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U.S. DEPARTMENT OF LABOR

ERISA ADVISORY COUNCIL

Meeting to study issues involved in the Social Investment of pension plan assets

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Statement of

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* The views expressed in this statement are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members, or other staff.

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Mr. Chairman and members of the Council, it is a pleasure to join with you today for a discussion of Social Investment of pension plan assets. As you know, this subject, under various definitions, has been discussed for many years. The Institute held a multi-interest group policy forum on the subject in December 1979, and published an edited book in 1980 titled: Should Pension Assets Be Managed For Social/Political Purposes?

Mr. Shotland and Mr. Glover participated in that policy forum and contributed to the book. Having reread that book, all back-copies of the AFL-CIO's "Labor & Investments" publication, and numerous other publications, the "state of the art," so to speak, has changed very little.

The summary of our book notes:

> "Participants in the Forum reached concensus on two significant points. First, they agreed that the primary purpose of benefit programs should be to serve participants as participants. Second, they agreed that when comparable risk/return investments are available it should be possible to consider secondary factors.
>
> Participants split . . . on accepting reduced risk/return investments knowingly in order to achieve non-benefit objectives."

Writing in July 1982, Elliot Bredhoff, General Counsel, IUD, AFL-CIO, and Special Counsel, United Steelworkers of America, AFL-CIO, concluded:

> "Social bonus investing occurs where a trustee, confronted with a number of prudent investments that are equally desirable from the financial standpoint, chooses the one that provides incidental social benefits as well.
>
> Social bonus investing is neither a panacea for all of society's ills nor an instrument for radical change. The paramount concern must always be the "conservative" one of preserving the security of pension and welfare funds for the benefit of the participants and beneficiaries."

One of the most recent contributions to the literature in this area is a book titled Social Investing For Pension Funds: For Love or Money. The two authors are lawyers specializing in labor relations. These authors argue that there should be the flexibility to make investments where "there is some sacrifice of traditional investment criteria." But, they conclude that the standards of ERISA "are too tight" to allow this sacrifice. They advocate amendments to ERISA to increase flexibility.

Proponents of reduced net returns have cited moral, humanitarian and political reasons when calling for increased socially dictated investments. Increased emphasis is being placed on socially sensitive investments designed to benefit plan participants directly. Two examples are investments by joint-trust plans which encourage unionization, and investments to encourage economic development in areas where plan participants live. Investment advocacy of this type has been viewed as sometimes having economic, political and social components.

Make Pension Assets Work For the Workers

Proponents of "social investing" hold that alternative investment approaches can be pursued without harming pension security and that joint control of this selection process is desirable. Studies have concluded that plans frequently exhibit investment characteristics that seem inconsistent with the long term interests of fund beneficiaries and that this provides justification for worker participation in investment selection.

Proponents believe that even though employer plan sponsors have the ultimate liability for fund deficiencies, employees should be concerned about rates of return and therefore should have a role. An AFL-CIO Industrial Union Department report notes that:

1. contributions to plans represent deferred compensation and thus employees have a vital interest.

2. concern over rates of return and a desire for involvement in the investment process in no way threatens the security of pensions and, the goal of higher returns actually promises greater security.

The IUD study urged unions to seek direct involvement in fund management through the collective bargaining process. The report outlined a number of options:

1. full joint administration
2. participation in the appointment of fund advisor
3. participation in the specification of investment goals
4. security input to proxy voting

The IUD report contends that pension security will not be adversly affected by worker/union participation or by alternative investments. Additionally, it cites specific examples of actions some plans have already taken to support their contention.

The IUD report, however, appears to be a relatively conservative document. For example, at the forum on "social investment" sponsored by EBRI in 1979 some union representatives made the following points:

1. elected officials and union representatives should have total control over investment decision making.
2. rate of return may not be as important as other investment considerations to participants and beneficiaries.

There is not, it would appear, a clear concensus among the proponents of "social investment" as to what it is or how it should be achieved. There is a concensus, however, that worker/union should have greater involvement in the investment process.

Preserve Pension Security

Traditionalists argue that "socially dictated" investments may involve costs and/or increased risks that should not be borne and are not legal. Concentrating funds in geographical areas or specific types of investments may violate reasonable diversification principles. Some approaches may present problems due to increased transaction costs or restricting trustee discretion beyond what is reasonable. Banning investments in certain areas which offer attractive returns could affect optimum fund performance. Opportunity costs associated with the inability to act rapidly could further dampen investment performance.

Opponents of "social investment" that involves greater worker/union involvement raise a number of issues. Bernard Curry, a senior vice president of Morgan Guaranty Trust Company of New York and a former member of this council has written:

1. if the fund does not perform up to expectations as a result of such worker/union intervention, who will make up the deficiency? Who will answer for the lost opportunities?

2. people without investment experience will have equal participation with experts in the investment of pension reserves. At best, a multiplicity of views on the making of investments usually results in the lowest level of performance - and at worst havoc.

3. funds should continue to be invested solely with the interests of beneficiaries in mind with the primary goal being pension security.

4. to achieve any substantial diversion in investment thrust would require massive disinvestment and reinvestment at substantial cost.

Curry also makes three points regarding investment decisions per se.

1. taking non-financial factors into account is highly subjective and would make common standards for evaluating investment performance nearly impossible.

2. the flow of pension assets cannot reverse a contracting economy and other economic conditions.

3. advocates of change must be burdened with showing that their particular vision can be addressed without diluting the economic interests of present and future pensioners.

In short, those who are opposed to "socially dictated" investments and greater worker/union involvement believe that the payment of pensions is a sufficiently desirable social purpose and that other economic and social objectives should be secondary.

Conclusion

As pension plan participation and the beneficiary population grow the political pressure surrounding investment policy will grow commensurately. Large federal deficits and retracting government social expenditures will serve to increase pressures. Government program retraction or slower growth will increase the importance of pensions as a source of economic security.

When EBRI begins publishing quarterly estimates of total pension assets later this year to replace those previously published by the Securities and Exchange Commission, a regular benchmark will be available of investment diversification.

The debate over the control and investment of pension assets will continue and will become even more controversial. Ultimately, participants and beneficiaries will dictate the level of importance that should be placed on the payment of benefits as a social objective.

BIOGRAPHY

DALLAS L. SALISBURY

Mr. Salisbury is Executive Director of the Employee Benefit Research Institute, a Washington, D.C. based public policy research institution dedicated to increasing knowledge and understanding of employee benefits.

Prior to joining EBRI, Mr. Salisbury served as Assistant Executive Director for Policy and Planning of the Pension Benefit Guaranty Corporation (PBGC); Assistant Administrator for Policy and Research of the Pension and Welfare Benefit Programs, U.S. Department of Labor; and as Assistant Director of the Office of Policy and Planning, U.S. Department of Justice, in addition to other positions. Before joining the Federal Government, Mr. Salisbury held public and private sector positions in the State of Washington.

Born in Seattle, Washington, Mr. Salisbury attended the University of Washington and the Maxwell Graduate School in Syracuse, New York. He is a frequent author and speaker on employee benefit topics.

ABOUT EBRI

The Employee Benefit Research Institute (EBRI) is a Washington-based, nonprofit, nonpartisan, public policy research institution founded in 1978. EBRI's overall goal is to promote the development of soundly conceived private and public employee benefit plans.

Through research, policy forums, workshops and educational publications, EBRI contributes to the expansion of knowledge in the field and to the formulation of effective and responsible health, welfare and retirement policies. This work is intended to complement the research and education programs conducted by academia, the government and private institutions.

EBRI's education and research materials aid the public, the media and decision makers in addressing employee benefits issues before policy decisions are made. The Institute seeks a broad base of support among interested individuals and organizations as well as those sponsoring employee benefit plans or providing professional services in the employee benefits field.

More information on the Employee Benefit Research Institute can be obtained by writing: Executive Director, EBRI, 1920 N Street, NW, Suite 520, Washington, DC 20036 (202) 659-0670.