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The Evolving Role of Labor in Pension Fund Investment

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by Jack Sheinkman*

Awakening Concern over Investment Policy

Within the last five years, union leaders and disinterested members of the public have become concerned over the administration of union pension funds by pension managers designated by employers. What triggered our concern was the increasing evidence that a substantial portion of the assets of pension funds which are controlled by employers and managed by banks, life insurers, and registered investment advisors (which I shall collectively refer to as "traditional pension fund management") are invested in a manner which conflicts with, and may indeed undermine and frustrate, the immediate and long-term objectives of the union members for whom the funds were established.

Initially, labor leaders felt a sense of frustration and outrage at this realization. As far back as 1978, I testified before the Senate Judiciary Subcommittee on Citizens and Shareholders Rights and Remedies. I said:

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> The American labor movement can no longer sit idly by. It is obligated to prevent its pension funds from being used in such a manner as will be inimical to the welfare of working men and women. We can no longer tolerate such abuse of assets held in trust for our workers.[1]

We then began the search for the hard facts that would justify the intervention of labor union leaders into pension fund investing. We knew that without the hard facts, we would be unable to shake the firm hold of traditional pension fund management on the investment of pension fund assets. A committee of the Industrial Union Department of the AFL–CIO[2] (the "IUD Committee") retained Corporate Data Exchange of New York to undertake in-depth studies of pension plans administered by employers or their hired managers. These studies were done in order to provide reliable data on the performance of the pension fund monies controlled by employers or their hired managers in financial institutions.

There were two major findings of the Corporate Data Exchange studies. The first and most significant finding was that the rate of return on company-controlled pension investments over the last decade has not only lagged behind the inflation rate and average stock market yields, but has amounted to less than the interest rate on savings accounts. This finding is consistent with those of the well-known A. G. Becker, Securities Evaluation Service, which in 1980 found the total return on pension funds was only 4.3 percent from 1970–80.[3] The second important finding was that the assets of the large pension funds often have been invested in nonunion firms and firms with high overseas employment.[4]

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[1] One of the former staff members of the Amalgamated Clothing and Textile Workers Union, Ray Rogers, has expressed labor's reaction somewhat simplistically, but in a manner demonstrating the outrage described above: "The damn pensions are our members' money . . . they own that money. I can't understand why, when we own something, we can't go get it and do whatever we please. Especially if it's subverting our interest. And when I have money in a bank and that money belongs to my members, and we make a decision that we don't like the way the bank is doing business, there is no reason why we should have to leave the money with that bank. It makes no sense." [Rifkin and Barber, *The North Will Rise Again* (Washington, D.C.: Peoples Business Commission, 1978), p. 145.]

[2] The AFL–CIO Industrial Union Department Executive Council's Committee on Benefit Funds.

[3] "Should Pension Funds Be Used To Achieve Social Goals," *The Wall Street Journal*, April 15, 1980; also, *Trusts & Estates*, 10–14 (September 1981).

[4] Industrial Union Department, *AFL–CIO Pensions, A Study of Benefit Fund Investment Policies* (Washington, D.C., 1980), p. 2.

These findings led the IUD Committee to conclude that the immediate and long-range interest of pension fund beneficiaries would be better served if unions representing employees covered by pension funds became active in the management of such funds. To achieve this objective, the IUD Committee recommended that where the employer alone controlled the investment of pension fund assets, the union use its leverage in collective bargaining with the employer to obtain a voice in the management of the funds covering its union members.

The IUD Committee further recommended that the union require fund investment managers to follow investment guidelines that optimize return on sound and secure investments and also serve the present and long-range needs of the labor union members who are the beneficiaries of the fund. Some examples of sound investments suggested by the IUD Committees are: (1) residential mortgages and other investments that promote the development of communities in which fund beneficiaries work and live; (2) securities of firms with large domestic work forces; (3) securities of firms that have good labor relations records and support their employees' organizational rights under the Fair Labor Laws.[5]

Opposition of Traditionalists

As soon as organized labor began to point out the failure of traditional pension fund management to perform well financially, and to object to investments that were in conflict with the objectives of the labor union members who were the fund's beneficiaries, representatives of the traditional pension fund management and employers began to vigorously oppose the demand of labor for a role in pension fund investment. They contended that the obligation of pension fund management was to act prudently and that the revisions in investment approach sought by labor almost certainly would jeopardize the safety of the pension funds involved. They argued that the use of the expertise of traditional pension fund management was essential for the safe and most productive investment of pension funds,

[5] Ibid., pp.2–6.

and, in any event, union participation in pension fund management was unworkable.

Our answer was that, of course, those who control the pension funds, whether labor or management, had to be primarily concerned with prudent investments, securing expected benefits for the workers covered by the funds. We pointed out that prudence did not, however, require that pension funds be invested against the economic interest of the workers. For instance, prudence does not require a pension fund to invest in a multinational corporation when such investment is likely to contribute to the outflow of capital investment and unemployment in the United States. Other investments not producing such results are generally available. Similarly, there are many prudent investment opportunities available that do not involve antiunion firms.

Our answer to the argument that labor's influence on pension and decision making could produce financial disaster for the pension funds is to point out that the few funds which take socially responsible criteria into account in determining investments have sustained a better record of performance than traditionally managed funds. The Teacher's Insurance and Annuity Association, composed of 650,000 members, has an $8.6 billion fund which has had an average annual return of 11.1 percent over the last five years, using an investment approach that takes consumerism, environmentalism, product safety, hiring practices, and investments in South Africa into account.[6] Another example is the Dreyfus Fund, a $200 million fund which increased the value of its net assets by 31.6 percent in 1981 by using an investment approach which took into account environmental protection, occupational health and safety, consumer protection, and product safety.[7] A third example is the Hospital and Health Employees $360 million pension fund, which, as a result of union demands, sold off $6 million of stock in 19 auto, oil, drug, and financial companies with an active presence in South Africa in 1978. The alternative investments selected produced a 30 percent return on the equities in the fund.[8]

[6] A. H. Raskin, "Pension Power," *The Journal of the Institute of Socioeconomic Studies* (Winter 1981–82), pp. 97–98.

[7] Ibid. p. 98.

[8] *The Wall Street Journal*, July 23, 1980, p. 25.

Fiduciary Issues

Union leaders have the same fiduciary obligation as does traditional pension fund management to make certain that pension funds are managed in such a way as to optimize the plan benefits for union members. However, the union leader is also accountable to his members for poor fund performance or poor investments. Intervention by union leaders in the investment of pension plan assets is therefore essential if union leaders are to satisfy their legal obligations to their members.

Organized labor is searching only for lawful ways of influencing the use of pension funds. We do not advocate the elimination of the requirements of ERISA that pension fund assets be invested prudently and be used for the exclusive benefit of the plan beneficiaries or that pension plan investments be prudent.[9] Nor does organized labor have any quarrel with the recent Supreme Court holding in *NLRB* v. *Amax*, 453 U.S. 322 (1981)[10] that the duty of loyalty of the trustee of a plan must overcome any loyalty to the party that appointed him.

Indeed, our objective is to have union pension funds avoid investments which conflict with the interests of the plan beneficiaries. It is a disservice to the interests of labor union members covered by a pension plan to invest pension fund assets in antiunion firms or multinational firms whose operations are overseas. It is a disservice to the interests of labor union members to invest in companies with strong connections in South Africa, when so many labor union members are morally outraged by the notion of dealing directly or indirectly with a country in which the rank discriminatory doctrine of apartheid is the state policy.

The elimination of investments in corporations engaging in morally repugnant activities will violate no legal rule, if alterna-

[9] Employees Retirement Income Security Act of 1974, § 404(a)(1) 29 U.S.C. 1104(a)(1).

[10] In *Amax*, the Supreme Court held that "although § 302(c)(5)(B) [of the Labor Management Relations Act] requires an equal balance between trustees appointed by the union and those appointed by the employer, nothing in the language of § 302(c)(5) reveals any congressional intent that a trustee should or may administer a trust fund in the interest of the party that appointed him or that an employer may direct or supervise the decisions of a trustee he has appointed." 453 U.S. at 330 The Court in *Amax* further held that "ERISA vests the 'exclusive authority and discretion to manage any assets of the plan' in its trustees alone, and not the employer or the union." 453 U.S. at 333.

tive suitable investments are available, as they always are. There is no legal obligation on the part of those managing the fund to search out investments in entities that are so tainted morally that they may yield an extraordinarily high return. The applicable rule is set forth in Scott's LAW OF TRUSTS as follows:

> Trustees, in deciding whether to invest in, or to retain, the securities of a corporation, may properly consider the social performance of the corporation. They may decline to invest in, or to retain, the securities of corporations whose activities or some of them are contrary to fundamental or generally acceptable ethical principles. They may consider such matters as pollution, race discrimination, fair employment, and consumer responsibility.[11]

As I said before the Senate Judiciary Subcommittee on November 22, 1978: "No one is advocating imprudent investment of pension funds. . . . But, within the area of equally acceptable investment risks, there are often alternative choices. It is in this area that broader social and economic criteria can be used to take advantage, without sacrificing the dollar return or the invested funds."

This approach has been approved by the U.S. Department of Labor. In 1979, Ian Lanoff, who was until recently the administrator of Pension and Welfare Benefit Programs at the Department of Labor, testified before a Senate subcommittee in February 1979: "If, after evaluating other factors, two investments appear to be equally desirable [in economic terms] then social judgments are permissible in determining which to select."[12]

In my view, union leaders have a fiduciary obligation to attempt to influence the investment of union pension funds in a manner which promotes the interest of the members of the union covered by such fund. I can see no justification whatsoever for barring participation of union leaders in the investment of assets of union pension funds. These pension funds have been built up solely by contributions obtained as a result of the efforts of unions through collective bargaining. They were created by the efforts of unions; their assets are held exclusively for the benefit

[11] Scott, *Law of Trusts*, vol. III, § 227.3 (1978 Supp.).

[12] Ian Lanoff, "The Social Investment of Private Pension Plan Assets" and "May It Be Done Lawfully Under ERISA?" 31 *Lab. L. J.* 387, 390 (1980).

of union members, and their assets increase whenever unions, through collective bargaining, obtain an increase in contributions.

Traditional pension fund management has attempted to discredit union influence in pension fund investing by contending that the leaders of unions are ignorant of the intricacies of investment practice and are ill equipped to make sound judgments in the selection of investments.[13] This claim is totally unwarranted. Almost every major union has millions of dollars of its own funds to invest and does so generally with its own expert personnel cooperating with investment counselors or financial institutions such as the Amalgamated Bank. Indeed, unions such as Amalgamated Clothing and Textile Workers Union, United Federation of Teachers, and the International Ladies Garment Workers Union, have secured much higher returns on their investments than the returns secured on the pension fund investments managed by the traditional pension fund management.

Union leadership does not wish to substitute the standard of "socially responsible" investment for prudent financially responsible investment. Where an investment deemed injurious to union members is eliminated, there is no desire by responsible union leadership to substitute any investment, whether or not it serves some social objective, with an investment that is not financially sound. Similarly, investments which improve the economy, the job opportunities, and the public services available for union members in urban centers need not, and should not, be made with pension funds unless they are financially sound. The recent experience of public pension funds investing in New York City with special safeguards at a time when New York City was in financial distress indicates innovative investment in such areas may possibly be prudently made.

The potential impact of union attempts to have pension funds make socially responsible and union-oriented investments should not be minimized. The total amount of nonfederal pension plan assets has been estimated as of 1980 to be in excess of $650 billion, of which union pension funds constitute several hundreds of billions of dollars.[14]

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[13] *The Wall Street Journal*, July 23, 1980, p. 25.

[14] Lawrence Litvak, *Pension Funds and Economic Renewal*, vol. 12, Studies in Development Policy, the Council of State Planning Agencies and Raskin, *Pension Power*, p. 76.

Recent Developments

Since the late 1970s, the leaders of organized labor have asserted that they have every right to use union influence to assure that union pension funds shall not be used for purposes conflicting with the interests of the union's members.[15] This is a proposition which, although first advanced only a few years ago, is beginning to gain acceptance even in the world of traditional pension fund management. Indeed, some of the leading investment firms—Drexel Burnham Lambert, Inc., the Prudential Insurance Company of America, National Bank of Washington, Aetna Life Insurance Company—have established funds which will invest primarily in union-built construction.[16]

What is far less accepted, and would indeed require federal legislation, is the next logical step—the use of union pension funds to assist their own ailing industries to renovate and replace their equipment, thereby helping to eliminate unemployment in industries covered by a union pension plans.

Labor leaders have announced programs to provide mortgages for middle-income residential housing, investments in nursing homes, nursery schools, and similar nonprofit entities. Some labor union leaders have been able to get their pension funds to agree to invest in union-built construction. The Marine Engineer's Beneficial Association plans to use some of its $400 million pension funds to construct union-built ships and a pension-owned shipping company.[17]

While these programs move in the right direction, we need even more affirmative action and swift implementation. Thus far, pension funds have been used to create jobs for union workers primarily in the construction industry.[18]

Most union leaders outside the building trades have done little more than use their influence to prevent pension funds from being invested in a manner which clearly conflicts with the objectives or welfare of the union members covered by such

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[15] Ibid., p. 84.

[16] Shearson/American Express, Inc., has in registration with the SEC an equity fund having as its primary objective capital appreciation but will also be concerned with social responsibility.

[17] Raskin, Pension Power, p. 5 and Department of Labor Advisory Opinion, 80-33A (June 3, 1980).

[18] Raskin, Pension Power, p. 5.

funds. While such efforts are significant and will ultimately operate to the benefit of union members, so far they have had little impact on eliminating unemployment of union workers.

We are all sadly aware that the current recession is deep and particularly painful for the over 10 million workers, including millions of union members, who are unemployed in this country. Many industries are unable to compete in the marketplace because of their failure to replace worn-out or outdated equipment. It has become increasingly obvious in recent years that one of the major reasons imports have made significant inroads in a number of different product areas, such as steel, is that the domestic manufacturers of such products are producing with outmoded equipment. An industry that has largely obsolete equipment may have unemployment even where general demand for the industry's product exists.[19]

Organized labor believes that this country must use all available tools to eliminate unemployment. Certainly, it is in the interest of labor leaders and union members to stimulate employment in the very industry which employs or has employed them. At various times in its history, this country has determined that the health of one of more of its industries or the production of certain products or services justified the use of federal guarantees or insurance. The housing industry still benefits from Federal Housing Administration insurance of mortgage loans and a significant amount of American industry has for many years received direct or indirect assistance from federal and state governments designed to assure its survival and ability to compete. The use of guaranteed pension loans to industry, which are essential for the program I suggest, is certainly not without precedent.

It is true that if a pension fund lends money to a manufacturer in the industry covered by such fund to enable him to retool and compete more effectively, such loans may violate the party-in-interest standards of ERISA. However, if legislation is adopted by Congress providing for a guarantee of such loans by either the U.S. government or an appropriate agency of the government, such loans would then be prudent under the standards of ERISA, and the welfare of the pension fund's beneficiaries could not be

[19] *See* Sol C. Chaiken, "Trade, Investment and Deindustrialization," *Foreign Affairs* 60, no. 4 (Spring 1982), pp. 845–47.

jeopardized. Loans by pension plans to an employer secured by certain real estate or the marketable securities of an employer in a principal amount exceeding 10 percent of the fair market value of the pension fund's assets and all other loans by a pension plan to an employer not secured by marketable securities or certain real estate of the employer would constitute prohibited transactions under ERISA,[20] but an exemption for such prohibited loans can be granted by the U.S. Department of Labor. Such an exemption has, in fact, been granted recently for a pension fund loan to the employer of an amount equal to 21 percent of fair market value of the assets of the pension fund.[21]

A Proposal

The legislation providing for establishing such guarantees should establish a federal administrative agency like the Federal Housing Administration to determine which employers merit this type of guaranteed financing. The enabling legislation should also amend ERISA to authorize the Department of Labor to establish regulations which simplify the process of obtaining Department of Labor exemptions for loans to employers which qualify for the federal agency guarantee. Under the program the agency would have the obligation to determine that other commercial financing was not available, and that with the guaranteed financing furnished by the pension fund, the company would be able to survive in the marketplace. Strict enforcement by the agency of these conditions is essential to limit the exposure of the federal government under the guarantees used in the program, and to assure the achievement of the objective of the program to make employers more competitive and capable of surviving in the marketplace.

The use of such guaranteed pension fund loans would complement other efforts of the AFL-CIO to establish an independent institution, similar to the New Deal's Reconstruction Finance Corporation, to facilitate the reindustrialization of America[22] and would hopefully allow a substantial portion of

[20] § 406(a)(1)(B) and § 407(a)(2) of Employee Retirement Income Security Act of 1974, 29 U.S.C. 1106 (a)(1)(B); 29 U.S.C. 1107 (a)(2).

[21] P. T. Exemption 79.3, 44 Fed. Reg. 8366 (1979).

[22] Raskin, *Pension Power*, p. 5.

this country's industry to regain the competitive position it has lost in the U.S. market and world markets over the last several decades. Such a gain in competitive position should help eliminate much of the unemployment plaguing our domestic industry and make available many of the jobs lost as a result of deterioration of plant equipment.

One of a union leader's most important objectives is the full employment of the members of his union. Indeed, union pension funds have [financial] difficulties if too many covered members are unemployed. Every union leader who is a trustee of a pension fund, or is able to influence pension fund investment decisions, should encourage affirmative investments that are prudent and likely to reduce unemployment or the risk of unemployment in the very industry in which his members work.

The proposal I have advanced arises out of the growing conviction in the circles of labor, industry, and economics that traditional approaches to the complex economic problems that have significantly affected the health of American industry are not likely to yield a solution to such problems. And if we fail to solve our economic problems, the working men and women of this country will suffer greater and greater hardship.

Organized labor must lead the way toward regeneration of the nation's economic health. Financing plays the critical role in the reactivation of any economy. The pension funds, with their abundant assets, amounting to hundreds of billions of dollars, are available in every sector of industry throughout the country. Trustees are generally knowledgeable about the industry covered by their own pension fund and are well equipped to make the initial financial judgments required for pension fund loans to employers in the industry. These trustees, subject to supervision by the federal agency established to administer the proposed guaranteed loan program, can serve as part of the administrative structure of the agency thereby minimizing the amount of federal governmental personnel required and the time needed to initiate the program.

Admittedly, this approach to pension fund investment is new. However, the technique suggested is substantively the same as used in the New York City fiscal crisis several years ago. The trustees of the New York City municipal employees' pension plans, after obtaining certain legislative safeguards, committed a substantial portion of the assets of their pension plans to buy all the New York City bonds that no one else wanted. This investment saved New York City from default, gave the pension funds an excellent return on interest on their bonds, and secured the jobs of the thousands of municipal workers who were covered by the pension funds assisting the city in its crisis.[23] As the experience of New York City's municipal pension funds indicates, pension fund investments in the very industry which employs the beneficiaries of the pension fund may at times be necessary to secure the jobs of the beneficiaries.

In this country whole industries have failed to modernize their equipment, and the result has been a steady attrition of the industry's work force in such industry. Substantial portions of numerous other industries suffer from obsolete and worn-out equipment the employers do not have the funds to replace.[24] I do not believe we can wait much longer before direct measures are taken to eliminate this type of unemployment. Such unemployment will be permanent unless we remedy the loss of a competitive posture.

The proposal is basically simple. I believe affirmative action, making use of the pension funds created by union members, can play an important role in reducing the high rate of unemployment now crippling the nation. This process will not only help the economy, it will help strengthen the pension fund system participating in the new program, for by reducing unemployment, it will increase the contributions into pension funds.

Organized labor now has an opportunity to provide a meaningful counterthrust to the decline of American industrial strength by using its political and economic power to press for a major retooling of American industry. Such an endeavor is one in which labor and management combine for their common good to restore the employer's prosperity and ability to employ a full complement of union workers. I submit that labor leaders, employers, and other sharing their concerns throughout the country should lend their support to this initiative, an initiative born out of watching the sadness and despair of those who already have lost their means to earn a living in a country known for so long as a land of opportunity.

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[23] Ibid., p 5.

[24] "Rebuilding American Industry," *Viewpoint*, Winter 1981, published by Industrial Union Department, AFL–CIO; see also Chaiken, *Trade*, p. 13, and Raskin, *Pension Power*, p. 5.