Social Investing

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Investment of Pension Funds—The Concerns of Organized Labor

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by John H. Lyons*

The AFL-CIO has a right and a duty to be concerned about the rapid growth of pension funds and the impact of these funds on the economy and on the economic well-being of union members. Pension funds are the nation's fastest growing source of capital. This year alone they will probably invest $60 to $70 billion in the economy—potentially one half of all the funds that will be raised by American corporations from all outside sources.

There are about 500,000 private pension plans, 6,600 state and local government pension plans, and 30 special federal workers' retirement plans, which, in 1980, collectively held more than $834 billion in assets. Of this amount, about $550 billion was in private plans, $368 billion of it in plans negotiated by unions. Of that amount, about $147 billion was in joint-trust multiemployer plans and $221 billion in single-employer plans. Nonfederal public employee plans had more than $200 billion in assets.

These pension funds can be most simply defined as the deferred wages of workers that belong to them. Yet, the true owners do not exercise control over their property. Moreover, there is considerable evidence that much of their pension money is invested in ways that injure their own interests. The economic and

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industrial policy of the United States is to an ever-increasing degree being dictated by banks and insurance companies which are investing the funds they control, including union pension funds, in antiunion firms in the United States, and increasingly, overseas.

For example, 10 large banks, in which U.S. Steel and Bethlehem Steel pension funds held $133 million in stock, loaned over a half-billion dollars to several Japanese steel companies for modernization and expansion of their facilities. In other words, steelworkers' pension money was used in a way that has injured American steelworkers and their industry.

I can personally attest to another example. Not too long ago, with a number of labor officials, I made a tour of "Condominium Row," a new apartment complex being built on Florida's Gold Coast. We were all shocked to discover that 11 of the 12 structures were being built nonunion, and all were financed with union pension fund money.

These are two of many examples that have convinced the AFL-CIO and its affiliates that union pension funds are being used in ways that often work to the detriment of the workers who own them. The labor movement can no longer watch these developments and do nothing. We have an obligation to insure that our members' pension money is not used in ways that are harmful to their own interests.

Committee on Investment of Pension Funds

Three years ago, the AFL-CIO executive council established a Committee on the Investment of Union Pension Funds to study the problem and to make recommendations on appropriate pension investment policies. I was named Committee Chairman.

In August 1980, on the committee's recommendation, the executive council unanimously adopted a broad set of pension investment guidelines based on these four policy objectives:

1. To increase employment through reindustrialization including manufacturing, construction, transportation, maritime, and other sectors necessary to revitalize the economy.
2. To advance social purposes such as workers' housing and health centers.
3. To improve the ability of workers to exercise their rights as shareholders in a coordinated fashion.

4. To exclude from union pension plan investment portfolios companies whose policies are hostile to workers' rights.

Since there are cost, legal, and other difficult problems which have to be overcome, the committee recommended and the council adopted a number of implementation proposals directing the AFL–CIO to:

1. Take the initiative in working for the establishment of a new independent institution, partially supported by pension funds and aimed at the promotion of employment as part of a program of reindustrialization.
2. Encourage greater participation of union pension funds in programs designed to increase employment.
3. Urge increased participation in the AFL–CIO Mortgage Investment Trust in order to increase the supply of housing for workers and other socially useful projects where there is a government guarantee of the investment.
4. Encourage pension fund trustees to exercise shareholder rights associated with the equity stocks held by individual pension funds and to explore the possibility of coordinating the exercise of such rights.
5. Establish an information system to advise its affiliated organizations which companies should be considered unworthy of investment.
6. Establish a special training program to assure that those responsible for determining pension fund investment policy have the knowledge they need.
7. Endorse the recommendations of the Industrial Union Department concerning trade union representation in the management and direction of pension funds.

Industrial Union Department

The Industrial Union Department (IUD) is one of eight AFL–CIO trade and industrial groupings for unions with strong common interests—in this case industrial unions. The IUD urged its affiliates to consider securing as much say as possible in the investment of collectively bargained benefit funds with joint administration as the objective and, at the very least, obtaining full information on fund operations.

The interim steps short of joint administration could take many forms. For example, the union could use collective bargaining to restrict trustee selection to neutral outsiders, or to require that trustee selection be subject to a union veto. Alternatively, the union might insist on a voice in the selection of pension fund administrators, investment advisors, or other organizations that provide financial services to the fund.

This represents a significant policy change for AFL–CIO industrial unions which traditionally had negotiated levels of pension benefits but had left the operation and investment of pension funds solely to management. In fact, some industrial union leaders in the past had taken the position that involvement in the investment of these funds would conflict with their obligations as trade union officials.

Unions that have negotiated multiemployer plans are in a better position than those with single-employer plans, since the former have equal representation with management. Since multiemployer plans are widespread in the construction industry, it is not surprising that building trades unions have been in the forefront of efforts to use pension funds to create jobs for members and to insure that projects are built with union labor.

For example, the AFL–CIO Building and Construction Trades Department has begun a program to place $500 million in pension fund money in job-creating investments. The department will not make any investments itself, but will provide education and guidance for union pension fund trustees and plan administrators.

The department will hold a series of regional pension investment "expositions" to discuss coordinated investment opportunities and to hear presentations from groups that are looking for funding for construction projects. Both union and management trustees will be invited, along with their legal counsel. We believe this effort will significantly increase pension fund investment in union-built projects within ERISA's requirements for prudent investment of plan assets.

Mortgage Investment Trust

The AFL–CIO presently operates a nonprofit Mortgage Investment Trust (MIT). This is a comingled trust fund for investment of union funds in federally insured or guaranteed construction loans and mortgages. It accepts investments only from AFL–CIO affiliates and qualified labor-management pension, welfare, and retirement plans. Participating plans buy AFL–CIO MIT certificates, which represent a share of the trust's mortgage pool. It has provided mostly short-term construction financing loans because participation certificates can be redeemed on 60 days' notice.

The trust is now planning to establish a separate MIT fund to provide long-term residential mortgages. This new fund will invest in long-term government-insured and guaranteed real estate mortgages and will provide a safe, diversified investment vehicle to finance needed housing and other construction.

Public employee pension funds are especially active in seeking socially responsible investments largely due to the efforts of state governors. Although there are some major exceptions, public employees are normally represented on the boards of trustees of these funds, frequently as representatives of unions. Public employee unions are increasingly bringing pressure on fund managers to insure that public pension funds invest in ways consistent with the interests of their members. These unions have emphasized using pension funds to build affordable housing for participants and to support regional economic development.

The AFL–CIO would prefer that most of this stimulus for such economic development be done through a national industrial development authority which would mobilize public and private pension funds to create jobs in areas affected by economic dislocation. Such an institution should provide attractive interest rates and loan guarantees. President Carter was moving in this direction in 1980 when he appointed Lane Kirkland, President of the AFL–CIO, and Irving Shapiro, then Chairman of the Du Pont Corporation, as co-chairmen of a new Economic Revitalization Board, to recommend the structure and goals for this kind of a development authority.

Such an authority would enable pension funds to voluntarily and safely invest a portion of their funds in projects aimed at rebuilding American industry. This is clearly in the best interest of pension participants and workers, as well as the nation. Though the present administration has no interest in such a proposal, we believe it is only a matter of time until economic realities and a friendlier administration will revive it.

In addition to gaining a voice in choosing pension fund investments, the AFL–CIO feels that unions should help insure that shareholder rights are exercised in the best interest of union members. Traditionally, voting rights of stocks owned by pension funds have accrued to plan fiduciaries and investment managers who are, to a considerable degree, concentrated in a few major banks and other financial institutions. We are concerned that such control enhances the economic power of institutions which are already too powerful to the disadvantage of both union members and the general public.

For example, one recent study of the largest shareholders of the Fortune 500 companies revealed some interesting conflicts of interests in the takeover of Conoco by Du Pont. Thirty-four of the top shareholders of Conoco were also principle shareholders of Du Pont, holding 22.9 percent of Conoco and roughly 19 percent of Du Pont. (The holdings of the 34 shareholders when added to that of the Du Pont family amounted to 60 percent of the total for the Du Pont Corporation.) In effect, these 34 shareholders in both companies were voting to merge and to pay themselves $3 billion—an amount far in excess of what their Conoco shares cost them and more than they would have been worth had there not been a takeover by Du Pont.

Similarly, the U.S. Steel Corporation recently spent $6 billion to outbid Mobil Oil to purchase control of the Marathon Oil Corporation. This money, spent to purchase inflated stock, could much better have been spent to modernize the steelmaking facilities of U.S. Steel and to enhance the productivity and competitiveness of the American steel industry.

Computer Tracking Project

Concern over these kinds of activities is one reason the AFL–CIO has begun a computer tracking project, coordinated by the AFL–CIO Department of Social Security, which will analyze the stockholdings of the one hundred largest union-influenced pension funds in the nation. This information will be updated at least twice a year and will be made available to affiliates for exercising shareholder rights, for organizing drives, or for any other purpose or activity for which the affiliate might find the information useful. While it is not anticipated that the AFL–CIO would use the information to initiate shareholder actions itself, the availability of the information should greatly assist affiliated organizations in developing this strategy. This project will reinforce AFL-CIO objectives to insure that union pension fund investments are used in the best interest of union members and retirees.

These new AFL-CIO initiatives relating to the investment of union pension funds have aroused some alarm. Despite what some journalists and some banking and insurance executives have said, the AFL-CIO is not advocating the imprudent investment of pension funds. The primary objective must be to make retirement benefits secure for workers. But there are alternative choices to be made well within the area of equally acceptable investment risks. Broader social and economic criteria can be used to achieve AFL-CIO policy objectives without sacrificing the return on invested funds and perhaps even enhancing it.

Critics of union involvement in the investment of union pension funds generally assume that those who manage the investments are doing so well for participants that any alternative would be worse. That isn't so. A. G. Becker, Inc., a fund evaluation service that monitors the performance of pension funds, has consistently found that pension funds produce low rates of return. For the 15-year period 1966-80, the funds earned a median annual return of 5.5 percent. Compare this with an annual return of 6.8 percent for Standard and Poor's Index of 500 stocks. Obviously, if fund managers had blindly invested the funds in a cross-section of stocks, the return could have been higher than they were through selection and analysis by these so-called experts.

Even this performance is deceptive since it was distorted by the strong stock market of 1980, when oil stocks held in large quantities by pension funds skyrocketed. For the 15-year period ending in 1978, the annual rate of return on pension funds was only 4.4 percent. In other words, participants would have been as well off if their funds had been invested in passbook savings accounts.

In view of this record, the warnings of these same investment advisors that social investment will result in low rates of return have little weight. The fact is that investments that include social criteria may perform as well and even better than investments that ignore such criteria. For example, the Dreyfus Third Century

Mutual Fund, the leading institutional investor using social criteria, has consistently outperformed the market. From January 1975 through September 1980, it grew 384 percent, compared with 140 percent for Standard & Poor's 500.

At the same time, broader economic and social criteria may well have a greater long-range beneficial impact on union pension plan participants. Employment for union members, economic growth in their communities, and the achievements of workers' rights elsewhere are benefits as tangible as money.

We believe consideration of these broader criteria is permissible under existing law. If an investment advisor conducts a careful analysis, based on appropriate financial criteria, which yields a group of equally prudent and attractive investments, why should the trustees not examine the result in the light of additional criteria to determine which might be more advantageous to union members? Other things being equal, what could be more appropriate, prudent, and in the interests of participants than to invest in a project that would make jobs for union members as contrasted with financing an antiunion employer with a record of federal labor law violations, or the subsidizing of foreign steel modernization, or the building of ships that handle U.S. exports in foreign countries?

Not everyone will agree that these new pension investment activities are a proper function of trade unions, but the AFL–CIO believes that when workers' own money is used against their interests, there is no other choice. We need this new tool to more effectively advance the economic well-being of workers. The safe and prudent investment of pension funds to better the life and conditions of this nation's working men and women is not only proper but essential.