, Mar. 29, 2016, https://www.washingtonpost.com/news/monkey-cage/wp/2016/03/29/how-wall-street-became-a-big-chunk-of-the-u-s-economy-and-when-the-democrats-signed-on/, (observing that "[m]odern economies depend on a thriving financial sector," and noting that "[s]cholars and politicians alike point to the "financialization" of the economy — and an increased reliance on the financial sector to create growth — as the root cause of many of our economic problems.").

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explain why PE firms currently "own over 5,000 storefront payday and online lenders that make loans at 300% annual percentage rates (APR) and more."[270]

B. Incentivizing Marginalization

To the extent that institutional investors rely on interest rates and fees are the primary means of wealth accumulation,[271] then an army of potential borrowers, from whose debt-power their profits might be realized is necessary.[272] For those investors in marginalized debt specifically, marginalized debt-power is itself a valuable asset as is the continued marginalization of communities for whom this type of debt is generally intended. An analogy to labor-power as discussed in other contexts is again instructive on this point. In production-based notions of capitalism, wages are the price of labor-power as a commodity.[273] The theory expects that profits will rise to the extent that wages remain low. The lower the wages required to produce, the higher surplus value available to capital owners for their accumulation.[274] Moreover, the theory also expects that wages will remain low relative to profits provided that there is a surplus of labor-power relative to available capital investment.[275] For this reason, wages would remain relatively low (and thus capital owners would benefit) from an economically-depressed "industrial reserve army," that was not yet fully integrated into the capitalist system but was prepared to enter should the need for labor arise. Consequently, scholars have posited that this need for excess labor has incentivized, for example, continued unemployment and other precarious states of being from which could arise new members of the so-called industrial reserve army of labor.[276]

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[270] Americans for Financial Reform Education Fund, *Private Equity-Owned Payday Lenders Profit by Trapping People in Debt*, Feb. 2020, https://ourfinancialsecurity.org/wp-content/uploads/2020/02/AFREF-Private-Equity-Payday-Lenders-FS-1.pdf.

[271] *E.g.*, Lapavitsas & Mendieta-Munoz, *supra* n. 277.

[272] Mauricio Lazzarato, THE INDEBTED MAN 23 (2011) ("In neoliberalism, what we reductively call 'finance' is indicative of the increasing force of the creditor/debtor relationship."); *also* Costas Lapavitsas, *The Financialization of Capitalism: "Profiting without Producing"*, 17 CITY 792, 796 (2013) (observing that "[t]he epochal turn of the capitalist economy toward finance reflects a malaise in the realm of accumulation [by production]" while "financialization is about capital seeking profits in the realm of finance").

[273] Marx, *supra* n. 265 at 20.

[274] *Id*. at 25.

[275] *Id*. at 26-27 ("Wages will now rise, now fall, according to the relation of supply and demands, according as competition shapes itself between buyers of labo[]r-power, the capitalists, and sellers of labo[]r-power, the workers."); *see also* Roemer, *supra* n. 261 at 25. Id.; see also id. at 4 ("This process permits accumulation and economic growth. But workers are, in the same process, unfairly treated, and this unfair treatment constitutes the essential inequity of a system based on the private ownership of the means of production.").

[276] *Id.*

Returning to the present context, to the extent that debt-power (and more specifically, marginalized debt-power) is a significant commodity in a financialized world, then institutional investors similarly have a vested interest in maintaining a steady supply of potential marginalized borrowers; a financialized version of the "reserve army," ready to borrow the types of subprime, high-interest rate products endemic to marginalized communities. In other words, the appetite for value accrued from investment in marginalized debt incentivizes a surplus of people whose socio-economic conditions force them to borrow both for survival and for opportunity and that simultaneously limit their ability to borrow at prime and conventional interest rates is beneficial.

Indeed, what makes marginalized debt profitable is the high rate of interest which is justified by the default risks associated with precarious circumstances of marginalized communities. It is this state of socio-economic distress that is most profitable. For example, Pamela Foohey, Robert M. Lawless, Katherine Porter, and Deborah Thorne have examined the difficulties of borrowers that exist in the "sweatbox." The sweatbox is the time in which distressed borrowers are on "the brink of defaulting on their debts," which permits lenders to "charge high interest rates and fees and otherwise profit from their customers' financial misery."[277]

It is while debtors are in the sweatbox, i.e., in a state of financial distress (whether chronic or acute), that lenders can squeeze the most profits from them, in part because those borrowers are a captive constituency because of their high-risk status.[278] For example, per Ronald Mann's account of the sweatbox with respect to credit cards: "The successful credit card lender profits from the borrowers who become financially distressed."[279] Moreover:

> As the credit card borrower spirals downward, however, with the monthly balances growing to amounts that equal, or even surpass, the borrower's annual income, the issuer begins to earn large monthly profits on the relationship. The question for the lender is how long the borrower will remain in the unstable position before failure occurs.[280]

This latter question is also important for the lender's institutional investors because it is similarly their sweet spot for participant wealth

[277] Foohey, Lawless, Porter, & Thorne, *supra* n. 287 at 220.
[278] Mann, *supra* n. 288 at 388 (observing that "the standard way [for credit card lenders] to increase profits is to focus on those customers who are unable to take their business elsewhere" and that "[i]f the customers do not have realistic options, lenders are free to raise the interest rates and fees that they charge to those borrowers").
[279] *Id.* at 385-387.
[280] *Id.*

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maximization. Indeed, it gives some context to why Santander Consumer U.S.A.'s decision allegedly to offer auto loans whose payments exceed the monthly disposable income of the borrowers. Santander has no incentive to lend to people who have the ability to pay because, following Ronald Mann's insights in the credit card context that "[f]inancially secure customers or 'convenience users' do not generate any interest income, late fees, or overlimit penalties," that is not where the value exists.[281] Rather, the profit lies in maintaining a reserve army of marginalized people who, in the self-help welfare state, must rely on debt for income smoothing,[282] and who will struggle with the high interest rates, fees, etc. for as long as they can before ultimately defaulting.[283] In the meantime, Warburg Pincus can report positive outcomes for their institutional investors, including those that have invested in Santander Consumer U.S.A. Consequently, because marginalization is central to the business of subprime lenders and other purveyors of marginalized debt, in whose businesses private equity leads their institutional investors, entrenched marginalization is itself a valuable commodity.[284]

C. Pitting Borrowers Against Workers

The rise and institutionalization in American culture of employment pensions has added a significant social benefit insofar as it has fostered a means of subsistence in old age.[285] In this regard, one might understand the continued existence of marginalized debt that supplements pension funds as serving a public good given that retirement security, and pensions more specifically, are "central[] to modern social policy."[286] Pensions developed as a means of relieving families, and if not families, then the state, from the burden of having to care for old people for whom work was no longer possible.[287] To the extent that the state was charged with the care of a destitute old person who could no longer engage in subsistence work, public poorhouses and other early social

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[281] Mann, *supra* n. 288 at 388.
[282] Atkinson *Rethinking*, *supra* n. 4 at _ ### .
[283] Foohey, Lawless, Porter, & Thorne, *supra* n. 287.
[284]https://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf (observing that "repeat borrowing is the norm" for most payday borrowers)
[285] THE GREAT RISK SHIFT, *supra* n. 155 at 116.
[286] THE DIVIDED WELFARE STATE *supra* n. 2 at 72.
[287] *Pension v. Poorhouse*, N.Y. TIMES, Jun. 28, 1927, https://timesmachine.nytimes.com/timesmachine/1927/06/28/96657541.html?pageNumber=24, (describing the poorhouse as the "cheerless refuge of the aged left without friends or means of support and with no other fate to choose except what King Lear preferred to the ungrateful daughter's proffered shelter—To be a comrade with the wolf and owl—Necessity's sharp pinch.").

welfare measures were often the only alternative.[288] These options, however, were far from ideal, with many old people relegated to poorhouses and left to expire alone and in poverty.[289]

Employment pensions helped to address this problem, yet their current market-based funding structure has led them to prey, however inadvertently, on equally vulnerable individuals.[290] In this regard, the rise of pension fund investment in forms of marginalized debt is remarkable because it reveals how the increasing privatization of public welfare has pitted one vulnerable group against another. Moreover, that workers are encouraged to accumulate wealth on the backs of marginalized borrowers is symptomatic of the deeply-embedded notion of individualism that has guided much of welfare retrenchment over the last several decades,[291] which does not appear to find much fault in this zero-sum approach to social provision. Instead, the dictates of "personal responsibility, self-reliance, individual discipline, [and] private probity" sanction a narrow vision of well-being in which the ends justify the means.[292]

Consequently, by sending individual workers and pension funds alike into the market to procure their own retirement security, the state has created a new breed of capitalist, whose image is uncharacteristically more closely aligned with the image of a sheep rather than that the proverbial "swindler" wolf.[293] These are not familiar caricatures of Wall Street titans, smugly proclaiming that "greed … is good" for the broader society.[294] Nor are they the captains of

[288] *E.g.*, Skocpol, *supra* n. 143 at 143. Skocpol describes the fate of "elderly paupers" in 1915 Massachusetts by explaining that: "[They consisted of] 60 percent foreign born, even though the foreign born constituted only 39.4 percent of all the the Massachusetts elderly in 1915. Mostly these were elderly men and women without families to help them. They did not qualify for either federal or state aid to veterans, and thus had no choice but to fall back on the poorhouse or outdoor relief."

[289] *Id.*

[290] *See* Soederberg, *supra* n. 11.

[291] THE GREAT RISK SHIFT, *supra* n. 155 at 53.

[292] *Id.*

[293] *See* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 8, 17; Martin Fridson, *The Non-Original Wolf of Wall Street*, FORBES, Dec. 26, 2013, https://www.forbes.com/sites/investor/2013/12/26/the-non-original-wolf-of-wall-street/?sh=610666781a8a.

[294] WALL STREET, 20th Century Fox (1987). In this film, the main character Gordon Gekko, (who represents the stereotype of a 1980s Wall Street financier and corporate raider) gives a well-known monologue in which he gives an impassioned Hayekian speech expounding on the broader benefits of the self-interested pursuit of profits. Gekko says:

"In the last seven deals that I've been involved with, there were 2.5 million stockholders who have made a pretax profit of 12 billion dollars. Thank you. I am not a destroyer of companies. I am a liberator of them! The point is, ladies and gentleman, that greed -- for lack of a better word -- is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms -- greed for life, for money, for

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industry that stand in as stereotypes of mercenary labor exploitation in the era of industrial production.[295] Instead, the workers whose savings are pooled to create the mammoth pension funds wielding billions of dollars are often economically-vulnerable workers of limited means who act to secure a modest livelihood in their old age.[296] In other words, their aim in high-risk institutional investment is, at the individual level, modest and seemingly justified in light of the retirement structure in which they exist.

Indeed, the identity of the ostensible beneficiaries here, retirement insecure workers, and the public purpose that underlies this form of regressive investment, arguably shifts the balance in ways that make the whole-sale denouncement of pension fund investment in marginalized debt more difficult to countenance. It complicates the story that high interest rate debt that is concentrated in marginalized communities is bad, when one considers its purported benefit to retirement security as a pillar of the project of American welfare.

Moreover, when one considers who occupies the ranks of public pensioners and the significance of a solvent pension fund to their livelihood, then there is even greater complexity. Teachers, police officers, DMV workers, and other public servants alike rely on their pensions to be able to retire in relative dignity and comfort. In this light, there is also an equality valence to the balance of things that complicates the critique of public pension fund reliance on investment in marginalized debt. Civil service, public school teaching, and police work, for example, are the sorts of occupations that were traditionally available to Black Baby Boomers and women. As a consequence, solvent and prosperous public pension funds are a significant aspect of maintaining and improving the already-burdened wealth of these groups. From this perspective, a robust, well-funded public pension fund that can meet its retirement obligations as promised has important social and public significance.

From a consequentialist perspective, this significance perhaps softens the rough edges of regressive wealth redistribution, particularly in this particular context. As a normative matter, it might, in the balance of things, justify the practice even though it seems to pit the interests of one vulnerable group against

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love, knowledge -- has marked the upward surge of mankind. And greed -- you mark my words -- will not only save [the fictional corporation at issue in the film], but that other malfunctioning corporation called the USA."

[295] *See, e.g.*, Harris, *supra* n. 37 at 53 (observing how "fantasies about captains of industry, unfettered by the state, leading the way to riches for everyone without regard for ecological limits" are often represented as symbolic of capitalism); Chester McArthur Destler, *Entrepreneurial Leadership Among the "Robber Barons": A Trial Balance*, 6 J. ECON. HIST. 28, 43 (1946) (describing the "robber barons" as "the semipiratical entrepreneurs who roamed the United States virtually unchecked before 1903, save for the opposition of a few publicists and some short-lived vigilante committees" and noting their "[m]arked hostility to labor").

[296] *E.g.,* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9.

those of another and, maybe even with respect to a single person, pit one identity and set of interests against another. In the language of Professor Barbara Fried, it is a "tragic tradeoff" that is nevertheless properly subject to aggregative considerations from a policy perspective.[297]

The question of net gains and losses is further complicated by the likelihood that retirement-insecure workers and marginalized borrowers are not entirely discrete groups. Instead, a single person might find themselves situated on both ends of the retiree and marginalized borrower divide. For example, online subprime lenders like SafetyLend, market their subprime loans directly to teachers (often beneficiaries of large public pension funds) noting that "[]any credit history," will suffice and that "quick and easy online form" can expect to be followed by a "fast decision."[298] The company's online materials opine that:

> Unsecured personal loans can help school teachers overcome temporary cash needs without having to risk or refuse such necessary things as a house, boat, car, life insurance, or investment account. With such emergency loan you can also resist unexpected personal problems with health or repairing as such trouble involve urgent money need and cannot wait till paycheck.[299]

The perversity of pension fund wealth accumulation from marginalized debt-power is perhaps most pernicious in this context, where the quest for wealth accumulation is so decidedly circular.[300] Yet, even if retirement-insecure workers and marginalized borrowers are discrete and separate groups, in the current financialized economy and self-help welfare state, they must both depend heavily on high-priced risky debt in order to secure their wellbeing in which one's loss is meant to serve the other's gain.

Ultimately, while neither lending and borrowing nor the accumulation of wealth through investment is inherently harmful, [301] a question deserving of

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[297] Barbara H. Fried, *Facing Up to Risk*, 10 J. LEGAL ANALYSIS 1, 4 (2018) (observing the "growing philosophical literature on harm to others [that] has been concerned principally … with conduct that is… 'intuitively permissible' but potentially harmful to others" and arguing that "in a world of indeterminate consequences, we cannot logically resolve the vast majority of interpersonal conflicts in civil society without resort to aggregation").

[298] https://www.safetylend.com/emergency-loans-for-teachers/.

[299] *Id.*

[300] *Accord* S. Jacoby, *supra* n. 93 at 34 (describing American modern financial develop as, in part, fomenting a "war of all against all").

[301] *See, e.g.*, Atkinson *Rethinking*, *supra* n. 4 at 1100 (observing that "credit and debt often amplify the underlying set of circumstances into which they are introduced" and that "where credit and its amplifying qualities are concerned, what is good gets better, and what is bad gets worse"); King, *supra* n. 40 (preaching that, "[W]ealth is amoral like any other force, such as the force of electricity. It can be used for good or evil.").

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further empirical research is whether public pension fund investment in marginalized debt is in fact a public good when balanced against the well-documented harms that marginalized debt and chronic indebtedness engender in the lives of marginalized communities.[302] CalPERS, California's behemoth pension fund, employs this consequentialist framing to justify and tout the work that it does on behalf California's public employees. For example, in a promotional video posted on the CalPERS web site, CalPERS touts the many benefits of its investment strategies, opining that: "[W]e work hard to get the best risk-adjusted returns to secure your retirement… Overall, the benefits we pay generate economic activity across the state, helping to propel California's economy to the 5th largest in the world."[303]

IV. ON ADDRESSING MARGINALIZATION AS VALUE

Pension fund wealth extraction together and private equity profiteering by investment in marginalized debt exemplifies two distinct problems. First, it undermines the notion that private interests can serve the public welfare without significant regulation that seeks to curb socially-harmful opportunism.[304] Indeed, as a general matter, American social provision policy has "enshrine[d]" a largely market-based, public-private welfare regime administered by private individuals and entities, whose own guiding, efficiency-rooted principle is wealth maximization without obligation or duty to consider the means by which that end is achieved.[305] By leaving the task of wealth accumulation to private markets,

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[302] *See* Barbara H. Fried, *Facing Up to Risk*, 10 J. LEGAL ANALYSIS 1, 4 (2018) (observing the "growing philosophical literature on harm to others [that] has been concerned principally … with conduct that is… 'intuitively permissible' but potentially harmful to others" and arguing that "in a world of indeterminate consequences, we cannot logically resolve the vast majority of interpersonal conflicts in civil society without resort to aggregation").

[303] CalPERS Video, *supra* n. 13.

[304] *See* Christine Desan, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM (2014) (observing how private investment moved to the center of modern monetary policies); *see also* Martha Minow, *Seeing, Bearing, and Sharing Risk: Social Policy Challenges for Our Time* in Jacob S. Hacker & Ann O'Leary, SHARED RESPONSIBILITY, SHARED RISK: GOVERNMENTS, MARKETS, AND SOCIAL POLICY IN THE TWENTY-FIRST CENTURY 253 (2012) (observing that in the American welfare regime, "the dominant rhetorical framework obscures the real choices and stakes by using crude alternatives of private markets and collective responsibility, with inadequate attention to the details that determine incentives and reallocations").

[305] *See* Jedediah Britton-Purdy, David Singh Grewal, Amy Kapczynski, & K. Sabeel Rahman, *Building A Law-and-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1791 (2020). The authors describe the "Twentieth-Century Synthesis" in law, that "has muted problems of distribution and power throughout public and private law." *Id.* They then posit that "[a]s a result, the economy has receded as a subject in fields now reconstituted as fundamentally political, and politics has receded as a subject in fields reconstituted as fundamentally economic." *Id.*

including credit/debt markets, social provision policy unjustifiably delegates issues of redistribution to a set of actors for whom mere efficiency in wealth extraction is their operative lodestar.[306]

For public pension funds, with their "fund-first" fiduciary duty to the pot of money itself, and for private equity firms, with their similar fiduciary duty to their investors and their own bottom lines, the consequences of wealth extraction are largely irrelevant and thus merely discretionary. Wealth comes first, regardless of its source, leaving private financial intermediaries free to commodify the distress of others in service of wealth accumulation. Consequently, a set of regulatory interventions that seek to disincentivize both financial intermediaries and pension fund managers from commodifying marginalization would work to reduce the harms engendered by institutional investment in marginalized debt.

Second, the investment value of marginalized debt highlights an enduring feature of American (no largely-financialized) capitalism—namely the persistence of socioeconomic marginalization as a source of wealth extraction and accumulation and the degree to which debt has become embedded in our system of social provision as a means of survival and opportunity for marginalized groups. With respect to this deeper and more deeply complex issue, the mere regulation of pension fund institutional investment in marginalized debt, while harm reductive,[307] would not do much to address the sourcing economic value in the debt-laden socioeconomic distress of marginalized communities, including the distributive implications. Thus, in addition to specific regulatory interventions in pension fund and private equity institutional investment, policymakers should be increase their focus on the ways in which the private profit motive undermines socioeconomic wellbeing.

A. Regulatory Reform and Harm Reduction

Pension fund wealth extraction and private equity profiteering through marginalized debt investment warrant regulatory intervention. For example, as pillars of social welfare, public pension funds should have a more public-regarding mission that precludes extractive, regressive wealth maximization

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[306] Professor Zachary Liscow has christened this efficiency-focused approach as "one-pieism," which assumes that "there is a single economic pie consisting of perfectly commensurable ingredients." Zachary Liscow, *Redistribution for Realists* 8 (2020), https://law.yale.edu/sites/default/files/documents/faculty/papers/liscow_-_redistribution_for_realists_2020-08-03.pdf. Liscow explains that, "[t]he first aim of the 'one-pieist' approach is to maximize the size of the pie," and "[t]o maximize the size of the pie, traditional economic reasoning suggests that policymakers focus on efficiency…[and] should not consider distributive implications." *Id.*

[307] *See* MacCoun, *supra* n. 39 at 92 (defining harm reduction as "making an objectionable behavior safer").

investment policies. Thus, one intervention might be to define public pension fund fiduciary duty in such a way as to preclude this type of investment. Similarly, given their practical significance in the solvency of an important pillar of American social welfare, private equity firms should be subject to greater oversight and regulation of their internal processes.[308] From a second-best perspective, these reforms would be useful in mandating that various financial intermediaries to attend to the broader consequences of their economic decisions.

1. Expanding the Fiduciary Duties of Public Pension Funds

Public pension fund managers hold the retirement security of millions of workers in their hands. In light of this tremendous responsibility (fraught as it is with significant underfunding and political consequences), it is unsurprising that public pension funds might find "[private equity's] high returns are too tempting to ignore."[309] Indeed, because the public-private welfare regime has developed to force investment as the main source of funding, pension funds seemingly have no other options.[310] This reality should not preclude investment guidelines that limit broader social harm of certain investments.[311] Specifically, one way to address this issue would be to incorporate such limits into public pension funds' fiduciary duties.

Public and private pension fund managers owe a fiduciary duty of prudence and loyalty only to those individuals who participate in the plan.[312] This duty is largely predicated on common law trust doctrine, and "limits [pension fund managers'] ability to direct the fund in ways that would not serve the interests of the pension plan participants and their beneficiaries."[313]

[308] *See* Appelbaum & Batt, *supra* n. 53 at 73. The authors describe other ways in which private equity firms, as general partners/managers, impose harms on other stakeholders like employees of the target company for investment. The observe that "a third source of private equity gains is a transfer from workers to PE investors when employees at healthy companies are laid off [in order to increase profits] and those who remain are subjected to an intensification of work." *Id.*
[309] S. Jacoby, *supra* n. 93 at 57.
[310] *See* Beerman, *supra* n. 11 at 15 ("unfunded pension and retiree health care liabilities are significant and, absent serious reform, will contribute to future fiscal problems").
[311] *But see* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 852 (1993) (arguing that "political pressure to support local firms and engage in other forms of social investing places important limits on the effectiveness of public fund activism in corporate governance").
[312] Webber, *supra* n. 11 at 2122-23.
[313] Rose, *supra* n. 44 at 893. With respect to public pension funds, this duty is a creature of state law, while ERISA generally governs private pensions. *Id.* at 897-903 (describing ERISA's duty of loyalty which "requires a fiduciary to discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing

Moreover, to the extent that a pension fund manager appropriately satisfies their fiduciary duties upon electing to invest in a fund that is managed by a private equity firm, the latter similarly owes a fiduciary duty as general partner to the pension fund as limited partner.[314] The general partner's fiduciary duty to its limited partners, however, does not impose any responsibility to consider "externalities" stemming from the general partner's investment decisions "so long as [those decisions] do not negatively affect the returns of the fund's investments."[315] For this reason, Paul Rose has argued that, at least with respect to public pension whose liabilities are ultimately borne by "taxpayers, current and future, as the [pension fund's] true residual claimants and guarantors," the fiduciary duty should encompass a "public wealth maximization model" that requires managers to "consider all of the impacts of various investments—including positive and negative externalities that would be borne by the taxpayers—in determining how to invest."[316]

Likewise, David Webber has critiqued the "fund-first" posture of public pension fund fiduciary duty, proposing instead a "member-first" approach that would "properly prioritize the economic interests of plan members in the making of investment decisions."[317] In this regard, Webber has highlighted the tremendous power the public pension funds could wield through their control of the vast sum that constitutes labor's capital. Pointing out that pension funds control over $5.6 trillion, Webber has argued that pension funds should deploy this "transformative" power to prioritize workers' interests.[318] In other words, the influence of labor's capital in the market is a viable alternative to the waning influence of labor unions in the fight for workers' right, including retirement benefits.[319] This "member-first" approach to public pension fund trustee fiduciary duty would, for example, preclude investment in private companies that seek to displace public employees through privatization.[320]

benefits to those participants and their beneficiaries, as well as defraying reasonable expenses of administering the plan" and observing that it "functions as a participant wealth maximization rule").

314 For example, California Corporations Code § 15904.08 defines the "fiduciary duties [of loyalty and care] that a general partner owes to the limited partnership."

315 Rose, *supra* n. 44 at 895; Webber, *supra* n. 11 at _ ### (critiquing this fund-first approach).

316 Rose, *supra* n. 44 at 913.

317 Webber, *supra* n. 11 at 2168; *see also* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 183 ("It is an errant view of fiduciary duty that locks labor into using its investment power to undermine it worker interests and overall economic interests.").

318 *Id.* at 9.

319 *Id.* at 96 (arguing that "public pension and labor union funds can be used to undercut further assaults on the well-being of workers by some of the most powerful entities in society—hedge funds and private equity funds").

320 Webber, *supra* n. 11 at 2168; THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 183-184.

A similar restriction on public pension fund trustees, rooted in their fiduciary duty, might consider the broader societal harms associated with their investment choices, including those associated with marginalized debt.[321] This approach is consistent with the tenets of "stakeholder primacy," a theory of corporate decision-making in which corporate managers consider the interests of "a broad array of people and groups impacted by a corporation's activities, from employees to the people living in the local community."[322] Stakeholder primacy is in stark contrast to shareholder primacy, the "dominant theory of corporate governance," in which "corporations should, first and foremost, make decisions that benefit shareholders."[323] Stakeholder primacy is a more outward-facing approach to corporate management that expressly considers environmental, social, and governance (ESG) implications of corporate decision-making.[324]

ESG decision-making is a position that many corporations, at least nominally, endorse, including at the request of their influential institutional shareholders like pension funds.[325] For example, the Business Roundtable, a self-described "association of chief executive officers of America's leading

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[321] *See, e.g.*, Simon Deakin, *The Rise of Finance: What is It, What is Driving It, What Might Stop It?*, 30 COMP. LAB. L. & POL'Y J. 67, 73 (2008) ("The pension fund issue is a striking example of a situation in which better or more carefully managed targeted regulation could help bring about a reversal of the negative effects of financialization."); *but see* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 37-38 (arguing that in light of solvency concerns, there has to be some limit on public pension investment decisions that hinge entirely on "purely social or political considerations").

[322] Edward S. Adams, *Corporate Governance After Enron and Global Crossing: Comparative Lessons for Cross-National Improvement*, 78 IND. L.J. 723, 724 (2003); *also* Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, 4/15/2020 U. CHI. L. REV. ONLINE 1 (2020) ("Non-owners and non-managers, including employees, suppliers, customers, community members, and advocacy groups of various stripes, have argued that corporations ought to consider non-owner and non-management views and interests in corporate decision-making.").

[323] *Id.*

[324] *Id.* at 5; *see also* Karen Firestone, *How Investors Have Reacted to the Business Roundtable Statement*, HARV. BUS. REV., Nov. 20, 2019, https://hbr.org/2019/11/how-investors-have-reacted-to-the-business-roundtable-statement, ("The concept of ESG arose in 2004 when U.N. Secretary General Kofi Annan urged the world's leading financial institutions to consider ESG factors in their allocation of capital, which he believed would ultimately benefit not just society and the environment, but also businesses.").

[325] *See id.* at 4 (observing that "[p]owerful institutional investors—public pension funds, activist hedge funds, and most recently the big mutual funds—have consolidated shareholder power and pressured management to make changes at shareholders' behest"); *Id* at 6-7 (noting that "that pressure from shareholders has been the primary reason that public companies have choose to adopt ESG-related policies"); *see also*, Michal Barzuza, Quinn Curtis, & David H. Webber, *Why Millennials Will Win Trump's War on Socially Responsible Investing*, THE HILL, Oct. 27, 2020, https://thehill.com/opinion/finance/522955-why-millennials-will-win-trumps-war-on-socially-responsible-investing, (suggesting that the Trump Administration's anti-ESG posture would likely succumb to increasingly-influential Millennials ESG commitments).

companies working to promote a thriving U.S. economy and expanded opportunity for all Americans through sound public policy,"[326] issued a statement in August 2019 redefining the purpose of a corporation.[327] Signed by 181 CEOs, the statement professed a "fundamental commitment to all of our stakeholders," including to "support[] the communities in which we work," and to "respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.[328]

Similarly, financial intermediaries[329] and institutional pension fund-shareholders[330] alike have embraced this notion of an expanded commitment to sustainable investment embedded in the ESG approach. For example, even Warburg Pincus, purveyor of investment opportunities in subprime lenders Mariner Finance and Santander Consumer USA, advertises that it "adopts best practices in responsible investing and abides by Warburg Pincus' internal ESG Policy and the Guidelines for Responsible Investment as developed by the American Investment Council, where Warburg Pincus is a member."[331] Moreover, there are a range of investment funds that cater to various ESG concerns. Investors can "invest [their] values" by choosing funds that reject, for example, investments in deforestation, fossil fuels, gender inequality, civilian firearms, the prison industrial complex, and tobacco.[332]

There is, however, a legal limit to investment by reference to social values and morals that not even ESG principles would contradict.[333] The "equal value rule" promulgated by the Department of Labor permits pension trustees to choose between investments on non-economic bases "as long as they are of

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[326] Business Roundtable, *About Us*, https://www.businessroundtable.org/about-us.
[327] Business Roundtable, *Statement on the Purpose of a Corporation*, Aug. 2019, https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.
[328] *Id.*
[329] For example, investment giant, BlackRock, has developed a sustainability mission statement in which, for example, BlackRock "aspires to be an industry leader in how we incorporate sustainability into… our sustainable investment solutions offered to our clients." *BlackRock Mission Statement on Sustainability*, https://www.blackrock.com/us/individual/literature/publication/blk-sustainability-mission-statement-web.pdf.
[330] Firestone, *supra* n. 335 (noting that CalPERS "has begun mounting activist campaigns in recent years to change public company policies, for example pushing Red Rock Resorts last year to amend their governance practices or risk losing their vote in proxies").
[331] Warburg Pincus, *ESG at Warburg Pincus*, https://warburgpincus.com/responsibility/.
[332] As You Sow, https://www.asyousow.org/invest-your-values/.
[333] *See e.g.*, Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1411 (2020) ESG is not a utopian, quixotic effort to turn altruism into profitmaking, but a business strategy designed to protect shareholders from downside risk, which represents a potential reversal of positive returns and decline in value. Viewed as shielding company assets from negative impact, ESG has little trouble fitting squarely with shareholder primacy.

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equal value [i.e.,] they have the same risk-return profile."[334] In other words, what matters most relative to fiduciary duty is that the trustee "prioritize returns," relegating any other concerns, like whether the investment supports gender inequality for example, to a subordinate position.[335] Thus, it is only when the funds' fiscal interests converge with the preferred social values and morals that investment guided by the latter is consistent with pension trustee fiduciary duty.[336] Consequently, while an ESG approach might give pension fund trustees some purchase in considering moral or social concerns, that discretion stops when those concerns would negatively affect the fund's bottom line.[337]

Nevertheless, the existing fund-first fiduciary duty may already preclude investment in high-risk private equity ventures such as those rooted in marginalized debt.[338] For example, Tim Jenkinson, Miguel Sousa, and Rudiger Stucke studied "fund cash flow, valuation and performance data for the entire current and historical portfolio of 761 private equity funds invested in by [CalPERS]."[339] On the one hand, the authors found "evidence of significant long-term smoothing of returns over the life of the fund, consistent with conservative valuation of portfolio companies."[340] On the other hand, the authors observed "that valuations of remaining portfolio companies…are inflated" during the fundraising period for follow-on funds, when the fund is soliciting new investors.[341]

Moreover, "the performance figures reported by funds during fundraising have little power to predict ultimate returns [which is] especially true when performance is measured using internal rate of return".[342] In other words, the authors suggest that managers can and do manipulate their funds'

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[334] THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 98.
[335] *Id.*
[336] *Accord*, Derrick Bell, Brown v. Board of Education *and the Interest-Convergence Dilemma*, 93 HARV. L. REV. 518, 523 (1980) (in the context of civil right, pioneering the principle of "interest-convergence" in which "[t]he interest of blacks in achieving racial equality will be accommodated only when it converges with the interests of whites," and positing that "the fourteenth amendment, standing alone, will not authorize a judicial remedy providing effective racial equality for blacks where the remedy sought threatens the superior societal status of middle and upper class whites").
[337] *See* Gadinis & Miazad, *supra* n. 344.
[338] Alexis Leondis, *Private Equity Isn't What Retirement Savers Need*, BLOOMBERG, Jun. 12, 2020, https://www.bloomberg.com/opinion/articles/2020-06-12/private-equity-isn-t-what-retirement-savers-need, (citing research that shows that "the median private equity buyout fund has basically matched the stock market's performance since 2006" and consequently, "the future of private equity fund performance isn't so rosy").
[339] Tim Jenkinson, Miguel Sousa, & Rudiger Stucke, *How Fair are the Valuations of Private Equity Funds?* at 2, Feb. 27, 2013, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2229547.
[340] *Id.*
[341] *Id.* at 3.
[342] *Id.*

performance both to disguise significant fluctuations in risk[343] and, when raising capital from investors, can and do manipulate the success of the predecessor funds in order to entice capital investment for the follow-on fund. Consequently, the authors warn that "investors should be extremely wary of basing investment decisions on the returns of the current fund, especially when looking at reported [internal rates of return.]"[344]

There is evidence, however, that both supports and contradicts Jenkinson, Sousa, and Stucke's observations. For example, consistent with their analysis, one study of CalPERS' performance over time suggests that as its appetite for greater investment risk has grown, its rates of return have steadily decreased,[345] while another suggests that most of the returns are eaten up by private equity firm fees.[346] By contrast, another account reports that "[p]rivate equity added 14% to U.S. public pensions over the past decade, beating out other asset classes while allocations varied widely."

As Paul Rose suggests then, it may be the case that "fiduciary duties alone are much too slender a support to carry the governance load of a public fund, particularly in the context of public funds that carry political risks."[347] Indeed, given that public pension funds—although deeply influenced by ERISA—are creatures of state law, states could override traditional notions of fiduciary duty by legislatively prohibiting certain investments that are socially or morally harmful. This approach, however, is fraught with political risk relative to the ultimate burden and liability born by taxpayer/voters.[348] Pension funds

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343 *See e.g.*, Olivier Le Marois &Raphael Douady, *Return Smoothing Practices: A Potential Threat for Alternative Investment Growth*, THE HEDGE FUND JOURNAL, Sept. 2007, https://thehedgefundjournal.com/return-smoothing-practices/, ("The principal consequence of return smoothing seems to be that it apparently mitigates the risks, when taking the naïve view of an investor based on performance indicators…").

344 Jenkinson, Sousa, & Stucke, *supra* n. 353 at 3.

345 Estes & Kremling, *supra* n. 32 at 83; Lauren Coleman-Lochner & Eliza Ronalds-Hannon, *Everything Is Private Equity Now*, BLOOMBERG BUSINESSWEEK, Oct. 8, 2019, https://www.bloomberg.com/news/features/2019-10-03/how-private-equity-works-and-took-over-everything (observing that private equity firms have expanded power to "game" their returns).

346 Indeed, by one account: "Private equity funds tend to charge an annual management fee of 2% and a performance fee of 20%. Added to the generally higher fees already paid for target date funds, the returns will really have to be supersized to justify the cost of the alternative investments." Phalippou, *supra* n. 56 at 24-25; *accord* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 81 (observing that [h]edge funds are very often a bad investment for everyone except hedge fund managers").

347 Rose, *supra* n. 44 at 922.

348 *E.g.*, Romano, *supra* n. 322 at 796 ("Public fund managers must navigate carefully around the shoals of considerable political pressure to temper investment policies with local considerations, such as fostering in-state employment, which are not aimed at maximizing the value of their portfolios' assets.").

that cannot meet their obligations must turn to the taxpayers, making social investment that reduces the funds solvency a politically impractical venture.

2. Regulating Private Equity Funds

Similarly, as managers of public wealth, private equity firms and other financial intermediaries could be better regulated to mandate that they deploy their expertise in a manner that is beneficial to the public interest.[349] Indeed, notwithstanding private equity's significance to social welfare, their investment choices appear minimally constrained by concerns for the overall public welfare. For example, when confronted with the reality of Mariner Finance's predatory behavior in its sale subprime loans, Warburg Pincus officials, including Former Treasury Secretary, Timothy Geithner, apparently declined to comment.[350] Instead, the private investment firm's spokesperson responded by suggesting that Mariner Finance was providing "a valuable service to hundreds of thousands of Americans who have limited access to consumer credit."[351] Profit-motivated financial intermediaries like Warburg Pincus, however, should not be the arbiters of what industries have public value, particularly when they are functioning as a significant aspect of the social welfare system.

Thus, one place to begin would be to address the relative lack of transparency requirements imposed on private equity firms to disclose the relevant inner workings of their funds, especially those that are largely capitalized by labor's capital.[352] Currently, private equity funds are subject to relatively minimal oversight. For example, they largely escape the mandated disclosures that have been an important feature of American securities law since the Great Depression.[353] On the heels of the 1929 stock market crash, Congress passed the Securities Act of 1933 which mandated registration of any public offering of securities with the newly-constituted Securities and Exchange Commission (SEC).[354] In order to promote "truth in securities law," the 1933

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[349] *See* Gelter, *supra* n. 200 at 952 ("The changes in the private pension landscape have also had the effect of channeling the political power of shareholder value through the pension system, thus increasing the significance of the financial industry, both on the level of individual firms where pension wealth is invested and on the political level.").

[350] Whoriskey, *supra* n. 24.

[351] *Id.*

[352] *See* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 159 (observing that "when operating away from the sunshine, private equity funds were cheating on their fees and expense allocations over 50% of the time) (internal citations omitted).

[353] *Everything Is Private Equity Now*, BLOOMBERG BUSINESSWEEK, Oct. 8, 2019, https://www.bloomberg.com/news/features/2019-10-03/how-private-equity-works-and-took-over-everything, (observing that "[o]ne of PE's superpowers is that it's hard for outsiders to see and understand the industry').

[354] Securities Act of 1933, 15 U.S.C. § 77b *et seq*. The SEC was authorized by the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*.

Act's aim was to "require that investors receive financial and other significant information concerning securities being offered for public sale," and "to prohibit deceit, misrepresentations, and other fraud in the sale of securities."[355] Section 4(a)(2) of the 1933 Act, however, excludes from mandatory disclosure registration of non-public offerings, creating a "safe harbor" for certain private offerings.[356] Moreover, as implemented by Rule 506 of Regulation D, the exemption permits private equity offerings to sell shares in their funds without any mandatory information at all provided, in part, that the investors are limited to "accredited investors,"—individuals and firms (including pension funds) that exceed specified wealth limits.[357] In other words, private equity firms may sell shares in their funds to as many accredited investors as they'd like, without SEC oversight.

As pooled investment vehicles, private equity funds are also formally subject to the Investment Company Act of 1940 (the "1940 Act"), but they also escape SEC oversight under similar exemption from the Act. As described by the SEC, the 1940 Act mandates that companies (like private equity funds) who invest, reinvest, and otherwise trade in securities must "disclos[e] to the investing public of information about the fund and its investment objectives, as well as on investment company structure and operations."[358] However, under Section 3(c)1, funds that have no more than 100 accredited investors are exempt from this requirement, and under Section 3(c)7, funds that sell only to "qualified purchasers"—which includes most pension funds—are likewise exempt.[359]

Until the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") in 2010, private equity firms could similarly avoid SEC disclosures under the Investment Advisers Act of 1940 (the "Advisers Act").[360] The Advisers Act's goal was "to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful."[361] Initially, investment advisers to private funds were largely excluded from registration, but Dodd-Frank narrowed the exemption to apply only to venture capital funds and other private funds (i.e., those relying on Section 3(c)(1) or 3(c)(7) of the 1940 Act) having less than $150 million in assets under

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[355] U.S. Securities and Exchange Commission, *The Laws That Govern the Securities Industry*, https://www.sec.gov/answers/about-lawsshtml.html#secact1933.

[356] Securities Act of 1933, 15 U.S.C. § 77b(4)(a)(2) (2012).

[357] 17 C.F.R. § 230.506.; Steven E. Hurdle, Jr., *A Blow to Public Investing: Reforming the System of Private Equity Fund Disclosures*, 53 UCLA L. REV. 239, 245–46 (2005).

[358] https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940

[359] 15 U.S.C. § 80a *et seq.*; *also* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 84 (describing the relevant 1996 amendments to the 1940 Act).

[360] 15 U.S.C. § 80b-3 as amended by Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[361] H.R. Rep. No. 76-2639.

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management.[362] These "exempt reporting" advisers are, however, required to file an annual report with the SEC and are subject to SEC inspection.[363] This change now means that advisers to hedge funds and private equity funds are subject to the Advisers Act once they have at least $150 million in assets under management.

As reflected in the Dodd-Frank amendments to the Advisers Act, increased regulation of private equity has risen to the top of the legislative agendas of several member of Congress. In 2019, several members of Congress, including Senators Warren, Baldwin, and Brown, and Representatives Pocan and Jayapal, introduced the Stop Wall Street Looting Act to more closely regulate private equity funds.[364] The legislation proposes to impose several new requirements on private equity funds. For example, the bill calls for private equity firms-as-fund-managers to maintain liability for the debt they cause their target companies to take on,[365] and it would amend the 1940 Act to require private equity firms to disclose increased financial information about their funds, including, "[a] list of each entity with respect to which the fund owns a percentage."[366]

There has been significant opposition to increased regulation of private equity. For example, one congressional opponent of proposed legislation has categorized it as "a danger to free society" and as "nothing more than [a] central planning scheme[] that [will] accumulate power in the government at the expense of the people."[367] Yet, a democratically-elected government is a legitimate locus for the accumulation of power and social welfare decision-making, unlike the C-Suite of a major private equity fund.[368] Namely, we have "enshrine[d]" a largely market-based, public-private welfare regime administered by private individuals and entities, whose own guiding, efficiency-rooted principle is wealth maximization without obligation or duty to consider the

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362 15 U.S.C. § 80b-3(m)(1) (2010).
363 15 U.S.C. § 80b-3(m)(2) (2010); *see also* THE RISE OF THE WORKING-CLASS SHAREHOLDER, *supra* n. 9 at 155-158 (describing the run up to the passage of the registration requirement).
364 Press Release, *Warren, Baldwin, Brown, Pocan, Jayapal, Colleagues Unveil Bold Legislation to Fundamentally Reform the Private Equity Industry*, Jul. 18, 2019,https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-unveil-bold-legislation-to-fundamentally-reform-the-private-equity-industry
365 *Id.*
366 *Id.*
367 *The Blessings of Free Enterprise and Capitalism*, Statement of Rep. Garland Barr (R-Ky), 165 Cong. Rec. H 10007, Dec. 10, 2019.
368 *See* Dick Bryan & Mike Rafferty, *The Financial Responsibilities of Our Grandparents: Toward a Political Economy of Pension Restructuring* in Skerret, Westar, Archer, & Roberts, *supra* n. 210 at 88 ("It turns out that, as owner, labor's capital has behaved pretty much like capital's capital.").

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means by which that end is achieved.[369] By leaving the task of wealth accumulation to private actors in private markets, including credit/debt markets, social provision policy unjustifiably delegates issues of redistribution to a set of actors for whom mere efficiency in wealth extraction is their operative lodestar.[370]

For public pension funds, with their "fund-first" fiduciary duty to the pot of money itself, and for private equity firms, with their similar fiduciary duty to their investors and their own bottom lines, the consequences of wealth extraction are largely irrelevant and thus merely discretionary. Wealth comes first, regardless of its source, leaving private financial intermediaries free to commodify the distress of others in service of wealth accumulation. The instrumental value of marginalized debt in retirement wealth maximization is evidence both that marginalization remains a valuable state of being.[371] Private equity firms can justify their investment in predatory for-profit schools or high-interest-rate small-dollar lenders in the name of wealth maximization if the money rightly comes first. Moreover, and perhaps most perversely, these intermediaries take from the vulnerable to give to the vulnerable, lending a patina of legitimacy to their opportunism.[372]

B. On Marginalization, Debt, and Value

The regulatory reforms described in the preceding section, while intended to be harm-reductive, would nevertheless merely play at the edges of the deeper structural issues implicated by the incidence of marginalized debt as regressive redistribution in investment-based retirement security.[373] Namely,

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[369] *See* Jedediah Britton-Purdy, David Singh Grewal, Amy Kapczynski, & K. Sabeel Rahman, *Building A Law-and-Political-Economy Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784, 1791 (2020). The authors describe the "Twentieth-Century Synthesis" in law, that "has muted problems of distribution and power throughout public and private law." *Id.* They then posit that "[a]s a result, the economy has receded as a subject in fields now reconstituted as fundamentally political, and politics has receded as a subject in fields reconstituted as fundamentally economic." *Id.*

[370] Zachary Liscow, *Redistribution for Realists* 8 (2020), https://law.yale.edu/sites/default/files/documents/faculty/papers/liscow_-_redistribution_for_realists_2020-08-03.pdf. Liscow explains that, "[t]he first aim of the 'one-pieist' approach is to maximize the size of the pie," and "[t]o maximize the size of the pie, traditional economic reasoning suggests that policymakers focus on efficiency…[and] should not consider distributive implications." *Id.*

[371] *E.g.*, K-Sue Park,

[372] *Sene* Harris, *supra* n. 37 at 53; Britton-Purdy, et al.

[373] *Cf.* MacCoun, *supra* n. 39 at 84 (describing debates about harm reduction as a policy approach and observing that "advocates argue that pragmatic steps to reduce the harmful consequences of a risky behavior will save lives and reduce needless suffering, while opponents counter that these steps might 'send the wrong message'—encouraging or enabling the behavior and weakening society's moral stigma against it").

notwithstanding that equality has nominally characterized the American project, our American capitalist society that has always sourced and extracted value from marginalization. Moreover, the embeddedness of consumer debt, and specifically marginalized consumer debt, in our current financialized economy perpetuates this phenomenon.

1. On the Historical Value of Marginalization

Historical accounts show that the commodification of marginalized experiences has been central to wealth maximization in the development of American capitalism. Indeed, these accounts bear a striking resemblance in kind to the conundrum of marginalized debt expressed here in which marginalization is a valuable commodity. For example, historian Eric Williams was among the first to describe the primacy of wealth maximization in the development of African slavery in New World capitalism, including in the southern American colonies.[374] Williams observed that the enslavement of Africans was primarily "economic; not racial."[375] Instead, racism developed to serve the economic interests of mass agricultural production. The maximization of wealth thus engendered the subsequent social subordination of African-Americans, and the reproduction of that subordination, including the development of racism, was necessary in order to continue to serve the economic interest. Thus, Williams observed:

> The features of the man, his hair, color and dentifrice, his "subhuman" characteristics so widely pleaded, were only the later rationalizations to justify a simple economic fact: that the colonies needed labor and resorted to Negro labor because it was cheapest and best. This was not a theory, it was a practical conclusion deduced from the personal experience of the planter. He would have gone to the moon, if necessary, for labor. Africa was nearer than the moon, nearer too than the more populous countries of India and China. But their turn was to come.[376]

Similarly, historian Bonnie Martin argues that the continued subordination of enslaved Africans was "central to the expansion of [early] local and regional [American] economies."[377] For example, Martin observes that by

[374] Williams, supra n. .
[375] Williams at 19.
[376] Williams at 20.
[377] Bonnie Martin, *Slavery's Invisible Engine: Mortgaging Human Property*, 76 J. SOUTHERN HIST. 817, 818-820 (2010).

the early 18th century, "British colonists in South Carolina were using salves they already owned to attract lenders and the cash and credit they needed to buy more land and slaves—capital they needed for economic expansion." Moreover, rich planters and poor speculators alike sought to raise their own economic status by exploiting the marginalization of others by "work[ing] their slaves to generate cash and credit where both were scarce."[378] These transactions, in turn, "represented a small burst of capital injected into local and regional economies" that, when considered together with other similar enslaved person-backed credit transactions, "became significant enough to accelerate economic growth."[379]

This practice of commodifying marginalization helped to fuel the development of American capitalism in the 19th century. For example, historian Edward Baptist describes the Consolidated Association of the Planters of Louisiana (C.A.P.L.): an organization developed in the early 19th century to facilitate greater liquidity in the American slave-based agriculture while reducing the risk of financial loss to investors.[380] Baptist describes the aspiring planters and speculators' high risk of failure, in significant part because: "They depended on the bodies and the lives of people whom they also brutally exploited, beginning with their forced migration to a deadly environment. The cotton country of the Mississippi Valley was hot and wet, and the people transported there died of fevers in great number."[381] Thus, writes Baptist:

> For everyone who drew profit in the system, enslaved human beings were the ultimate hedge. Cotton merchants, bankers, slave traders—everybody whose money the planter borrowed and could not pay until the time the cotton was sold at a high enough price to pay off his or her debts—all could expect that eventually enslaved people would either 1) make enough cotton to enable the planter to get clear or 2) be sold in order to generate the liquidity to pay off the debt.[382]

To mitigate the high risk of loss that investors faced, some enslavers developed a means of securitizing their human collateral. For example, the Consolidated Association of the Planters of Louisiana (C.A.P.L.) created a bond system in which planters in need to liquidity "mortgaged slaves and cultivated land to the C.A.P.L., which entitled them to borrow up to half of the assessed

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[378] *Id.* at 825.
[379] Id. at 825.
[380] Edward Baptist, *Toxic Debt, Liar Loans, and Securitized Human Beings: The Panic of 1837 And The Fate Of Slavery*, COMMONPLACE, http://commonplace.online/article/toxic-debt-liar-loans/.
[381] *Id.*
[382] *Id.*

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value of their property from the C.A.P.L."[383] C.A.P.L. then "convinced the Louisiana legislature to back $2.5 million in bank bonds" backed by the "'faith and credit' of the people of the state."[384] Because the risk of loss was spread across the ventures of several planters, "the bonds created a pool of high-quality credit … at a rate significantly lower than the rate of return that [planters] could expect that money to produce," in turn "allow[ing] a much wider group of people to profit from the opportunities of slavery's expansion."[385]

Historian Caitlin Rosenthal's study of the accounting methodology of slaveholders confirms this commitment to the commodification of marginalization in the development of American capitalism.[386] Rosenthal shows how slaveowners and planters developed scientific management techniques engendered by "frequently experimenting with new methods for maximizing output."[387] Rosenthal documents how planters used "sophisticated accounting techniques" to increase production and profits, recording in "neat columns of numbers" how their manipulation of the lives they enslaved positively or negatively the bottom line.[388] Consequently, she observes that: "Slaveholders' calculations show that they were keenly aware of human processes on profits and losses, and they attempted to manipulate enslaved lives to increase their earnings."[389] Moreover, "planters [made] efforts to quantify output" and "efforts to estimate and maximize the value of the men and women themselves."[390]

2. On the Continued Value of Marginalization

In a modern account of the same phenomenon, Keeanga-Yamahta Taylor has described the phenomenon of "predatory inclusion" in the late 20th century credit-based housing market. Defining predatory inclusion as "how African American homebuyers were granted access to conventional real estate practices and mortgage financing, but on more expensive and comparatively unequal terms,"[391] Taylor shows how the exclusion of African Americans from access to Great Depression-Era and mid-century federally-subsidized mortgages

[383] *Id.*
[384] *Id.*
[385] *Id.*
[386] Caitlin Rosenthal, ACCOUNTING FOR SLAVERY: MASTERS AND MANAGEMENT 4 (2018) (observing that "plantation records can tell us about the history of capitalism
[387] *Id.* at 85.
[388] *Id.* at 86.
[389] *Id.* at 121-122.
[390] *Id.* at 122. Based on this research, Rosenthal ultimately concludes that, "Inequality can drive innovation, and innovation can entrench inequality, particularly in highly unregulated labor markets that put everything—even lives—up sale." *Id.* at 192.
[391] Keeanga-Yamahta Taylor, RACE FOR PROFIT: HOW BANKS AND THE REAL ESTATE INDUSTRY UNDERMINED BLACK HOMEOWNERSHIP 5 (2019).

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resulted in a rich source of profit for banks and mortgage brokers in the 1970s willing to lend to this marginalized community.[392] Socioeconomic exclusion, coupled with a renewed federal policy of promoting homeownership in the economically-depressed inner cities, provided a breeding ground for spectators looking to capitalize on a new source of investment wealth. Thus, by commodifying the marginalization of hopeful Black homeowners in the immediate post-Civil Rights Era, spectators were able to extract value from these already vulnerable communities and spaces by charge higher interest rates and extending more burdensome terms.

The instrumental value of marginalized debt in retirement wealth maximization is evidence that even though indebtedness is now a channel for redistribution rather than enslavement, marginalization remains a valuable state of being.[393] Just as in historical accounts of how the bottom-line-first orientation of antebellum investments justified securitized slave bonds as a tool to maximize investor wealth (never mind the underlying social consequence), private equity firms in the present can similarly justify their investment in predatory for-profit schools or high-interest-rate small-dollar lenders in the name of wealth maximization because their duty lies with the money, not the people affected by the money. Moreover, because at least in the pension context, these financial intermediaries are taking from the vulnerable to give to the vulnerable, their approach reflects a patina of legitimacy.[394]

At a minimum, pension funds' reliance on marginalized debt to promote retirement security raises broader normative concerns regarding entrenched regressivity in wealth redistribution and wealth accumulation. Indeed, those who tend to occupy the economic "sacrifice zone[s],"[395] are predictably marginalized across a range of measures.[396] They have to rely on debt for survival and for opportunity in the current welfare regime,[397] and they exist in a structure that both emphasizes and supports their use of credit/debt to mitigate socio-economic inequality and foster socioeconomic mobility.[398] The reality is that there is profit to be made from this combination of marginalization and the

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[392] Taylor at 4

[393] *E.g.*, K-Sue Park,

[394] *Sene* Harris, *supra* n. 37 at 53; Britton-Purdy, et al.

[395] *See* Carmen G. Gonzalez, *Environmental Racism, American Exceptionalism, and Cold War Human Rights*, 26 TRANSNAT'L L. & CONTEMP. PROBS. 281, 300 (2017) (discussing from an environmental justice perspective, the "national and state patterns, whereby hazardous industrial facilities operate in close proximity to communities predominantly populated by people of color").

[396] *But see* Fried, *supra* n. 313 at 21-22 (arguing that because we live "in a world of uncertain consequences, [in which] any rule of conduct we adopt imposes tradeoffs among competing and often fundamental interests," nonconsequentialists must offer concrete solutions and explain how those solution are meaningfully different "from conventional aggregation").

[397] Ondersma, *supra* n. at __.

[398] *Id.*

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market. Thus, even if not to benefit social provision, private equity and other institutional investors will continue to extract wealth from the marginalization of others.[399] It is this larger part of the structure that requires our sustained focus and effort if we are seriously interested in improved socioeconomic equality.

CONCLUSION

The phenomenon of public pension fund investment in marginalized debt reveals how the retirement security of millions of American retirees lies in the hands of a relatively few financial intermediaries who are increasingly relying on debt as a means of regressive wealth extraction. The fund-first focus that private equity funds embraces is not aligned with the broader public mission that pension plans are supposed to reflect, nor is it consistent with a robust sense of accountability for the externalities that private equity investment in alternative assets, like marginalized debt, may impose. In this regard, the socioeconomic well-being of the most marginalized communities and other ordinary Americans is subordinate to profits, and debt is a significant channel of this form of redistribution. This market-based, debt-funded social provision should cause policymakers to look more deeply and closely to assess the operation and optimality of consumer credit/debt, particularly its interaction with its professed aspiration of increasing socioeconomic equality.

[399] *See, e.g.*, Divya Kirti & Natasha Sarin, *What Private Equity Does Differently: Evidence from Life Insurance* at 22 (SSRN, Jul. 6, 2020) (describing private equity's incursion into insurance and their penchant for "direct[ing] premiums from their insurance subsidies toward risky alternative investments, like ownership stakes in other portfolio companies").

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