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# Your Retirement or Our Political Agenda

How Politicized Investment Strategies Threaten Workers' Pensions

By F. Vincent Vernuccio*

The current economic crisis has brought retirement security to the forefront of worker consciousness. Americans saw their retirement investments plummet in 2009. As in other economic downturns, the market is bound to rally back eventually, and most investors will recoup their losses. However, some workers may be surprised to learn that their pension fund managers sometimes pursue political goals that are ancillary to providing the best return on the investments they oversee and making sure the pensions they manage are fully funded. They pursue these goals in two ways. The first is by targeting investments or divesting, screening out certain investments. The second is by shareholder activism using the pension's stocks in proxy campaigns.

Defined Contribution (DC) plans are held by individuals and traditionally consist of 401(k), 403(b), employee stock ownership, and profit-sharing plans. Generally an employee will make contributions to a DC plan—sometimes with matching employer contributions—which vests after a specific time period. The value of the plan can fluctuate depending on the success of the investments.[1] Once a DC plan vests, an employee is entitled to its entire balance. Critics of DC plans claim that they shift risk from businesses to workers and are not a secure as Defined Benefit (DB) plans.[2] Proponents argue that DC plans are better investments and yield higher returns because the investments over the lifetime of a worker are stable and less risky than DB plans, which can fail if a company sponsoring them goes bankrupt.[3] Finally, in an ever mobile society, DC plans allow workers to switch jobs without jeopardizing their retirement.

DB plans are pensions that promise a specific monthly benefit during retirement and are federally insured up to a limited (in some cases very limited) amount by the Pension Benefit Guarantee Corporation (PBGC).[4] DB plans are large and beneficiaries generally have very little,

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if any, control over the investments made by investment managers. Plan fiduciaries manage the investment and the employer or plan sponsor is responsible for ensuring that the investment earnings will be able to pay for the promised benefit.[5] Critics of DB plans claim they do not yield as large returns as DC plans and prevent employees from having the mobility they may need to further their careers. Another criticism is that groups such as unions advocate for DB plans so they can utilize the investments under their control for social and political agendas unrelated to investment performance.[6] Proponents argue that DB plans are safer than DC plans and provide a stable and dependable retirement income.[7]

If an individual holder of a defined contribution plan wants to direct his investments to political or social ends that is his choice. On the other hand, defined benefit plan managers are bound by a fiduciary duty to the participants and beneficiaries in their plan.[8] As the courts and many Department of Labor (DOL) pronouncements have said, it is the job of pension plan managers and fiduciaries to invest with an "eye single to the interests of the participants and beneficiaries"[9] and not to "subordinate the interests of the participants and beneficiaries to unrelated objectives."[10] However, many defined benefit plan mangers—including labor union and state government officials—have pursued politically targeted investment and shareholder activist strategies that have led to diminished results for their members. By doing so, they are endangering the retirement security of millions of American workers.

DB plan managers are doing this is at a time when many plans are seeing severe funding shortfalls. In a recent study Diana Furchtgott-Roth of the Hudson institute revealed that only 59 percent of labor unions had 80 percent or more of the funds needed to make expected benefit payments.[11] And in September 2009, Moody's Global Finance estimated that the majority of U.S. multiemployer plans—most of which are union plans—have only 56 percent of the funds needed to pay for current and future liabilities.[12]

**Politically Targeted Investments and Shareholder Activism.** As irresponsible as some pension fund managers have been, they would not have been able to carry on like this for long without a change in public policy. In 1994, the Department of Labor defined the term Economically Targeted Investments (ETIs) as "investments selected for the economic benefits they create apart from their investment return to the employee benefit plan."[13] Rep. Jim Saxton (R-N.J.) criticized them thus: "ETIs are really PTIs—Politically Targeted Investment—and use the participants' money in ways that would not occur except for political pressure. Who pays for this party? You do. Lower returns imply lower incomes for retirees. Unless more is paid into plans from wages or other sources, defined benefit plans cannot fulfill their promises."[14]

Similar to ETIs, Socially Responsible Investing (SRI) is "an investment strategy that integrates social or environmental criteria into financial analysis."[15] ETIs and SRI share the common theme of considering goals other than what is best for the financial value of the plan. Activist investment managers utilize the massive shares of stocks they control—but do not own—to propose and fight for proxy resolutions which may have no relation to a company's health and profitability—or could even harm the company in the future. Resolutions can range from support for environmental causes and universal health care to opposition to Social Security reform and tax cuts.[16]

**Types of Activism and the Groups Who Use Them.** Most private pension plans are governed by the Employee Retirement Income Security Act (ERISA), which requires that the fiduciaries act solely in the interests of plan participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable plan expenses.[17] However, many activist groups advocate using PTIs and proxy actions concerning global warming, health care reform, political contributions, and other social agendas. These agendas probably do not fall under the exclusive purposes of providing benefits or defraying expenses. Organized labor has been at the forefront of shareholder activism and politically targeted investing. Since 1997, the AFL-CIO has annually published a "Key Votes Survey" to help "pension fund trustees fulfill their fiduciary obligations to monitor their investment managers' proxy voting performance."[18] Among other criteria, the "Key Votes Survey" rates investment managers on how they vote on resolutions concerning officer political disclosure and greenhouse gas emission reduction.[19]

The AFL-CIO and other labor organizations have made health care reform an issue in their politically targeted investment campaigns. In November 2007, AFL-CIO Secretary-Treasurer Richard Trumka—elected president of the labor federation in September 2009—wrote to the boards of directors of 15 companies demanding that board members who oppose universal health care legislation "be asked to recuse themselves from voting and from chairing board committees when necessary."[20] Trumka went on to note, "Union-sponsored pension plans hold more than $400 billion in total assets and are significant holders of the company's common stock. Union members across America participate in retirement systems with assets in excess of $5 trillion."[21] Trumka uses the term "our company" several times, as if the stock owned by the pension plans were owned by the union leaders and not the pensioners.[22]

Environmental activism has become a leading cause in PTI and proxy campaigns. In February 2008, a group of 49 signatories—which included the Service Employees International Union (SEIU) and the UNITE-HERE hospitality union—released a nine-point plan to "[r]equire that our asset managers, consultants, and financial advisors consider climate risks and opportunities … [and] support appropriate shareholder resolutions, company engagements, and other efforts to encourage companies to reduce their carbon footprint, seize new market opportunities, and ask corporate suppliers to disclose and reduce greenhouse gas emissions and energy use." The plans also hoped to "develop and promote proxy voting guidelines that encourage support for reasonable shareholder proposals on climate risk … [and] expand climate risk scrutiny and collaboration by investors, stock market analysts, and others in the finance sector … [and to] encourage companies and investors to support government action on climate policy."[23] The nine-point plan was spearheaded by the Investor Network on Climate Risk (INCR), a project of Ceres, a coalition that describes itself as "a national network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change."[24]

Then in June 2009, 41 signatories representing some of the nation's largest public pension funds and others with approximately $1.4 trillion in assets wrote to the Securities and Exchange Commission, asking the agency "to improve disclosure of climate change-related risks, and material environmental, social and governance risks, in securities filings." California State Treasurer Bill Lockyer, who serves on the governing boards of the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), put climate change on par with protecting retirement funds, saying, "Pension funds

protect workers' retirement benefits, and they need to ensure their portfolios reflect the risks and benefits related to climate change."[25]

Lockyer's endorsement of using pension funds for anything other than retirement security is particularly brazen considering the huge losses that CalPERS and CalSTRS have sustained in recent years due to PTI investments. In 2000, then-California State Treasurer Philip Angelides launched his "Double Bottom Line" initiative to adopt certain social and tobacco-free investment policies—including using the pension funds in CalPERS and CalSTRS for local economic investments.[26] The divestment of tobacco was a costly mistake. CalSTRS revealed that its tobacco investment ban lost the plan $1 billion in gains, and in 2008 conceded that they "could no longer justify" avoiding tobacco stocks.[27]

However, notably absent from the letter were representatives from the UNITE-HERE and SEIU unions who signed the February 2008 INCR letter. UNITE-HERE and SEIU are subject to the fiduciary requirements of ERISA, unlike CalPERS and other public or governmental retirement plans. In October 2008, the Labor Department, under Secretary Elaine L. Chao, strengthened fiduciary requirements with two Interpretive Bulletins which will be address later in this paper. The DOL pronouncements may be the reason why the 2009 letter does not include signatories from ERISA covered plans.

**Department of Labor Pronouncements.** The Department of Labor monitors and sets minimum standards for most voluntary pension and health plans regulated under the Employee Retirement Income Security Act.[28] ERISA covers most private pension and health plans in the United States but not church, governmental plans, or plans that are maintained solely to comply with workers' compensation, unemployment, or disability laws.[29] ERISA requires plan managers to disclose features and plan funding to plan participants and comply with a strict code of fiduciary duty.[30] The Labor Department clarifies its interpretation of ERISA with Advisory Opinion letters sent to individuals and Interpretive Bulletins published in the Code of Federal Regulations.

During the Clinton administration, Secretary of Labor Robert Reich strongly advocated economically targeted investing and proxy activism. In 1994, Reich issued two Interpretive Bulletins to "foster the wider use of ETIs [and] … simultaneously consider … a variety of ancillary consequences of the economy."[31] Interpretive Bulletin 94-1 (IB 94-1) encouraged investment in ETIs to allow plan fiduciaries to be "influenced by factors that were not related to the plan's expected investment return."[32] Then-Assistant Secretary of Labor for the Pension and Welfare Benefits Association Olena Berg commented that DOL was "working toward a day when economically-targeted investing will be a rather unremarkable, ordinary, investment practice."[33] Reich and Berg conceded that there would be extra transactional and education costs involved in selecting ETIs. [34] They proposed creating a clearinghouse to vet investments and allow DOL to absorb the added transactional costs of investing in ETIs.[35]

In 1995, Rep. Jim Saxton introduced a bill to "place restrictions on the promotion by DOL and other Federal agencies and instrumentalities of ETIs in connection with employee benefit plans."[36] Saxton claimed that ERISA forbids ETIs because they necessarily involve pension fund managers pursuing social and political agendas rather than the best returns for the pension

plan beneficiaries.[37] He noted that ETI funds earned between 2 and 5 percent less than non-ETI funds.[38] Saxton's bill would ultimately be unsuccessful, but in 1996 the House of Representatives added a rider to the Department of Labor's annual appropriation banning the use of any funds being spent on ETIs.[39] The ban was not confirmed by the Senate, but the increasing political pressure killed any hopes of a DOL clearinghouse.

Interpretive Bulletin 94-2 (IB 94-2) dovetailed IB 94-1 and encouraged shareholder activism and proxy voting.[40] Reich attested to the power that a pension fund manager could wield over a company at a press conference introducing IB 94-2, where he said, "[N]othing concentrates the mind of a chief executive officer like a pointed inquiry from a large institutional investor."[41] Reich also encouraged using proxy voting to pressure corporations into what he called "good employment practices."[42]

During the Bush administration, the Department of Labor reversed Reich's liberal interpretation of ERISA's fiduciary duty requirements and issued two new Interpretive Bulletins in 2008. The 2008 Bulletins were published to clarify DOL's view that "'workers' money must be invested and used solely to provide for retirements, not for political, corporate, or other purposes."[43]

Interpretive Bulletin 08-1 (IB 08-1) superseded and removed IB 94-1 and limited the circumstances in which a fiduciary can consider non-economic factors when selecting investments. IB 08-1 stated that, "ERISA requires that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries."[44] IB 08-1 also clarified that "fiduciaries may never subordinate the economic interests of the plan to unrelated objectives [and] fiduciary consideration of non-economic factors should be rare and, when considered, should be documented in a manner that demonstrates compliance with ERISA's rigorous fiduciary standards."[45]

Likewise, Interpretive Bulletin 08-2 (IB 08-2) superseded and removed the Clinton-era IB 94-2. IB 08-2 warned against using proxy voting to further social policy goals, stating, "[I]n creating an investment policy, a fiduciary shall consider only factors that relate to the economic interest of participants and their beneficiaries in plan assets, and shall not use an investment policy to promote myriad public policy preferences."[46] IB 08-2 further clarified that "plan fiduciaries risk violating the exclusive purpose rule [of ERISA] when they exercise their fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process."[47] Interpretive Bulletins 08-1 and 08-2 marked a directional shift from the Reich DOL support of using pension funds to promote political and policy goals.

Union pension funds, which have historically used the money they control to push particular agendas, soon came out against the stricter standards. In December 2008, the Obama administration's transition website published the AFL-CIO's demand that DOL "rescind all 2008 guidance regarding the legal standards imposed on pension plan fiduciaries when considering investments in 'economically targeted investments' and 'the exercise of shareholder rights.'"[48] At this writing, both IB 08-1 and 08-2 remain in effect, but this could change any time.

**Multiemployer Plans and Union Underfunding** Multiemployer plans are created out of collective bargaining agreements and are almost exclusively union plans.[49] They cover about 20

percent of all workers in defined benefit plans.[50] As noted, in September 2009, Moody's Global Finance warned of a vast underfunding problem for multiemployer plans. Moody's estimates that the majority of multiemployer plans in the country have only 56 percent of the funds needed to pay for current and future liabilities.[51]

The Pension Protection Act of 2006 (PPA) sought to help shore up the nation's pension system by establishing new minimum funding standards.[52] The PPA classified multiemployer plans that were less than 80 percent funded to be in "endangered" status and plans that were under 65 percent funded to be in "critical" status.[53] The PBGC defines a multiemployer plan as "a collectively bargained plan maintained by more than one employer, usually within the same or related industries, and a labor union."[54] Multiemployer plans have far less federal insurance from PBGC than their single employer counterparts. If a multiemployer plan cannot fund its liabilities, a pensioner will be able to receive benefits from PBGC. Currently the benefits for someone with 30 years of contributions to the plan are only $12,870.[55] (Single-employer plans, on the other hand, are insured up to $54,000 a year.)[56] Without other investments, a person who has worked all his or her life and contributed to a defined contribution multiemployer plan would then be forced to live on an income below the federal poverty level if the plan becomes insolvent.

By June 2009, almost half of the nation's 20 largest unions had pension funds that were classified as either "endangered" or "critical" because of underfunding.[57] According to the PBGC, in 2006, the average union pension fund had only 62 percent of what is owed to participants.[58] As of September 2008—before the current financial crisis—96 union pension funds were considered to be in critical status and only 19 percent of union pension plans were fully funded, as opposed to 37 percent of non-union plans.[59] In April 2009, SEIU announced that its National Industry Pension Fund, which covers around 101,000 rank-and-file union members, was in "critical" status. *The Wall Street Journal*, which reported SEIU's announcement, also reported that 13 large plans operated for the Teamsters, taken together, are only 59.3 percent funded. Other severely underfunded pension funds are those for the United Food and Commercial Workers, at 58.7 percent, and the United Brotherhood of Carpenters, at 67 percent.[60]

Several reasons can account for the massive underfunding of union pension funds. One is the lack of new workers joining unions. In 2008, union membership accounted for 12.1 percent of the entire workforce—7.6 percent of private sector workers and 36.8 percent of public sector workers.[61] This is down from about one-third of the workforce in the 1950s.[62] The decline in union membership may explain why Big Labor has become so politically involved in recent years. Since 1990, unions have contributed $671,789,812 to politicians, the vast majority—$618,143,757—going to Democrats.[63] Unions need laws to make organizing easier to gain new members, in order to help pay for the pension requirements of older workers.

Unfortunately, the new members joining or being forced into these unions will be shackled with underfunded pension plans that may be insolvent by the time they retire. The first step in correcting this problem is to start investing only for the benefit of the pensioners' retirements and not for PTIs. Richard Trumka's idea that the "goal is to make worker capital serve workers, not just when they retire but on a day to day basis" cannot be the goal of fiduciaries.[64] The only goals must be providing benefits and defraying risk.

**Conclusion.** The Employee Retirement Income Security Act imposes a clear fiduciary duty on pension plan managers to invest only for the purpose of providing benefits and defraying risk. The rules for proxy voting are the same. Plan managers should not advocate or participate in proxy campaigns for social or political ends. Their only job is to ensure enough benefits for retirees and minimize risk through diversification. Department of Labor Interpretive Bulletins 08-1 and 08-2 faithfully adhere to the intent of ERISA and help safeguard pensioners' savings against objectives unrelated to their retirement security. The Obama administration should not give into the demands of those who would like use the retirement savings they control—but do not own—for political purposes.

Pension plan participants and the public at large should have ready access to detailed information on how their plan managers are investing their money. All ERISA plans must file a Form 5500 detailing the status of the plan and how plan managers invest the plan's capital. Currently, the only way a member of the public can access up-to-date information is by submitting a Freedom of Information Act Request or traveling to the basement of the Labor Department's building in Washington, D.C. DOL has all 5500s in an electronic database called the ERISA Public Disclosure System (EPDS), which is already publicly available to those who wish to travel to Washington. DOL should immediately publish EPDS on the Internet for easy access across the country.

As ERISA only applies to certain private pension plans, public pension plans such as CalPERS should adopt strict standards of fiduciary duty and limit their investing to providing benefits and not advocating social causes. State pension plans should model their fiduciary standards to those prescribed by ERISA and explained by IB 08-1 and IB 08-2. They should only invest for the benefit of the participants of the plan and not try to achieve any other goals. Like their private pension plan counterparts the money in those funds are for the retirement of workers and not for ancillary objectives.

Advocates of defined benefit plans claim direct investing is risky and will not guarantee a lifetime income. These advocates neglect to mention that many of the multiemployer DB plans they promote are vastly underfunded and could become insolvent in the near future. They also neglect to mention that if the plan becomes insolvent, the "insurance" provided by PBGC will pay only pennies on the dollar.

Most workers would be better off under defined contribution plans. However, workers who have already paid substantial amounts of their retirement savings into defined benefit plans deserve to have their savings protected from misuse for political purposes. To that end, it is crucial for Department of Labor Interpretive Bulletins 08-1 and 08-2 to remain in effect. If individuals want to use their retirement savings to promote specific social or political causes, that is their prerogative, but those controlling other people's retirement security must be held to a higher standard.

## Notes

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