UNIVERSITY OF CALIFORNIA, BERKELEY

BERKELEY • DAVIS • IRVINE • LOS ANGELES • RIVERSIDE • SAN DIEGO • SAN FRANCISCO SANTA BARBARA • SANTA CRUZ

CENTER FOR LABOR RESEARCH
AND EDUCATION
INSTITUTE OF INDUSTRIAL RELATIONS
(415) 642-0323

BERKELEY, CALIFORNIA 94720

RESEARCH REPORT

JANUARY 1980

PENSION FUND INVESTMENTS

by Bruce Poyer
and Ramon Castellblanch

Contents | Page

1. Background of the Investment Problem

A number of national economic trends have converged in their impact on pension plans, and in the process have produced a healthy revival of interest on the part of union members and officials in the subject of pension fund investments. Included among the trends are: (1) continuing high levels of unemployment which reduce contributions to pension funds and cause workers to suffer more breaks in service and more loss of pension plan coverage; (2) high inflation rates which reduce the real value of pension benefits, increase the competition for capital investment funds, and increase the pressure for higher rates of return on investments; (3) shifts of investment capital to low-wage areas of the country (especially to the less unionized sun-belt areas) and to the overseas operations of conglomerates and multi-national organizations which undermine the very jobs of those whose pension money is thus invested. In addition, huge firms like Studebaker and perhaps like Chrysler can still go under, jeopardizing the pensions promised to thousands of employees, and also jeopardizing the solvency of the agency which is supposed to insure the promises (the Pension Benefit Guarantee Corp., or PBGC, established by ERISA).

Such trends become more ominous with consideration of two additional factors. First, pension fund investments play an increasingly important role in the economy, now constituting 40% of the nation's equity capital (this figure is expected to increase to 50% by 1983). The Securities and Exchange Commission estimates that over 600 billion dollars have accumulated in pension funds, that this total is growing by 60 billion dollars each year, and that the total will double by 1985 to 1.2 trillion dollars. (The people who control this money are so few in number that they would not fill a typical college football stadium if they could all be assembled at the same time.)

The second factor is demographic--the increasing ratio of retirees to workers. All projections of population change for the next 25 years or more now feature a declining work force, which will be called upon to support an increasing army of retirees. This army will include in its ranks an increasing number of workers with disabilities incurred primarily on the nation's industrial fronts.

These trends and factors had sufficient impact to cause three major revisions in the financing of the U.S. Social Security System in the 1970s. They also led more or less directly to the vesting and funding protection established for employees by ERISA in 1974, and to the concurrent establishment of the Pension Benefit Guarantee Corporation--an unprecedented government sponsored program to insure the benefits promised but all too often not paid to retirees under private plans. Unfortunately, the same trends have also kept PBGC (so far) from implementing benefit guarantees for most employees covered by multi-employer plans, because the funding risks and other financial uncertainties of many private plans are still considered greater than any accumulation of PBGC funds available to insure them.

Basic trends influence nearly everyone, and also provide a good living to a small army of economic analysts. But they do not fully account for the healthy revival of interest on the part of union officials and many members in the subject of pension fund investments. One reflection of this revival is the recent outpouring of hearings, special reports, books and articles about pension funding and investment problems. (Some of the more important writings are cited at the end of this report.)

Of greater significance to private sector workers and unions has been the growing awareness that pension plans covering union members have invested considerable portions of their assets in firms such as J. P. Stevens, which have been using union pension funds at the same time they have been fighting and successfully blocking union organizing campaigns. Sometimes--as in the case of Texas Instruments and the UAW--the union taking a beating on the picket lines has turned out to be the same union whose pension fund was investing in the anti-union company.

The investment issues have been raised in the public sector in another disturbing context. In cities like New York and Cleveland and counties like Wayne (Detroit), one key issue has been whether or not to commit the pension funds of the employees to help their governments avoid "bankruptcy"--a condition which would certainly include mass layoffs of workers and mass disruption of services to residents. In California, fortunately, no government unit has yet come to the point of complete "bankruptcy." But all public sector investments in California have been adversely affected by the passage of Propositions 13 and 4--and are threatened even more basically by the pending Jarvis proposal to decimate the state government's taxing capacity. Even now there is more than a suspicion that those California workers who have been persuaded to join the so-called "tax revolt" may be helping to jeopardize their own pension prospects.

2. Investment Performance in the 1960s and 1970s

Pension and Investments Magazine concluded in 1978 that pension funds have operated until now in a politically neutral netherworld when it comes to the overall impact of their investment practices. "But the rumblings of change are beginning to be heard."

Undoubtedly the rumblings first became audible because of the poor performance of institutional investment managers--particularly since the mid-1960s. Barber and Rifkin found that in the 10-year period from the end of 1966 to the end of 1976, the annual return on investment for pension fund equity was 33% below the average annual return of the Standard and Poor 500 index stocks (S-P being a representative cross-section of all stocks listed on the New York Exchange).[1] During that time, the S-P average annual rate of return was 6.6%, while banks averaged only a 4.4% return and insurance companies only a 4% return. For the period 1972-1976, the figures were even more embarrassing. While the S-P index return averaged about 4.9% for the five years, bank equity returns were averaging 0.8% and insurance companies only 1%. In fact, between 1962 and 1975, 87% of all the money mangers in the country performed below the S-P index.

The conclusion reached by Barber and Rifkin is sharply critical of the investment bankers, and deserves careful consideration by all who have any responsibility for pension funds:

> Not only are the investment bankers failing to look out for the interest of their pension fund beneficiaries first; not only are they using these funds to protect a capital market that is sick and unstable; not only are they continuing to underperform in this already weakened market structure year in and year out with disastrous rates of return on investments; but to top it all, a well-programmed computer can do a better job of maximizing returns on investments than they can.[2]

Bill Behn's careful research work in California generally confirms the Barber and Rifkin findings--and raises some more thoughtful long-range questions.[3] The concentrated use of pension funds by the institutional investors in the period 1964 to 1974, in purchasing the favorite blue chip stocks of the largest corporations, meant that a considerable portion of some 400 billion dollars of U.S. pension funds were diverted to the equity capital of American industry. But at the same time Behn points out a massive number of unmet needs were emerging in the country: for low-income housing and neighborhood revitalization, for better and more universal health care, for rebuilding of cities and economic rebirth of rural areas, for pollution control, for transportation upgrading, for environmental enhancement, for energy retrofitting, and for many other things which run into the billions and probably even the trillions of dollars.

The poor record of pension fund investments in recent years--even more than the discouraging economic trends of the 1970s--has begun to suggest a kind of economic reality so contrary to popular conceptions that it is difficult to accept. On the most practical level, when computer selection can give a better investment performance than highly paid consultants supposedly operating under the "prudent man" principle incorporated in ERISA in 1974, then it is necessary to ask further: (a) how much money (in fees and commissions and retentions) is still being wasted on the investment bankers and managers and counsellors, and (b) is their continued dominance of investment decisions not only contrary to the basic economic interests of pension plan participants and beneficiaries, but also dangerous to the balance and the ultimate stability of our economy, and (c) what is left of the concept of the mysterious "prudent man" when he can be identified as the one responsible all these years for nearly unbelievable losses in the book value of private pension plans?

It is also necessary to ask more fundamental questions: Are the large financial investing institutions and the nation's major corporations (which are highly interlocked) planning to help the nation meet its real needs? Are they shifting too much needed capital to the global market place? Do they believe that domestic investment is not profitable enough, because our needs cannot now be met simply by increasing traditional GNP, and because domestic investment decisions are now more limited by the necessity to clean up our environment, which we have never done before, and to conserve resources, which we have always wasted? And are the financial investing institutions and their corporate allies now denying the use of capital to more enterprising small and medium sized users, with new ideas and more innovative approaches, with less fear of risk and change, and possibly with better understanding of the economic and environmental realities of the 1980s?

As pension funds begin to control a larger proportion of all funds available for investment, and as they continue to concentrate their investments on a narrow range of "blue chip" stocks and bonds, less capital is available to support the development of new companies. The dwindling of venture capital becomes more acute at a time when more money is needed to get a new company off the ground. Not too many years ago, five million dollars was enough to start most ventures, and could often be raised by individuals. More complex technology now commonly requires ventures of twenty-five or thirty million dollars. If capital is not available from the pension funds, the U.S. could lose the capacity to develop the I.B.M.s of the next several decades. Some believe that we may already be losing out on this score in competition in the global marketplace.

3. Pension Plan Concepts and the Control of Investment Funds

a. In the Private Sector

To understand how today's pension fund investment problems have arisen, it is necessary to review briefly some of the historical development of pension plans.[4]

The basis of pension plan growth and expansion in the 1950s and 1960s was laid in 1921, when Congress exempted from taxation the income earned by pension funds, and also exempted employees from paying income tax on contributions made to the fund on their behalf.

The economic insecurity of the 1930s increased the demand for retirement plans--as did the passage of the Social Security Act in 1935. Organized labor began pushing early for pension benefits from industry to supplement inadequate Social Security benefit levels. During World War II, high corporate income tax rates suddenly made the tax-deductible contributions to pension funds look very attractive to large corporations. The fact that pension contributions could also be reinvested in the company made these plans seem even more attractive. In addition, pension plans were considered a "fringe benefit" not subject to the tight wartime wage freeze.

The final step in the evolution of private pension plans was perhaps the most important: The U.S. Supreme Court decided in the Inland Steel case (1949) that pension benefits were part of the structure of wages as defined in LMRA 1947 (Taft-Hartley). Not only did pensions then become a "mandatory" subject for collective bargaining, but also the pension benefit began to be regarded as a deferred wage earned by current labor service. It began to be understood that the worker's interest in the pension fund is based on the work s/he performs during the term of the collective bargaining agreement, and is not dependent on any humane interest the employer may have in rewarding "long and faithful service," or in treating the aged decently, or even in getting the aged off the payroll more easily.

The tax laws have also contributed to this important change in the concept of a pension benefit. The pre-condition for the tax exempt status of a pension fund is that it must be for the sole benefit of the employee. Once a contribution is made to the fund, that money no longer belongs to the employer. And while no taxes are paid at the time the contribution is made, the retired employees do pay income tax when they receive their pension benefits--again reinforcing the deferred wages principle.

If the money contributed to the fund "belongs" to the worker, like any other kind of wage payment, what does such "ownership" of plan assets actually mean? The answer, under present arrangements, is very little. In particular, it does not mean control over use of the funds, which was described by Paul Harbrecht in 1959 in terms which are entirely relevant today:

> In the end, the anatomy of control of the pension trusts may be described quite simply. In general, financial control has been delegated by the employers to the banker-trustees, which exercise considerable power in the capital markets as a result. The employer controls the day-to-day operation of the plan itself, in many cases in accordance with a basic agreement arrived at with a union. It is the employer who, either unilaterally or in conjunction with a union, fixes the amount of pensions and usually alone determines how a plan is to be financed. The employee himself, without his union, has little or nothing to say about the pension plan which, ultimately, is financed out of his earnings.[5]

Excluding federal pension funds invested exclusively in U.S. government securities, the book value of all pension fund assets at the end of 1976 was 357.7 billion. The possibilities for increasing the influence of plan participants in such crucial areas as funding and investment policy would appear to be best in the state and local government pension funds, with estimated assets of 117.2 billion, and in the private sector negotiated plans which are jointly managed (under Taft-Hartley provisions), which have an estimated 45-60 billion in assets.[6] It is also possible through collective bargaining to increase the input of working people in corporate managed plans in unionized industries, which have an estimated 65-80 billion in assets--as the UAW has done in its recent agreement with the Chrysler Corporation.

It would seem that the interests of plan participants and beneficiaries would best be represented in the Taft-Hartley plans, with joint trustees from both the union side and the management side of the collective bargaining table. However, the union representatives on the pension plan's Board of Trustees are almost without exception the key officers of the union, and are already fully occupied with the duties of their elective poistions. They usually find that management representatives have more experience with pension plan administration, and investment policy than they have. So it is common practice for them to hand over both administration and investment policy to professionals. According to one New York bank official who manages Taft-Hartley funds, the only investment input most union trustees have is the promotion of low grade bonds in local companies that employ union members, and the sale of Israeli bonds during drives in which the union leadership is directly involved.

Because so few unions or union trustees have ever effectively challenged the typical employer's delegation of pension fund control to the banker-trustees or to other institutional investment managers, Harbrecht's 1959 description quoted above is still accurate. Not only do all employees, <u>with or without a union</u>, have very little to say about the pension plan which is financed out of their earnings; but also, twenty years after Harbrecht wrote, employees <u>with a union</u> are just beginning to ask the basic questions about why they should have so little to say about such crucial matters as funding and investment policy.

3. <u>Pension Plan Concepts and the Control of Investment Funds</u>

b. <u>In the Public Sector</u>

With respect to the funding and investment approaches of state and local public sector plans, the similarities to private sector plans are greater than the differences. Some plans in both sectors have the enormous problem of significant under-funding of the benefits promised to some groups in some areas. Most plans in both sectors have developed very little protection for retirees against the continuing impact of double digit inflation (although there are many 3-5% annual adjustment provisions appearing in public sector plans). Many plans in both sectors have suffered from unrealistic actuarial assumptions and from poor investment performance.

Further, most trustees and plan managers and investment managers in both public and private sector plans have continued to be surprisingly unresponsive either to increasing criticism of demonstrably poor investment performance, or to constructive suggestions for policy changes. In other words, both sectors have to break through the same monopoly control over investments exercised by those whose interests are not the same as those of plan participants or beneficiaries, or those of the union which they may have designated as their agent for pension plan bargaining.

With respect to structure, public plans have employee representation on their governing boards, but they are not necessarily representatives of the leading employee organizations or unions. Employee representatives on public plans tend to have the same investment background and experience as employee representatives on Taft-Hartley plans--which is very little.

There are also "public" or employer representatives on retirement boards. They are usually appointed by public officials with the approval of the legislative bodies that enacted the plans in the first place. These appointments are often made in settlement of the political debts of public officials. In San Francisco, the "public" representatives on the city employees retirement board are chosen from lists submitted by the local chamber of commerce and a few other "downtown" organizations.

As with Taft-Hartley plans, the public sector pension plan trustees generally hand over most of their authority to an administrator, and act only to hire or fire these administrators.

Some historical differences between public sector and private sector plans may give rise to different concepts of funding and investment, such as:

(1) Public sector plans were generally in existence long before private sector coverage was extensively negotiated. The California State Teachers Retirement System, for example, was established in 1913, and the Public Employee Retirement System (for State employees) in 1931.

(2) Almost all public employees are covered by pensions, but only about 48% of full-time employees in the private sector are covered.

(3) The typical public sector employee contributes 20% and his or her employer contributes 80% of the amounts going into the pension fund, while the typical private sector plan calls only for employer contributions; one consequence is that the benefit provisions of public retirement systems are generally more liberal than those of the private systems.

(4) There is as yet no centralized framework of standards for public sector plans, comparable to ERISA. There are many legislated standards and restrictions, however, and these may have more direct effects on investment policy than any ERISA standard or regulation has yet had.

It may also be true that public sector employees generally have coverage which is more successfully integrated with Social Security. In recent years there have been some examples of state and local employee groups opting out of Social Security. But such groups have either not been well informed when they made their decision, or have had truly exceptional local plans as exclusive options. (Where such exceptional plans actually exist there are further questions about how long they may continue to exist.)

There is now one additional and extremely important distinction between public and private sector plans in California, directly affecting both funding and investing policies. There are no restrictions or limitations on what can be negotiated in collective bargaining for private sector employees, either to improve benefit levels for future retirees, or at least to adjust these levels upward as inflation proceeds. However, many government jurisdictions in California now face severe restrictions on the taxes they can levy and the expenditures they can make--even those required to support pension "commitments." The restrictions will be extremely difficult if not impossible to surmount, because they are being established (in the Jarvis "tax revolt") by constitutional amendment, and because they usually require more than a majority vote in a local area to overcome either the taxing restrictions or the spending limitations --or both.

4. <u>Can Existing Investment Policies be Changed?</u>

Since there are no ERISA guidelines for public sector plans, the key question is: How much scope exists for increasing the influence of <u>private sector</u> pension plan participants in current investment policies, as these policies are now governed by ERISA's "prudent man" standard?

First, where did the famous "prudent man" come from? The first prudent man was established in 1830 by the <u>Amory vs. Harvard</u> decision of the Massachusetts Supreme Court. The case involved a trustee (Amory) being sued by a beneficiary (Harvard University) for failing to limit his investment of the trust to government securities, bank securities and other securities considered by the University to be "safe." The court reviewed the various types of securities available and concluded that there was no such thing as a safe investment. "Do what you will," said the court, "the capital is at hazard." The court went on: "All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs."

The original prudent man was thus a trustee with broad discretionary power to make investments. Today's descendant is the virtual opposite of his ancestor. Now he generally limits himself to a narrow set of investments, and even if they are not doing well, he sticks to what is described as "safe" and exercises little discretion.

The actual prudence standard of Section 404 of ERISA is very general:[7] It requires every pension manager to follow the investment practices which "a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise. . . .with like aims." However, Section 404(a) of ERISA is more specific in requiring that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries. . .for the exclusive purpose of (i) providing benefits to participants and their beneficiaries, and (ii) defraying reasonable expenses of administering the plan." (Emphasis added.)

It is thus quite clear that the overall strategy governing the investment of plan assets must be designed to protect the retirement income of the plan's participants. In making investments, most professional money managers try to reach a balance appropriate for the specific plan of acceptable risk and potential gain relative to the whole portfolio. The Department of Labor's prudent man regulations suggest a number of factors which would ordinarily be considered appropriate in evaluating how a particular investment would fit into the plan's whole portfolio, including (a) the composition of the pension portfolio with regard to diversification of risk; (b) the volatility of the pension portfolio with regard to general movements in investment prices; (c) the liquidity of the pension portfolio relative to the projected payment schedule for retirement benefits; (d) the projected return of the pension portfolio relative to the funding objectives of the pension plan; and (e) the prevailing and projected economic conditions of the entities in which the plan has invested and proposed to invest.

It would not be consistent with the prudence standard for the fiduciary to make an investment decision based on other objectives such as promotion of the job security of a class of current or future participants. And the fiduciary priority which must be given to investment performance cannot be sacrificed in order to advance the social welfare of a particular group or region.

However, an investment is not impermissible under ERISA solely because it may have social utility. If the socially beneficial investment meets objective investment criteria which are appropriate to the goals of the portfolio, it may be considered in the same manner as other investments which meet these criteria.

As summarized by Ian Lanoff, a chief official in the Department of Labor:

> In other words, what the pension plan fiduciary needs to determine about an investment is not, first, whether it is socially good or bad, but how the proposed investment will serve the plan's participants and beneficiaries. The stability of a company's labor relations, the political situation in a country in which the investment is located or with which a company does business, and the effect that the public view of a company's social commitment may have on the profitability of a company are all factors which may properly enter into the evaluation of an investment.
>
> If after evaluating other factors, two investments appear to be equally desirable, then social judgments are permissible in determining which to select. The point is that social judgments may not properly be substituted for any factors which would otherwise be considered in a given case.[8]

Lanoff adds that ERISA requires diversification of plan assets. Since risk must be spread, there is no one "best" investment to be made to the exclusion of all others, and there is no inherent conflict between social utility and prudence. Investments in different companies, industries and regions may be appropriate in meeting the diversification requirement.

It can be argued that the ERISA standards are broad enough to allow considerable scope and discretion to managers and others with fiduciary responsibility for the investment of negotiated pension funds. And a further question should at least be raised, even if it cannot be answered. Is it possible that a more honest interpretation of the prudent man concept would have made it impossible for the investors of negotiated pension funds to put so much of their plan assets in blue-chip corporate issues over the past 15-20 years, resulting in the loss of billions of dollars in the book value of pension assets? Since most of those losses will never be recovered, the amount of "prudence" that was exercised is open to challenge.

What kinds of changes should be made to improve the investment policies of pension plans--especially those which handle the funds of union members only? It is not an easy question. Even the simplest objective, such as "improving the rate of return to the plan," might not be appropriate for a particular investment if some other criteria, such as diversification of risk or the plan's need for liquidity, were violated in the process.

What can then be said about the following kinds of investment criteria of concern to any trade unionist:

(a) declining to invest in firms that carry on active anti-union campaigns, or that make huge sums available to lobby against the basic rights of unions and their members;

(b) declining to invest in firms that consistently violate labor standards such as Davis-Bacon, FLSA, OSHA, or EEO, or that make huge sums available to lobby for the weakening or the complete abolition of these standards;

(c) declining to invest in firms that in turn invest or do business in the Union of South Africa, and indirectly support or actively affirm that nation's apartheid policy;

(d) seeking to increase the amount of investment in products or services (such as housing or a medical clinic) that meet the needs of (1) plan participants and beneficiaries; (2) union members; (3) working people generally; (4) the unemployed/ the poor/the underprivileged;

(e) seeking to increase the amount of investment that will help to improve the economic climate of a locality or an area or a state or a region.

What can be said is that any or all of these are legitimate investment criteria that can and should be used in certain situations by any fiduciary with investment authority who is carrying out his/her responsibilities solely in the interest of the plan participants and beneficiaries.

What are the "certain situations?" When there is comparability between two or more alternative investments, not only in their projected yield, but also in their overall impact on the total portfolio of the plan.

How often will these "certain situations" arise? If those who are most involved in a plan's investment policy don't want to bother to search out the "certain situations," they will continue to regard them as quite unusual and they will not often arise. If they are concerned, and do bother to search out the alternatives, they will probably find them to be quite commonly available.

5. What is Being Done (or Actively Considered) to Change Investment Policy?

a. In the Public Sector

In the public sector more than in the private sector there is awareness that traditional ways of investing are not proving adequate to protect the value of pension fund assets in periods of rapid inflation. The public sector has also developed more discussion of investment problems and more active involvement of employees in the search for solutions. The approaches fall into several categories:

(1) Largely as a result of national concern over the export of U.S. capital to South Africa, a number of prominent universities, including Harvard, Yale, and Stanford, now maintain effective committees to advise their trustees on voting stockholder challenges, on new investments, and on the mix of the current portfolio. While the University of California is not among these prominent universities, Regent John Henning (who is also Executive Secretary of the California Labor Federation) has led the fight to divest the U.C. portfolio of South Africa holdings. The University of Wisconsin began to divest all of its South Africa holdings two years ago, after the state's Attorney General ruled that prior legislation prohibiting racial discrimination required it to do so. The University now reports no ill effects on investment performance. (Other public sector pension funds have not had the South Africa situation raised to the attention of their investment managers as forcefully as the college students have raised it on the major campuses.)

(2) A great many public sector jurisdictions in the U.S. have developed new investment policies which move away from traditional reliance on the equity issues of the blue-chip corporations, and move toward government insured loans--including housing loans which permit a preference for the state and a preference for low and middle income areas (such as those designed by Fannie Mae, or in California, by the state's Housing Finance Authority). Hawaii and Puerto Rico have gone a step further by directly investing part of their pension funds in low interest rate mortgages for pension fund members. Some jurisdictions have gone another step further to explore and to utilize investment possibilities in other federally guaranteed programs, in such areas as small business development, rural development, environmental clean-up, and development of new energy sources or methods of conserving energy.

(3) In a number of states an effort has been made to use pension investment policy to help enhance the economic climate of the state, or a particular region or local area. Kansas and Alabama in particular have had long-term success with this approach. A recently completed Wisconsin study concluded that a sizeable part of out-of-state investment of public employee pension funds could be redirected to stay in Wisconsin, with a more positive economic impact on plan participants, and without increasing risks or diminishing returns. In California, the San Diego City/County Reinvestment Task Force has issued a report which outlines over a dozen investment alternatives that would strengthen the San Diego economy by providing adequate capital for low and moderate income housing, rehabilitation, community economic development, and employment.

(4) In the arena of proposals, there has been an effort in at least nine states, including California, to establish a state bank or loan guaranteeing agency, backed up by taxing or bond-issuing authority, to act like existing federal agencies in guaranteeing or insuring loans and investment of funds deposited by governmental units or by public employee pension funds. The proposals to create such public banking agencies are usually designed to make a significant beginning in the rebuilding of U.S. cities, and to make more development capital available to nontraditional users. Many of these proposals have been modeled after the one existing public bank in the U.S.--the Bank of North Dakota (which has always contributed annual profits to the North Dakota State Treasury).

Although the California state bank proposal has not yet been voted out of legislative committee, it has been strongly supported by the California AFL-CIO. The Federation believes the state bank could be an effective tool to support low and moderate income housing, create long-term jobs in areas of high unemployment, provide efficient mass transportation facilities, and redevelop inner cities. The major public employee pension funds, PERS and STRS, have opposed the state bank proposal, along with the California Teachers Association and, of course, the California Bankers Association.

5. <u>What is Being Done (or Actively Considered) to Change Investment Policy?</u>

b. <u>In the Private Sector</u>

On the whole, private sector employees appear to be less concerned and less well informed than their public sector counterparts about the impact of inflation on their pension plan funding and investment policies. However, some understanding has slowly developed, and some different approaches have been taken or proposed. These appear to fall into several categories:

(1) While there is no official documentation, any discussion among union trustees or officials involved with their negotiated pension plans will soon reveal not only concern but also action on the subject of "divestment"--meaning the gradual substitution of other equivalent investments (a) for those which go to firms with heavy involvement in South Africa, and (b) for those which go to well-known anti-union firms. Over any time period of two years or more, enough alternative investment possibilities which are comparable in risk, potential return and diversification will usually arise to give wide scope for the legal use of divestment criteria.

(2) There are several important examples of investment policies of private sector plans designed to provide more services to plan participants and/or beneficiaries and/or working people generally:

(a) Some joint-trusteed plans have invested at good rates of return in the Mortgage Investment Program of the AFL-CIO, which makes housing units available in the geographic areas in which the plan participants live, and which takes advantage of government subsidies to permit the building of more housing units for low and moderate income wage earners. The same kind of result was more directly achieved when the ILWU pension plan made construction loan money available for the development of the St. Francis Square low income housing project in San Francisco. (The income limits for residents of this project excluded all regularly employed ILWU members, but the residents now include many lower paid union members.)

(b) The Retirement Trust Fund of the Plumbing and Piping Industry of Southern California (10,000 active participants, 4,000 pensioners) has been phasing out its equity investments and concentrating on first trust deeds on the completion of new construction projects in the Los Angeles area. All work on projects financed with these pension funds is done with union labor. There have been no delinquencies on the construction loans for years, and the interest yields have been high.

(c) The most impressive recent development came in the United Auto Workers' negotiations just concluded with Chrysler. The Corporation agreed to place at least 10% of available pension funds annually in "socially desirable" investments. A joint UAW-Chrysler Investment Advisory Committee will advise the pension fund trustees of communities in which UAW members reside, where residential mortgages will be picked up. The mortgages are to be for homes or condominiums which sell at or below the average price of sales in that community at that time. Investments will also be made in non-profit nursing homes, nursery schools, federally qualified Health Maintenance Organizations, or similar non-profit institutions in communities where there are large concentrations of UAW members. In addition, UAW and Chrysler have agreed to discourage investment in companies which do business in South Africa without having taken positive steps to support the elimination of racial discrimination there.

(d) A growing number of private sector plans now allocate funds to investors who utilize service or "social policy" criteria--such as the Third Century Fund of the Dreyfus Corporation, which began operations in 1972. This fund screens investments based on comparisons of companies in the same industry on issues of equal employment opportunities, occupational safety and health, protection and improvement of the environment, and consumer protection and product purity. Companies that pass these criteria are eligible for investments. In addition, a "special consideration" process, applied primarily to small companies, is used to select companies based on development of technology, products, or services related to health, housing, education or transportation. Other investment firms now using "social policy" criteria include the Union Labor Life Insurance Company ("J for Jobs" program), and Drexel, Burnham, Lambert (in a program called "Union Funds Management for Organized Labor").

(3) It has been possible in the past for unions to use pension fund investments to bring direct economic pressure to bear on corporate directors and institutional investors. One successful example was described by Barber and Rifkin as follows:

> The United Mine Workers were on strike against a Duke Power Company plant in Harlan County, Kentucky. Duke officials in Charlotte refused to come to terms with UMW demands. The union decided to break the deadlock by the threat of mounting a massive capital boycott against the company. Fifty-nine national labor unions joined the UMW in pledging not to buy Duke Power stock with their pension funds unless the company signed the contract in dispute. The company caved in almost immediately, but not before it was forced to withdraw a proposed $5 million new stock offering from the market. That little demonstration of raw economic power sent shock waves through the financial community. Within the labor camp it signaled (for some at least) the first real wave of recognition of this new and awesome form of potential power. . . .[9]

More recently, the matter of pension fund investments has become an extremely important element in the battle to organize J.P. Stevens. The Amalgamated Clothing and Textile Workers Union (ACTWU) has been successful in its campaign to unseat anti-union members of the Boards of Directors of Stevens, and Manufacturers Hanover, and New York Life Insurance Company (all highly interlocked in J. P. Steven's operations). The ACTWU has continued its campaign against other directors of Stevens, and has also been advising other unions on ways to apply pressure--in particular, the United Food and Commercial Workers Union, in its two-year effort to gain recognition as bargaining agent for the employees of the Seattle First National Bank. Last July, the AFL-CIO called for a national boycott of Seattle First National by union pension fund managers.

Roy Rogers of ACTWU argues that "unions must confront giant corporate capital with workers' capital. They must confront interlocking corporate power with interlocking workers' power." If either Stevens or Seattle First National is eventually unionized, labor's use of pension fund pressure on corporations and institutional investors is certain to increase.

(4) There are many proposals to develop more effective investment policies for private sector pension plans, of which several deserve special consideration.

(a) Two important suggestions were made in a recent Attorneys' Report to the Food and Commercial Workers Union:[10] First, organized labor should develop a list of corporations whose anti-union policies warrant a pension plan investment boycott, and a list of corporations whose relatively good labor relations records warrant the investment of pension plan funds. The key requirement for the use of such lists by trustees or investment managers is simply that the pension plan's financial stability must not be affected in the process. Secondly, any group of unions could hire an investment manager to create a fund that would invest only in companies whose labor policies are acceptable. The unions could decide which investments were unacceptable; fund managers could choose from among the eligible investments and create a financially sound, diversified investment portfolio. Shares in the fund could then be sold to private pension plans, public pension plans, and individual investors. (This approach would be the direct action equivalent to the use of other investing agencies which have begun to operate with "social policy" criteria, as mentioned above.)

(b) The Taft-Hartley or joint-trustee pension plans could opt to exercise the tremendous influence they might have on the nation's largest corporations and banks simply by accepting the responsibility to vote the shares of stock they hold, instead of allowing banks and other institutional investors to vote for them. Mel Rubin, President of Food and Commercial Workers, Local 137 (Bakersfield, California) who has had long experience in the development of this approach, suggests that:

> . . .by voting the shares and by coalescing with other unions also owning shares of stock, I believe we could, in fairly short order, be able to muster a 15-20% vote on almost any question at a shareholders' meeting, including the election of candidates to the board of directors. When we reach that percentage level I believe we will be able to attract the attention of other groups of shareholders who would seek our support for their own purposes. Together we could form a temporary coalition capable of fielding perhaps 30-35% of the votes. At that level we could legally insist upon the election of rank-and-file union representatives to the corporations' boards of directors and thereby help to influence a corporation's (labor-management) policy in the most fundamental of ways.[11]

(c) The AFL-CIO Executive Council recently appointed a committee to study and make recommendations on the pension fund investment problem. The committee has initiated a research project to determine how negotiated pension plans can be redirected to work more substantially in the interest of the workers they were created to serve, while fully protecting the fiscal soundness of the funds. The research is to include an examination of the domination of investment policy by a handful of financial institutions and corporations, and an investigation of how unions can obtain greater influence in investment policies.

In addition, the national Building Trades Council, in response to recommendations from the California Building Trades Council, is pushing for legislation to create a low-interest home loan program, which would take home financing and building out from under the extraordinary restrictions of high interest rate economic policy. If legislative guarantees to achieve this purpose could be joined with new opportunities for pension fund investments in a government home loan corporation, a variety of social and practical purposes could be served, and the nation's emerging housing crisis could be alleviated.

6. Conclusion

The two most important questions are whether workers who have been promised pensions are going to be able to collect them--and whether they will then be able to live on whatever amounts they can collect. For the promises to be met at present rates of inflation, either the contribution rates will have to go up significantly (which means they will cut heavily into the amounts that workers can bargain for wages and other benefits), or else traditional investment patterns will have to be changed. In most cases, both requirements will have to be met.

There are valid and legal alternative investment approaches which have been considered and explored carefully at least in the public sector. In the private sector, a few unions and individuals have shown concern and have provided leadership. But most others are not listening. Most unions prefer to rationalize that "it's all someone else's problem, not ours."

Unfortunately, when the impact of current inflation is added to the poor record of past pension fund investments, and the underfunding record of many plans, the result is a serious threat to the value of all pensions promised to all workers in all plans in the U.S.--public and private sector alike. In addition, the future development of our nation's economy depends on the answers given to many of the pension fund investment questions raised by the writers and analysts cited in this report.

A combination of divestment, alternative investment, and voting of proxies in current investments may well be the emerging strategy pension funds can use to further the interests of their participants. But the first step in beginning to implement new ideas is to provide trustees, plan participants and union officials with specifics on the kinds of investment policy proposals they can and should be making. A recent AFL-CIO resolution calls on affiliates to allocate resources to research and develop these specifics. Labor unions and labor organizations can best begin by joining together to establish a program and a staff to do this job.

Individual unions and labor organizations should also join together to encourage the continuing education of union trustees, officers, members, and plan beneficiaries in several important ways: first, by sponsoring or encouraging useful research or demonstration projects; secondly, by developing more contact and communication with community groups sharing the concern of some labor people about the social significance of pension plan investments; and third, by finding new ways of communicating within labor in order to learn about and share the pension funding and investing experience of other unions or organized groups of employees.