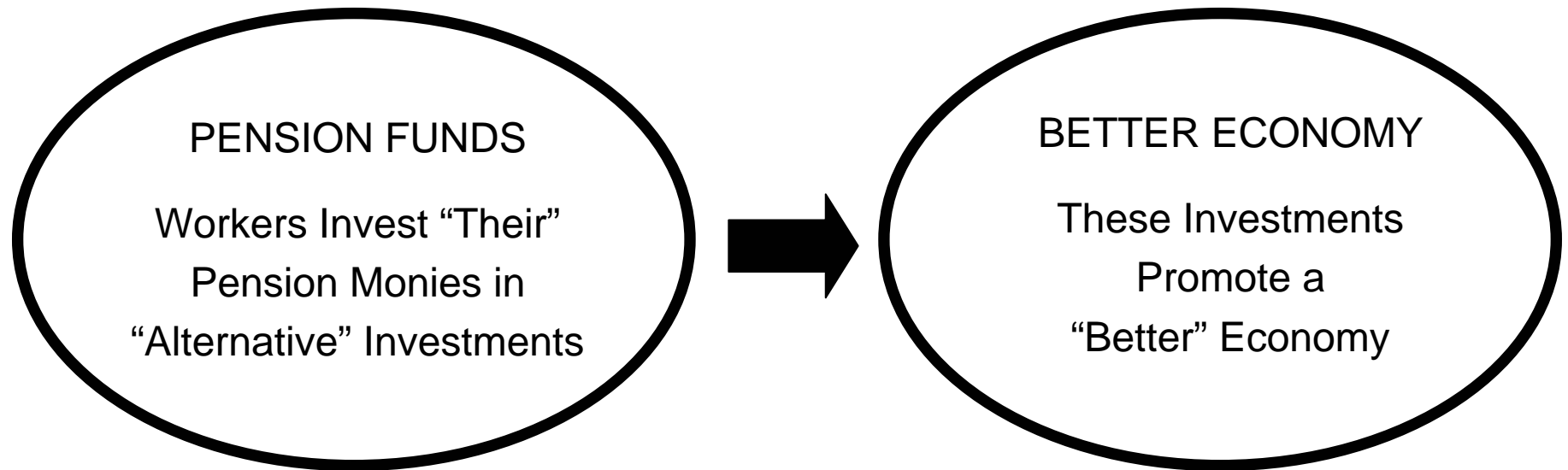


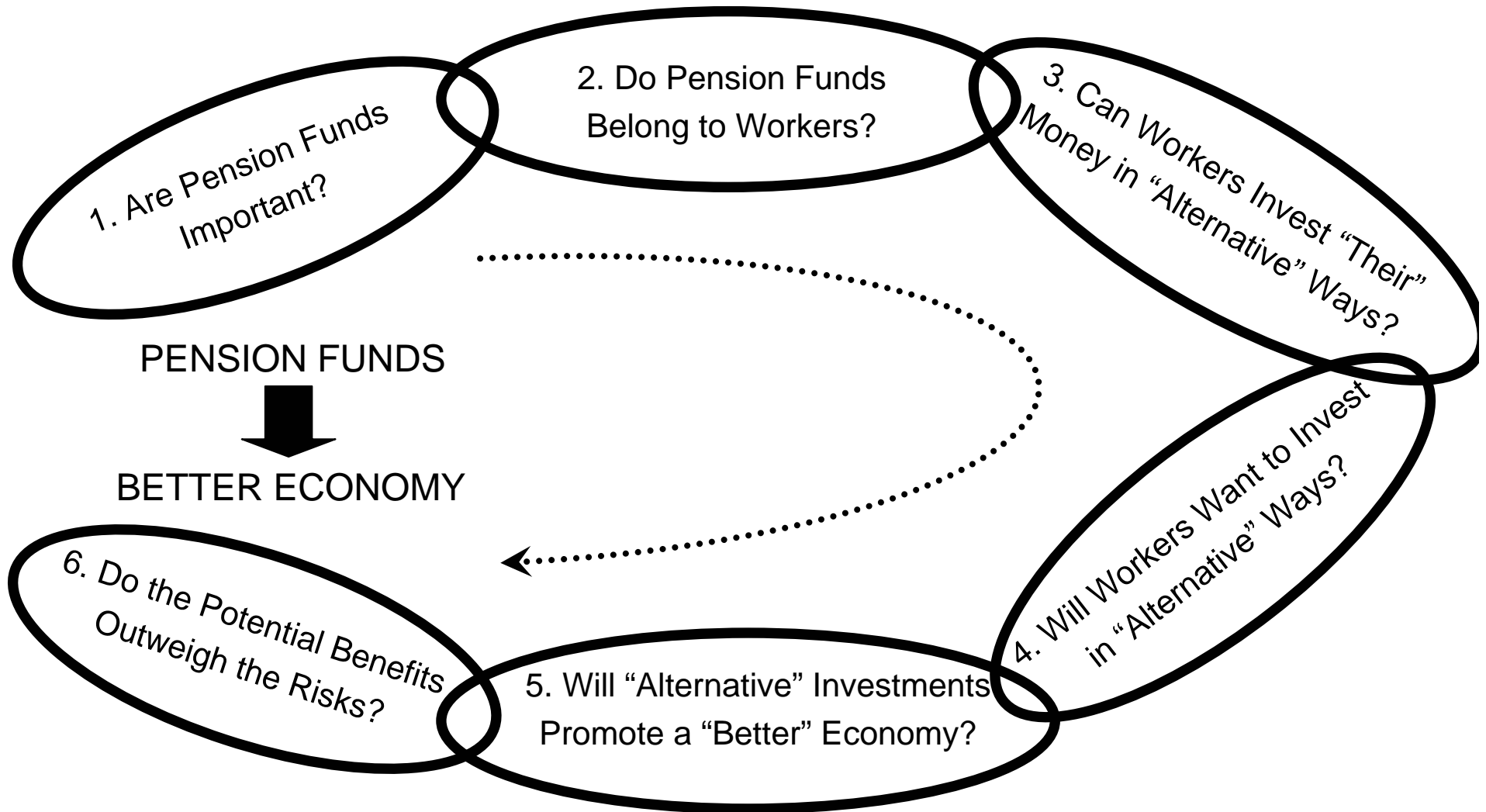
# Pension Fund “Activism”: Some Sober Second Thoughts

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Real Utopias Conference '04  
University of Madison—Wisconsin, June 2004

# A “Reduced Form” Hypothesis



# A “Structural Model”

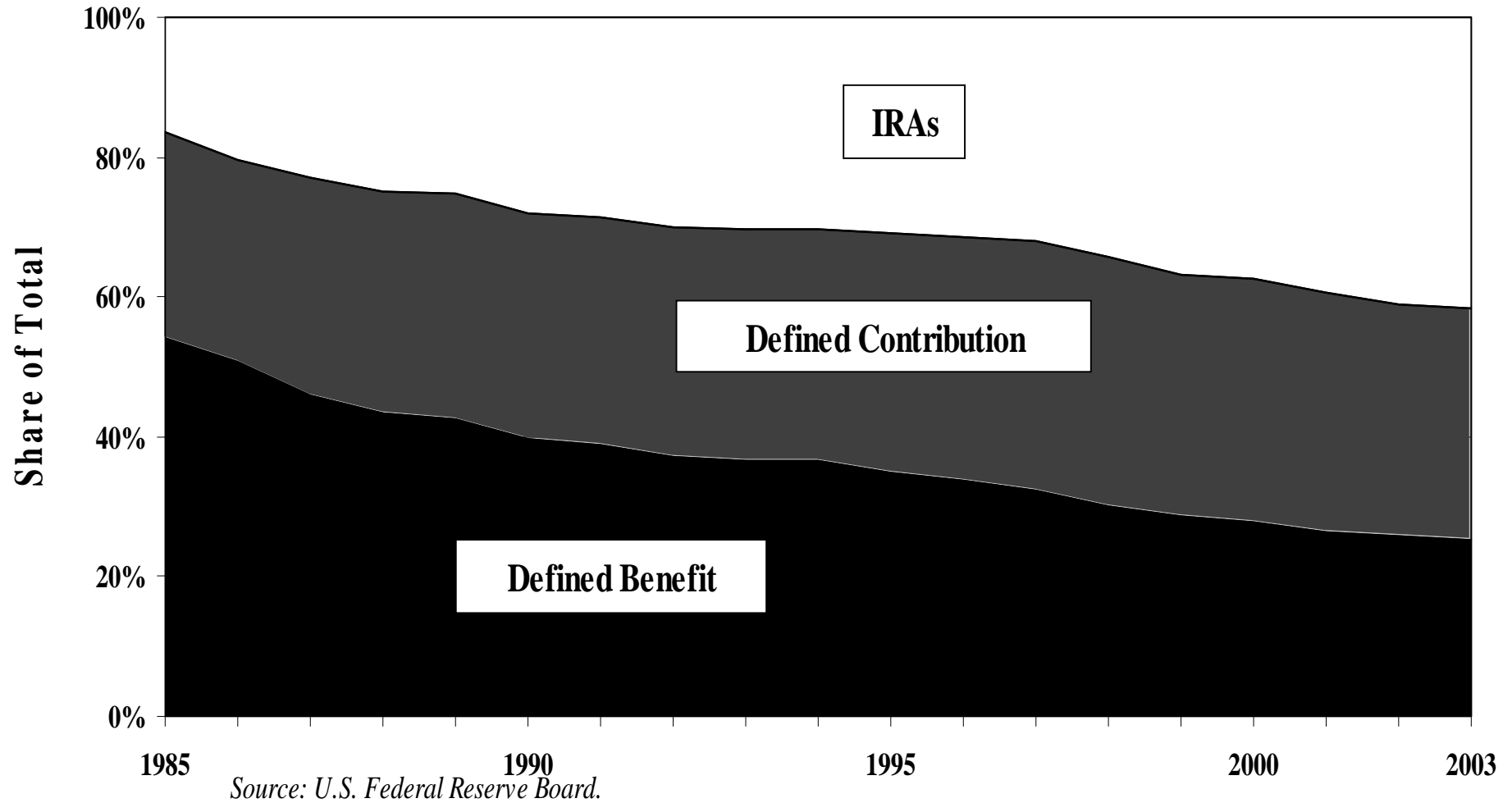


# 1. Are Pension Funds Important?

- “Huge size” of pension funds is taken for granted within SRI community
- In fact, pension funds are much less important than typically assumed
- Pension funds are shrinking (relatively)
  - declining pension coverage
  - shift to DC vs DB
  - rise of other forms of equity ownership

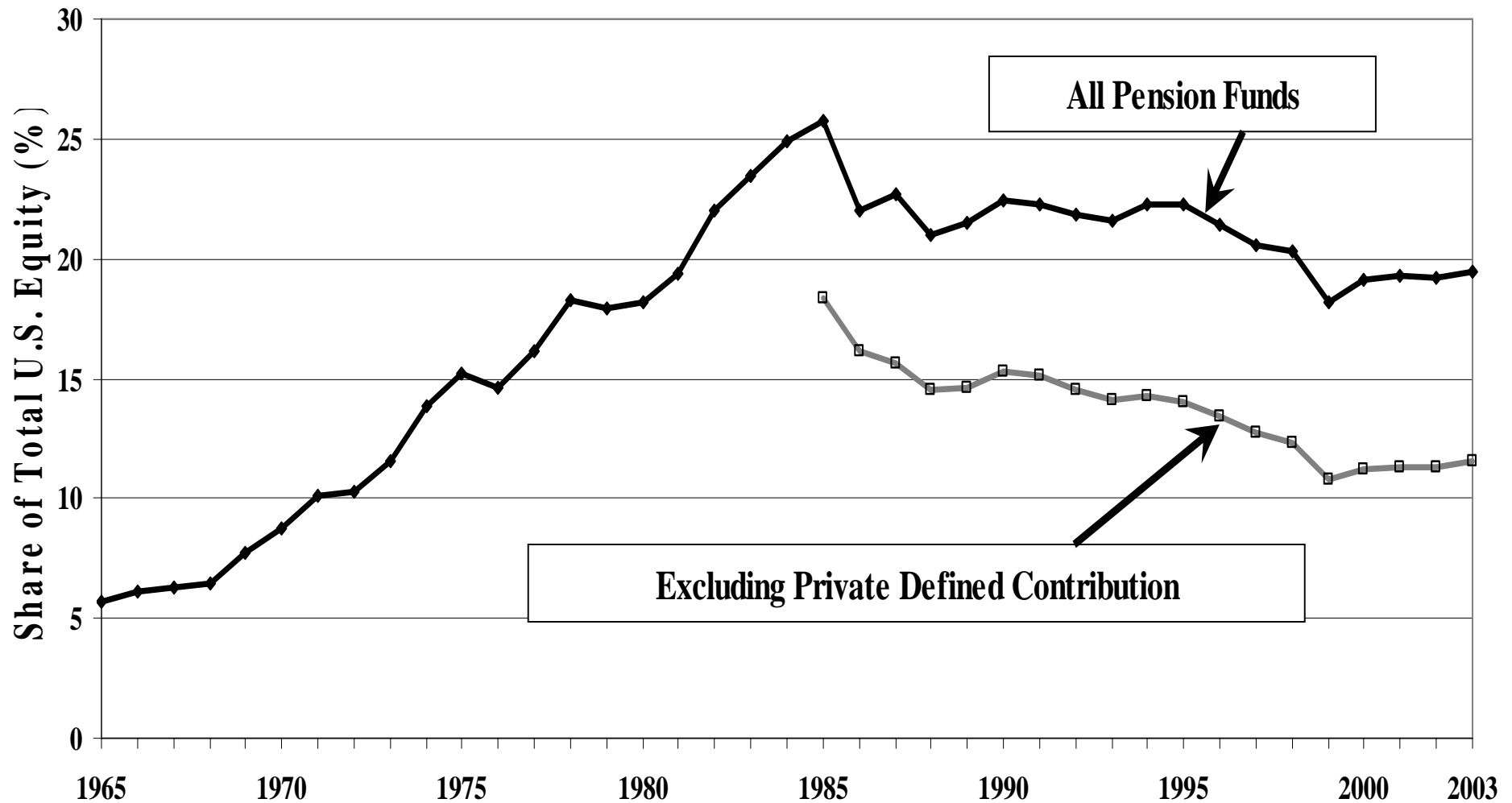
# Pension Assets by Type of Plan

*U.S., 1985-2003*



# Pension Equity Investments

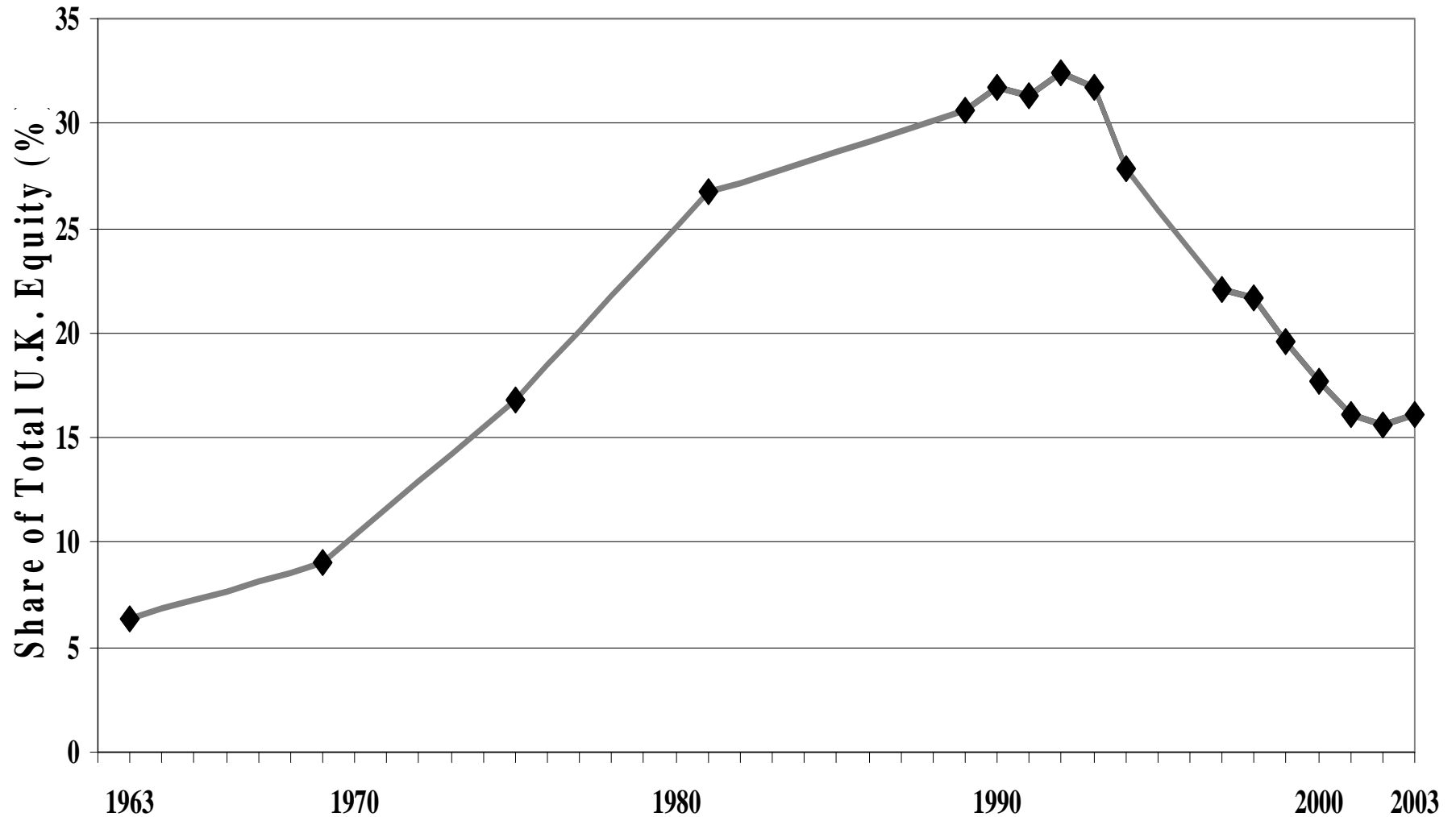
*U.S., 1965-2003*



*Source: U.S. Federal Reserve Board. Includes corporate equities and mutual funds.*

# Pension Equity Investments

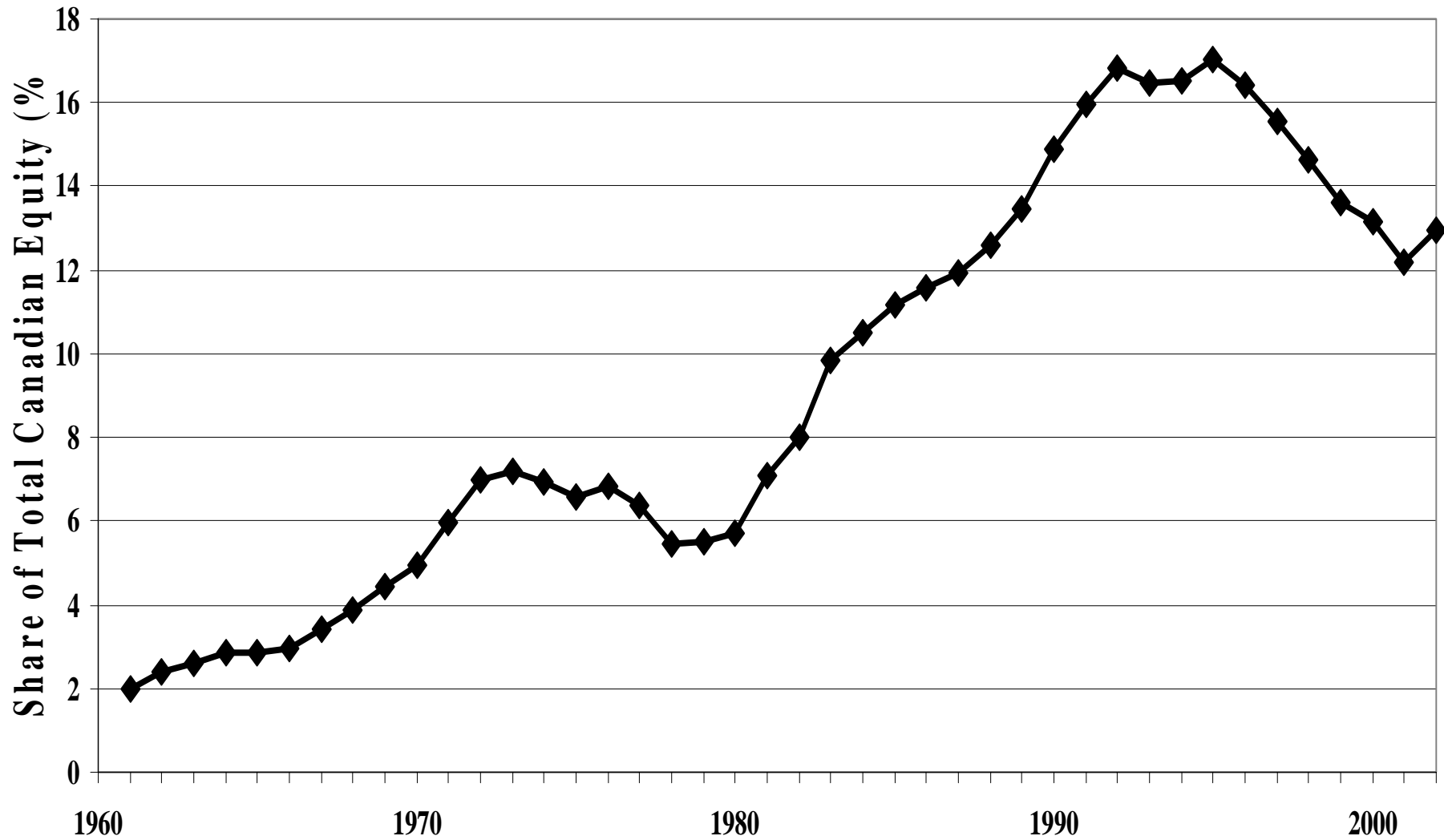
*U.K., 1963-2003*



*Source: CSO; interpolated data points indicated in grey.*

# Pension Equity Investments

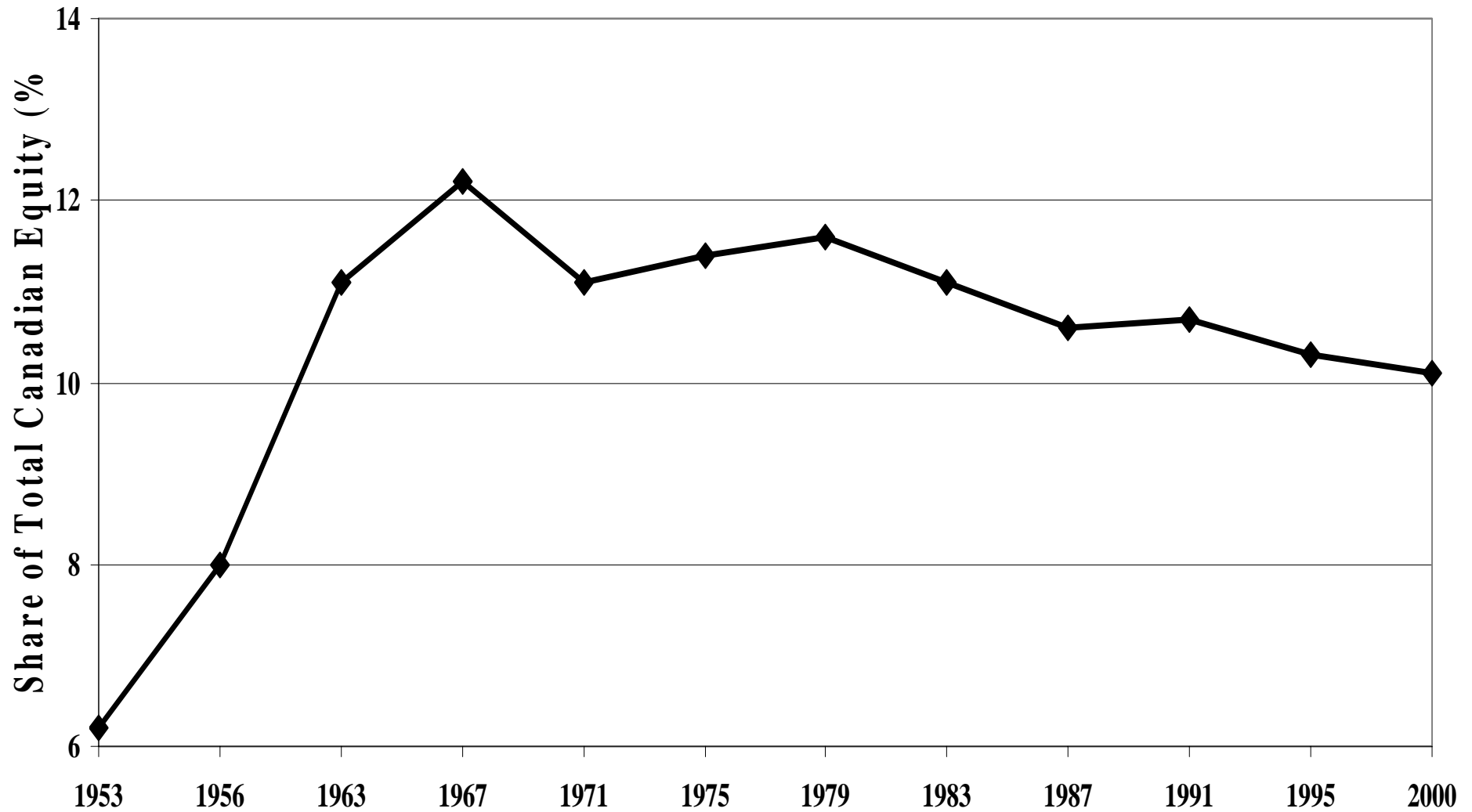
*Canada, 1961-2002*



*Source: Statistics Canada CANSIM.*

# Active Pension Members

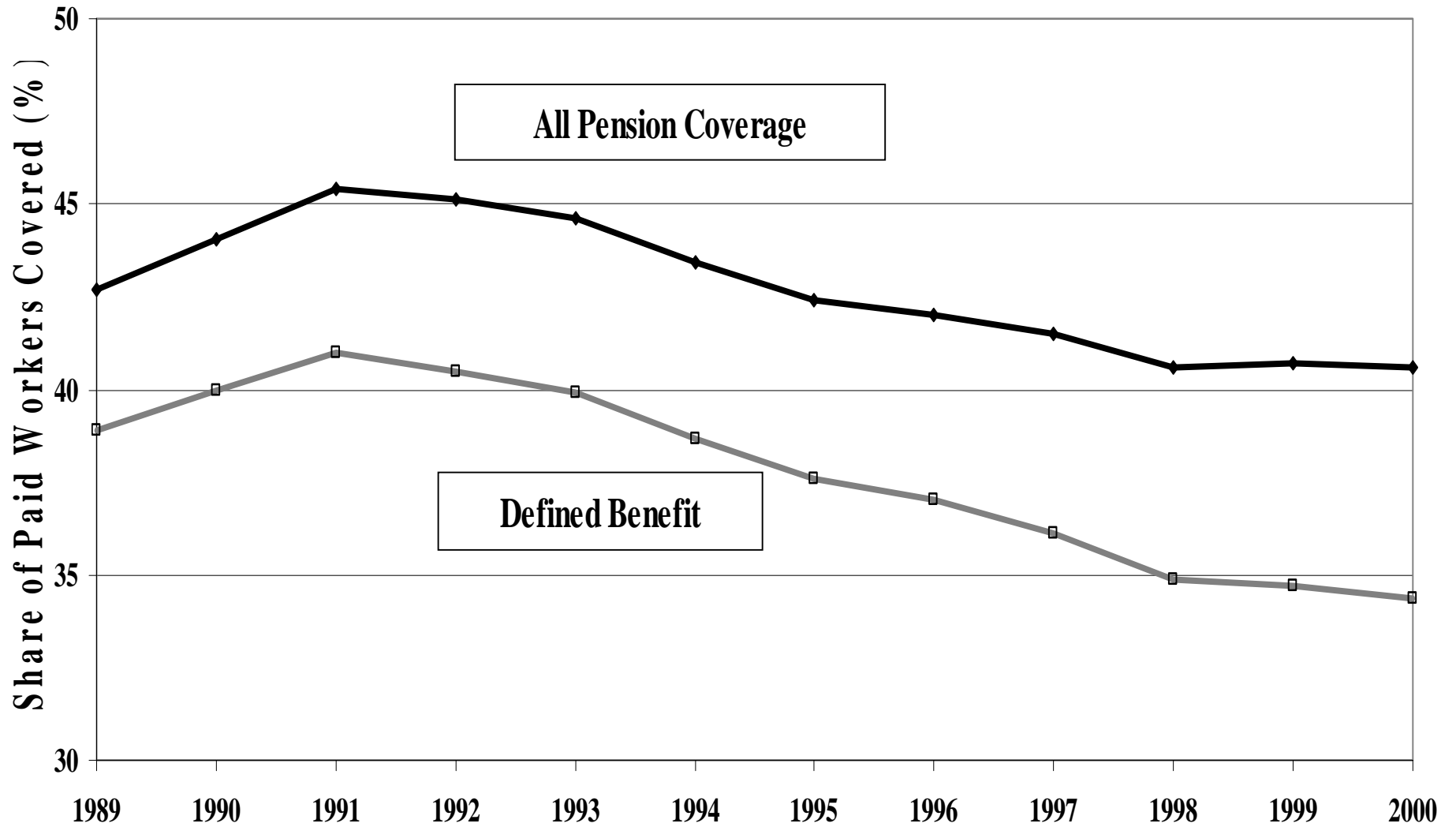
*U.K., 1953-2000*



*Source: Government Actuary Department; in 1995, 89% of members were in DB plans.*

# Pension Coverage

*Canada, 1989-2000*



*Source: Statistics Canada.*

# Pension Coverage

- U.S.: 20% have DB plan, another 30% have DB
- U.K.: About 50% have “occupational” coverage (DB), another 15-20% have DC
- Canada: 35% have DB coverage, another 5% have DC

# Riding the Wrong Coattails?

- DB pension funds control less than 15% of equity in all three countries
- What about controlling the other 85%?
- This share has been falling (since the mid-1980s in most cases), by as much as half
- Deunionization, perceived risk (for employers) of DB plans, and continued individualization of retirement finance will continue to reduce this share

# How Strong is the Chain?



1. Are Pension Funds  
Important?

## CONCLUSION:

Collectively-managed pension funds  
are modestly important, and becoming less so.  
This link is weak.

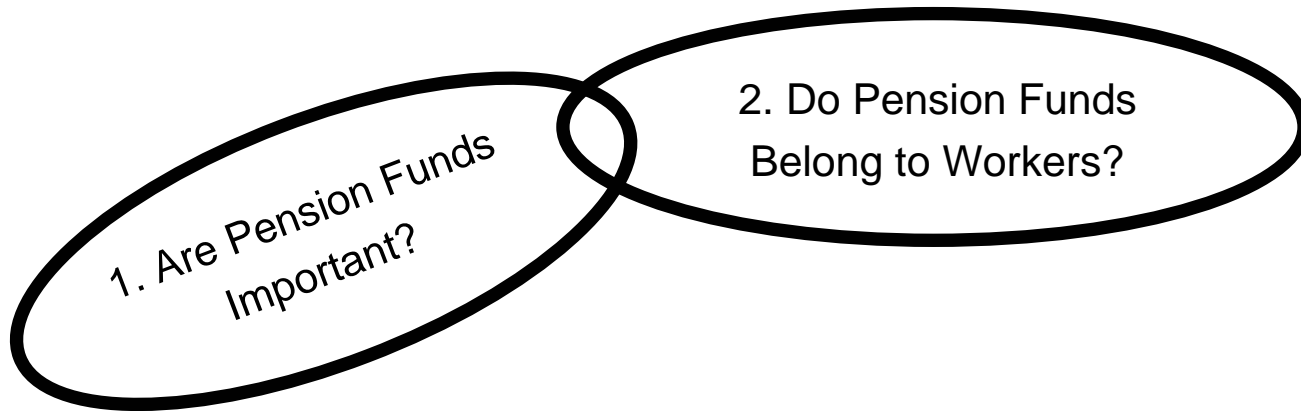
## 2. Do Pension Funds Belong to Workers?

- Why do DB pension funds exist?
- Supposedly convenient, affordable and reliable way for employers to meet their commitment to pay future pensions
- Is this the “workers’ money”?
  - LEGALLY: unclear (eg. rulings on surplus ownership)
  - MORALLY/POLITICALLY: unclear

# Opening a Pandora's Box

- Workers want to control the investment of pension funds
- Workers want employers to shoulder the risk of the DB pension structure
- These goals are incompatible
- Push for more control over investments implies acceptance of more risk

# How Strong is the Chain?



## CONCLUSION:

It is legally and morally/politically unclear whether workers “own” pension monies (or indeed whether they should even want to).

This link is uncertain.

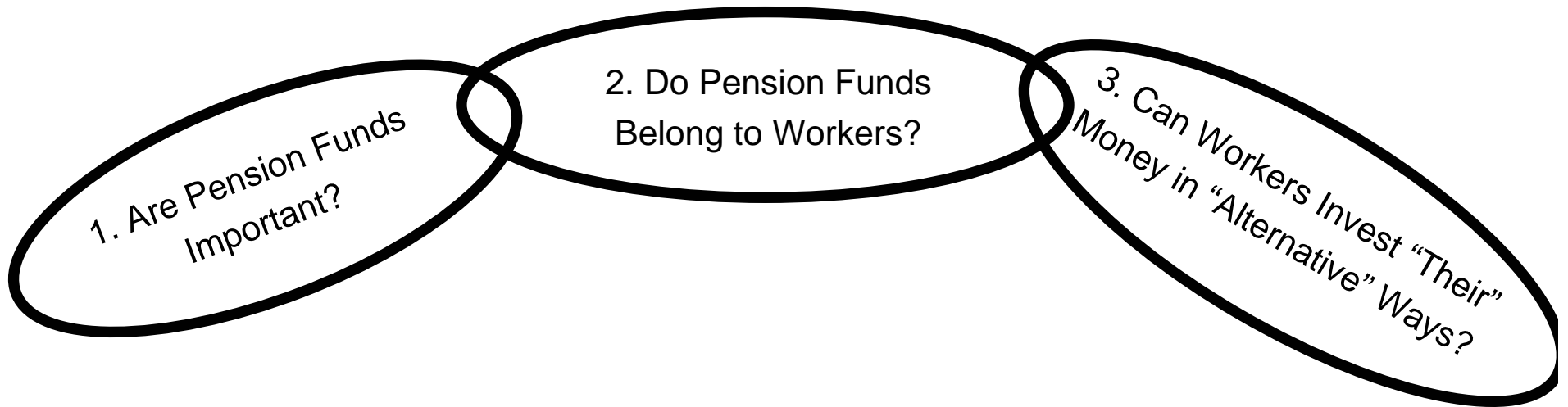
### 3. Can Workers Invest “Their” Monies in “Alternative” Ways?

- Even if the legal claim to sole or joint ownership of pension funds is sustained, a separate legal hurdle constrains the use of those monies:
  - trust law
  - fiduciary responsibility

# Cautious Precedents

- Jurisprudence indicates that pension trustees can consider the “broader well-being” of pension fund managers in making decisions
- This legal space could be confirmed & expanded with popular pressure

# How Strong is the Chain?



## CONCLUSION:

Pension fund trustees have some leeway to consider broader criteria in investment choices. This link is adequate and could be strengthened.

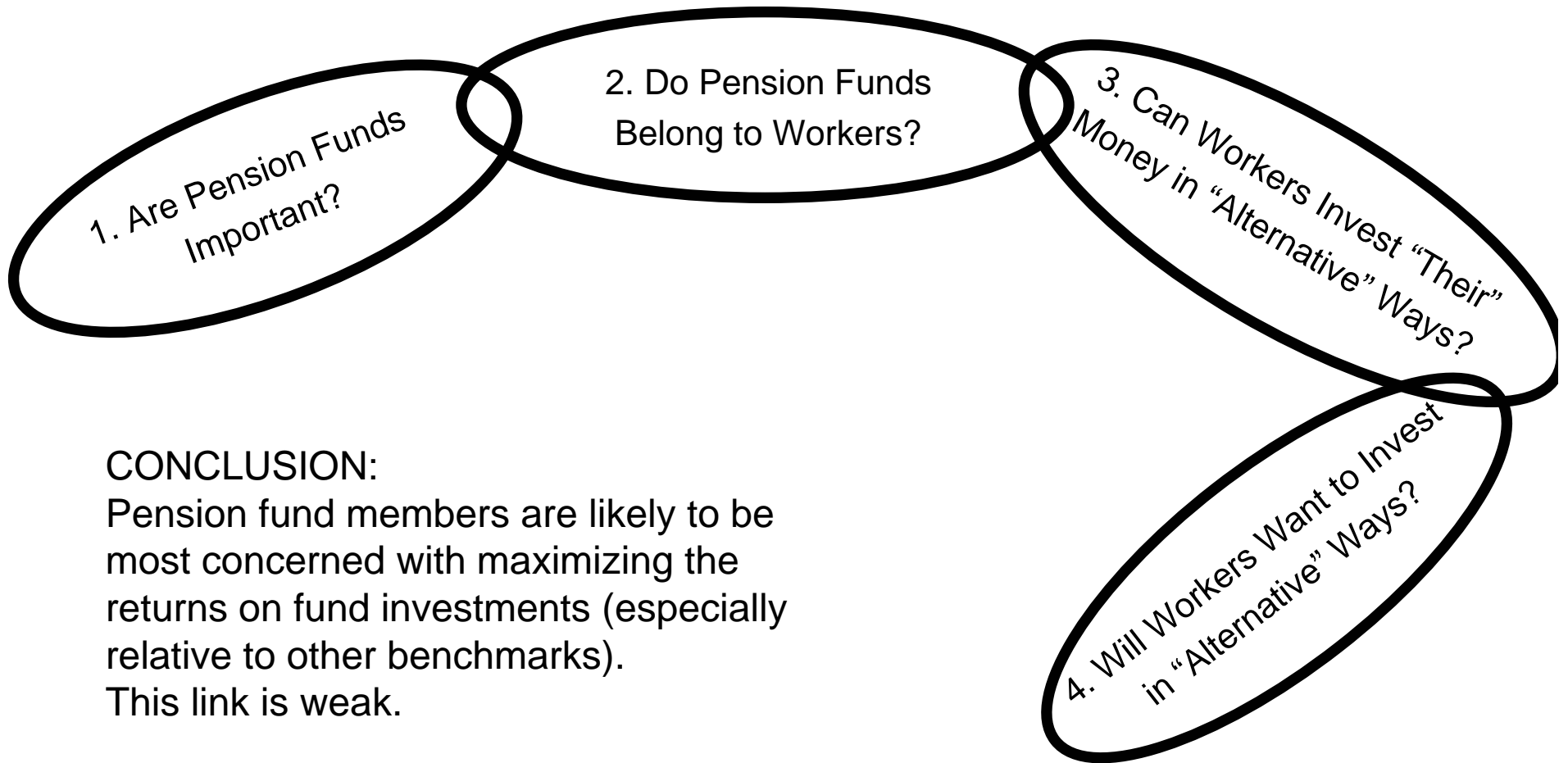
## 4. Will Workers Want to Invest “Their” Monies in “Alternative” Ways?

- Some membership support in some plans for screening-type criteria
  - don’t want to “support” the worst abusers
- No visible base for truly using pension monies differently
- There’s a difference between having a “clean conscience” and using resources pro-actively for social & economic change

# Examples

- Ontario Teachers: fought long and hard to be able to invest their whole fund on commercial markets
  - smaller activism for “ethical” screens on those investments is much less powerful
- Proposed 2004 Canadian law limiting pension fund investments in income trusts (tax evasive)
  - opposition from pension funds forced government to back down immediately

# How Strong is the Chain?



## CONCLUSION:

Pension fund members are likely to be most concerned with maximizing the returns on fund investments (especially relative to other benchmarks).

This link is weak.

## 5. Will “Alternative” Investment Choices Promote a “Better” Economy?

- Three distinct options for investing pension monies differently:
  - A. portfolio choice / screening
  - B. “active” shareholder engagement
  - C. mobilization of real capital in alternative ways

# A. Portfolio Choice / Screening

**Rationale**: Reward companies for good behaviour by buying their shares, punish others by selling their shares.

- Common use in “ethical” mutual funds, screened pension funds, “ethical” stock indices

# What's the Criteria, Anyway?

- Ethical screen typically accepts up to 90% of universe of corporate equities
  - no wonder “ethical” indices typically match market benchmarks!
- Screening excludes a few bad apples (tobacco, defense, nuclear)
  - but is the resulting “ethical” seal of approval for the remaining corporations meaningful or helpful?

# Example:

## The Royal Bank of Canada

- Canada's largest and most profitable private bank
- Heavy weighting (with other banks) in all ethical funds
- Top scores on all "responsibility" rankings:
  - \$26.3 million in charitable donations
  - \$18 million sponsoring public events (with RBC logo)
  - 3 women on its 19-person board of directors (kudos for good "employee" relations???)

# The Ethical Bank (cont'd)

- Pre-tax profit: \$4.6 billion
- After-tax profit: \$3 billion
- Employs thousands of (mostly female) bank tellers, average wage \$15 per hour
- Fiercely resisted unionization attempts
- Fierce supporter of financial deregulation
- Lobbied for 13-point reduction in federal and provincial corporate income taxes that will save \$500 million per year

# What If...

- Even if the screening criteria were meaningful, what impact would portfolio choice have on corporate behaviour?
- Not much: Consider the “ethical transmission mechanism”

# The “Ethical Transmission Mechanism”

- Does it reward or help a company to buy its shares?
  - secondary market accounts for 95% of trading; your money goes to someone else (not the company)
  - potential impact on cost of capital if ethical portfolio decisions could affect share price
    - BUT: selling shares to make ethical point, if it affects the share price, creates a capital loss for the pension fund (cut nose to spite face?)

# The “Ethical Transmission Mechanism” (cont’d)

- A pure “ethical” sell-off:
  - sale (or non-purchase) of shares reflects ethical failure of company only, not decline in profitability
  - if successful, this artificially depresses P/E
  - amoral investors (not “anti-ethical” investors) will purchase
  - impact: shift of wealth from ethically screened pension funds to amoral investors

# The “Ethical Transmission Mechanism” (cont’d)

- An ethical sell-off mediated by profit:
  - some unethical behaviour is thought to reduce profitability (at least in the long-run)  
eg. tobacco companies
  - in this case, sell-off (and decline in share price) reflects normal investment criteria
  - no “ethical” stance by the investor is required
- A better idea:
  - make unethical behaviour unprofitable (regulation, lawsuits, boycotts)

# The “Ethical Transmission Mechanism” (cont’d)

- Starving unethical firms of capital?
  - Limit unethical behaviour by allocating capital elsewhere
  - Again: if the unethical behaviour is profitable, amoral investors can fill the gap
  - Alternative forms of finance (eg. private equity) would also step in
  - If the goal is “starving” unethical behaviour, why do ethical funds invest in banks???

# The “Ethical Transmission Mechanism” Doesn’t Exist!

- It is impossible to change unethical corporate behaviour through passive portfolio choices and screening
- If the unethical behaviour is profitable, and the broader financial industry is unregulated, the corporations involved will finance their activities
- The only achievement: a “clean conscience” for the “ethical” investors

# Whose Side Are You On?

- Efforts to impose more meaningful constraints on the actions of screened companies are undermined by their “ethical” seal of approval:
  - Alcan
  - CNRail
  - Magna International
  - Offshore automakers
- Ethical screening constituency harms more genuine efforts at social change

## B. Active Shareholder Engagement

**Rationale**: Use influence over management that comes with large share holdings to reform corporate behaviour.

- shareholder resolutions
- behind-scenes pressure on management
- Irony: if goal is to change corporate behaviour, then this strategy suggests investing in the least ethical companies (not usually the advertized idea!)

# Results

Positive: some potential to influence management decision-points at margin

Negative: resolutions/engagement to date have been mild:

- most resolutions aim at “governance,” a few at specific bad practices (eg. sweatshops)
- sometimes counter-productive, if governance goal is greater accountability to shareholders
- no interest in challenging core issues of production relations & exploitation (eg. job security, unionization, compensation, pension/benefit provision)

# Sidestepped Again

- If goal is to prevent an unethical activity from occurring, then engagement cannot work either
- If the unethical activity is profitable, other firms will fill the void
  - “clean conscience” of the fund and its members is the only achievement

# Working Within the System

- Both “screening” and “engagement” strategies accept the dominant role of profit-seeking private management in overseeing production & enterprise
  - non-transformative
- Aim: stop certain practices by targeted firms (not whole economy)
  - basis to claim: investors (not citizens)

# Capitalist Competition and Corporate Behaviour

- Capitalism is a competitive system – and increasingly so
- There is less margin for “ethical” discretion than ever
- Corporations are amoral: actions dictated by structures & pressures of markets, not the preferences or choices of owners or managers

# Capitalist Competition and Corporate Behaviour (cont'd)

- If ethical behaviour has any impact on profitability, it will be difficult to sustain
- If ethical behaviour has no impact on profitability, then we don't need "ethical" investors
- Trying to influence particular companies to change behaviour in any economically significant manner is hard to imagine
  - and even if it succeeded, others would step in

# How to Stop Bad Practices?

- Must use regulation and other tools to make unethical behaviour illegal or at least unprofitable

## C. Alternative Mobilizations of Real Capital

- Instead of trying to stop companies from unethical but profitable activities,...
- ...Use influence on investment decision to undertake positive actions that the profit-seeking private sector does not
- A “positive” action with capital, rather than a “negative” constraint on capital
- Actually impacts on the real economy

# Possible Mobilizations

- Low-cost housing (Greystone)
- Non-profit banking and social insurance services
- Cooperative / 3<sup>rd</sup>-sector community services
- Public infrastructure (old Teacher's fund)
- Crisis interventions (Solidarity Fund, Heartland)
- National/regional economic development (QPP)
- Political goals (eg. newspaper)

# Be Careful

- Ask why the private sector isn't doing this (and why you think you can, and at what cost):
  - market failure?
  - political bias?
  - lower rate of return?
- Be honest about the trade-offs (lower return and/or higher risk)
- Work hard to educate/mobilize member support

# Pension Fund as Holding Company?

- Best European examples (Mondragon, Italian Red Belt) use pension funds to mobilize finance in alternative production
- Irony: Some Anglo-Saxon pension funds are moving in a similar direction:
  - private equity
  - response to dot-com losses
- Can we articulate a progressive vision of enterprise, that pensions would finance?

# How Strong is the Chain?

1. Are Pension Funds Important?

2. Do Pension Funds Belong to Workers?

3. Can Workers Invest "Their" Money in "Alternative" Ways?

## CONCLUSION:

Screening and engagement strategies have no potential to change real economic outcomes. "Real" alternatives are possible but undeveloped. This link is mostly very weak.

4. Will Workers Want to Invest in "Alternative" Ways?

5. Will "Alternative" Investments Promote a "Better" Economy?

## 6. Do the Potential Benefits of “Alternative” Investing Outweigh the Risks?

- Consider possible dangers:
  1. Lower returns
    - if returns are genuinely equal, then no alternative strategy is needed
  2. Impact viability of pension plans themselves
    - financial risk
    - falling workplace & political support for DB pensions (corruption, individualism, IRA option)
  3. Shift in corporate governance

# Trying Times

- Unions are fighting like hell to hang onto pensions
  - eg. USWA members in U.S. (Chapter 11), now in Canada (CCAA)
- This fight dwarfs efforts to make a difference with the investment of pensions
- Need to be extremely careful that pension fund activism does not undermine pension activism

# How Strong is the Chain?

1. Are Pension Funds Important?

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## CONCLUSION:

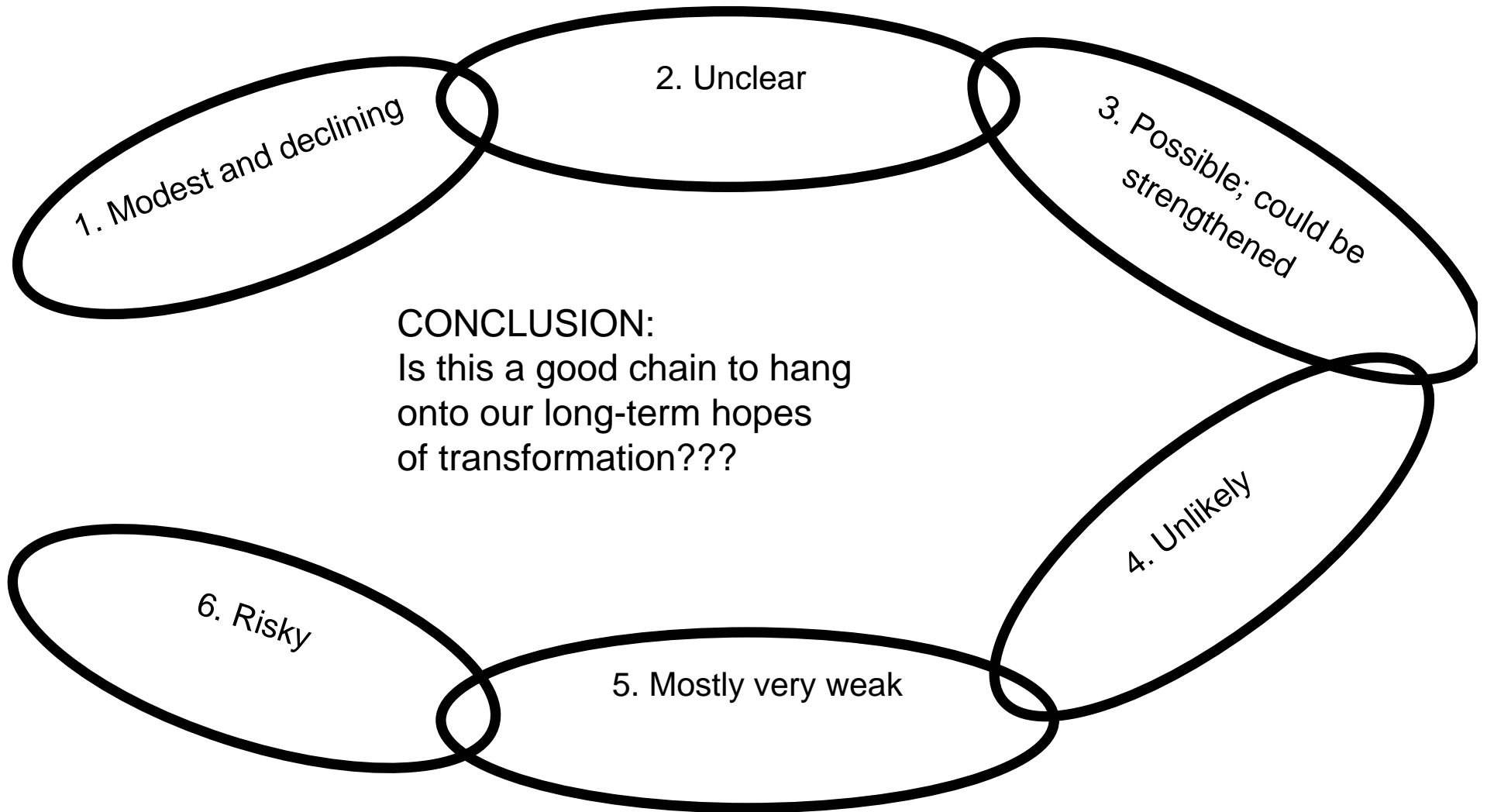
Strategies to invest pension funds in "alternative" ways could pose unintended risks to funds & members. This link is risky.

4. Will Workers Want to Invest in "Alternative" Ways?

6. Do the Potential Benefits Outweigh the Risks?

5. Will "Alternative" Investments Promote a "Better" Economy?

# How Strong is the Chain?



CONCLUSION:  
Is this a good chain to hang  
onto our long-term hopes  
of transformation???

# My View

- Dual interest:
  - socialist economist, seeking (like others) redefinition of transformation / socialization
  - union activist responsible to dues-paying members, for whom pensions are a huge priority
- Carefully explore options for using pension funds to mobilize real capital in alternative ways, in context of broader struggle to regulate finance, and in a manner that is supportive of broader social change mobilization

# The Coming Moment

- Historic conflict: both public and private
- Huge opening to fundamentally challenge the Anglo-Saxon model of intermediation
  - huge waste, huge losses
  - but SRI doesn't do that (Enron on every list!)
- Potential opening to challenge individualization
  - SRI's emphasis on "choice" reinforces individualization
- Opening for a new basis to claim

# Think Bigger

- Use pension funds as ONE pillar to support an alternative structure of financing real enterprise
- Chapter 16 *Paper Boom* (Stanford, 1999)
- Winning control over finance is part of the project
- But training and motivating real alternative entrepreneurship is the bigger barrier

