WIELDING LABOR'S CAPITAL:

UPDATING ERISA & PRESERVING COLLECTIVE INVESTMENT STRUCTURES TO AMPLIFY WORKER-SHAREHOLDER VOICE

DRAFT

Abstract

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Workers and worker-organizations have long participated in electoral politics and devoted resources to legislative and litigation strategies. But the ongoing development of capital strategies remains critically important to workers' ability to advance their interests. Worker-oriented capital strategies are made possible via the shareholder power vested in trillions of dollars of worker retirement funds. That shareholder power is maximally exercised in collective, pooled, separately managed retirement funds like public pension funds. And it is most diluted in the leading alternative to such funds, the individually-managed 401(k).

This policy brief identifies some overarching goals for labor's capital and sets forth one legislative proposal to advance those goals. The policy goals are (1) to preserve separate and pooled worker-retirement funds that facilitate the exercise of shareholder voice, and to restore such voice where it has been taken away and (2) to make legal changes that facilitate the exercise of that shareholder voice in ways that advance the actual economic interests of the workers contributing to these retirement funds. After discussing these goals, I outline draft legislation that I have been working on with a congressional office, the Investing POWER Act, that would reform ERISA to make it clear that pension trustees may consider the jobs impact of fund investments. I welcome inquiries about the proposed legislation.

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This paper discusses some overall policy goals for labor's capital, identifies and describes one specific legislative proposal to advance those goals. The policy goals are (1) to maintain and enhance collective investment structures for worker retirement funds, such as large public pension funds like the California Public Employees' Retirement System and the New York City Funds, and (2) to facilitate the use of these funds to advance worker interests. Time and again, these investment structures have demonstrated their ability to exercise worker-shareholder voice, voice that gets silenced in the most popular alternative, the individually-managed 401(k).

The legislative proposal is The Investing POWER Act, which would reform the Employee Retirement Income Security Act to clarify that pension trustees may consider jobs when making investment decisions, as described more fully below in Section II. I have been working on this legislation with a congressional office. Finally, in Section III, I very briefly suggest other legislative reforms that could advance the goals outlined in Section I.

I. Policy Goals: Preserving and Enhancing Collective Shareholder Voice[2], Enabling That Voice To Advocate for Workers

a. Retirement Fund Structure is Critically Important to Worker-Shareholder Voice

Traditional (or "defined benefit") pensions are pooled retirement structures overseen by a board of trustees and promising workers fixed payments in retirement. They have mostly disappeared in the private sector, replaced by the individually-managed 401(k), with the notable exception of labor union funds, which retain the traditional form. The boards of trustees for traditional pensions often have

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[2] For reference, please see an op-ed I wrote for the *New York Times*, The Real Reason the Investor Class Hates Pensions, which has been attached as an appendix.

representatives elected by workers. In the private sector, labor fund boards are 50% comprised of workers under Taft-Hartley. Public pension board composition varies according to state law, but such funds almost always have worker representation on boards, sometimes even outright majority control by workers. The combination of pooling and worker voice has significant implications for how these funds behave. The pooling enables entities like the California Public Employees Retirement System ($350 billion in assets) and the New York City Funds ($190 billion in assets) to speak with one voice on behalf of their members. (CalPERS has 2 million participants). The worker representation surfaces worker interests and concerns in fund decisionmaking, though it also has significant fiduciary duty implications. Worker voice may even be exercised on the employer-side of the equation, particularly when the employer representatives are elected officials or their appointees over whom workers may exercise influence through the electoral process.

It is no coincidence that public pension funds and labor union funds have become the most active of diversified shareholders. In some instances that means pursuing worker interests as shareholders, and in some instances it means pursuing worker interests as workers. On the shareholder side, The NYC Funds were the prime movers in corporate governance reform movements like proxy access. The United Brotherhood of Carpenters Fund filed over 700 shareholder proposals to push for majority voting rules. Public pensions backed the Shareholder Rights Project that pushed to declassify corporate boards. On the worker side, the American Federation of Teachers and others have pushed back against attacks from hedge funds or private equity funds on teacher pensions. The NYC Funds and Oregon's pension funds recently adopted responsible contractor policies requiring the hiring of contractors that pay fair wages and benefits to workers on infrastructure and real estate projects. Public pensions and labor funds have also served as lead plaintiffs in 40% of securities fraud and deal class actions.[3] These entities have the

[3] I will add citations for all of these points in a final draft of this document, but support can be found in my book, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON. (Harvard 2018).

financial might, the structure, and the incentives to implement effective worker-friendly investment policies, though there are some legal hurdles to said implementation.

The antithesis of the traditional pension is the 401(k). The 401(k) is an individually managed, tax-deferred retirement vehicle that enables workers to invest in markets. The mutual funds that manage 401(k)s have historically been the most passive of investors. The big three mutual funds rarely sue. Blackrock has never filed a shareholder proposal. And their 401(k) holders are often rationally apathetic. As I wrote for an op-ed in the *New York Times*:

> We 401(k) holders are the world's ideal source of capital. We let ourselves be charged high fees that we do not understand, we never sue to enforce our rights, we never vote as shareholders and we never tell our investment managers how we think they ought to vote. We are beyond passive; we are supine.

Still, there is a concerted effort to take the last traditional pensions and convert them into these 401(k)s. That effort is framed in terms of underfunding. Because traditional pensions are guaranteed, taxpayers have to make up any shortfall, at least for public pensions. Economists and actuaries hotly dispute the extent and even the existence of underfunding, but a well-funded campaign financed by the Koch Brothers, the Arnold Foundation, and others is backing the convert-to-401(k) drive anyway. That campaign persists despite ample evidence that 401(k)s are also in crisis because of both excessive fees and under saving.

Wherever one stands on these liability-side issues, the asset side issues are also significant and almost completely ignored. Convert CalPERS into 2 million individually-managed 401(k)s farmed out to the usual mutual funds, and CalPERS as we know it goes away. That shareholder voice is silenced. It is true that mutual funds have become more active in exercising their voice, particularly on environmental and gender diversity issues. In a forthcoming paper, my co-authors and I argue that this activism is largely

being driven by the effort to win over Millennials as investors.[4] But for well-documented structural reasons including the free rider problem (Blackrock competes for business with State Street; CalPERS does not compete against the NYC Funds), fear of managerial retaliation, social network effects, and other issues, there are significant barriers to mutual fund activism compared to pension and union fund activism, particularly on worker issues. The net effect of a successful push from traditional pensions to 401(k)s will be a significant loss of worker-shareholder voice. "A pension is like a union and a 401(k) is like right to work." In the *Times* and elsewhere, I called this push "economic voter suppression."

The key policy goal must be to preserve and enhance worker-shareholder voice by protecting worker investment vehicles, maintaining pooling and worker representation on boards. There are excellent reasons to protect traditional defined-benefit pension plans. But there are alternatives including collective defined contribution plans--effectively collective 401(k)s--that would preserve shareholder voice while addressing some of the underfunding concerns of pension critics. I wrote about that in a just-published law review piece, Reforming Pensions While Preserving Shareholder Voice, summarized here.

What follows is a description of advance the above goals.

II. The Investing POWER Act (Investing to Protect Our Workers, the Environment, and Returns Act ("The Investing POWER Act")

I have been working with a congressional office on The Investing POWER Act (Investing to Protect Our Workers, the Environment, and Returns) which would reform the Employee Retirement Income Security Act of 1974 ("ERISA") to further clarify that pension funds may consider participant jobs in making investment decisions. Jobs affect fund contributions, which also contribute to the fund's bottom line, like returns. This proposal is based on arguments made

[4] Barzuza, Curtis & Webber, "Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance," 93 Southern California Law Review (Forthcoming 2020).

in my book, THE RISE OF THE WORKING CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON, published by Harvard University Press in 2018, and in an article published in the NYU Law Review, "The Use and Abuse of Labor's Capital," which is summarized here. The act would also codify Clinton/Obama era Department of Labor ERISA interpretive bulletins that favor inclusion of environmental, social, and governance-oriented investment objectives. A brief description of The Investing POWER Act follows. I would be happy to speak to anyone who would like to learn more about the proposed legislation. I should be clear that I am not the sole author of this section, having worked on it with Congressional staffers not yet ready to be identified. David J. Berger of Wilson Sonsini also worked on this legislative proposal.

A. *Summary of the Issue:*

Most Americans gain almost all of their wealth from their jobs, including their ability to get a raise and obtain benefits and invest for retirement. Too often, ERISA fund managers invest the money of workers to increase returns – often short term returns – even if the net result of that policy is that the person who invested their money with that fund manager loses their job or is otherwise harmed in their position as an employee.

Americans also have environmental, social, and governance interests in their investments. Some have sought to delegitimize consideration of such interests in investment decision-making, or even to characterize such interests as breaches of the fiduciary duty of loyalty, improperly characterizing ESG considerations as being inconsistent with maximizing returns.

B. *Purposes of the Proposed Legislation:*

1. To ensure that fiduciary duties not be misinterpreted to bar money managers who invest the retirement savings of workers from exercising their right to seek investments and investee actions that are in the long-term best interests of the individuals who are entrusting the managers with the funds being invested.
2. To ensure that fiduciary duties not be misinterpreted to bar consideration of environmental, social, and governance factors in investment decision-making.

C. *The Current Statutory Problem, aka the "Duty of loyalty"*

The relevant language comes from Section 404 of ERISA, the "exclusive purpose rule", which states: "a fiduciary shall discharge his duties with respect to a plan *solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of (i) providing benefits to participants and their beneficiaries*; and (ii) defraying reasonable expenses of the plan."

D. *Proposed Solution*:

Amend the definitional section of ERISA in Section 404 which states that trustees should invest "*solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of providing benefits..."* to provide that the phrase "interest of the participants and beneficiaries" in the plan includes consideration of the interest of the participants and beneficiaries in the return on investment, but it may also include "the interest of the participants and beneficiaries in employer and participant contributions to the plan". Consideration of such interests in making investment decisions should not in and of themselves constitute a breaches of the fiduciary duty of loyalty embedded in Section 404.

EXAMPLE: A worker pension fund is considering an investment in a company that will compete with the pension fund's workers and likely to cause layoffs or downward pressures on wages and benefits

for the pension fund's workers. In addition to the return on investment, this legislative change would ensure that trustees of the worker pension funds are also acting "solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits" in considering the negative effect it might have on the jobs of fund contributors, and by extension, on the fund itself. Even if such an investment were projected to yield strong returns, it could also lead to job losses that could undermine the economic interests of fund participants and beneficiaries, and by extension, the fund itself through loss of both employer and employee contributions. Considering the jobs impact of these investments would be permitted.

Similarly, if an investment creates jobs for fund contributors, helping sustain employee and employer contributions, or if an investment creates jobs and new fund contributors, the benefit to the fund from such job creation may appropriately be considered in investment decision-making. For example, investments in infrastructure may create jobs for American workers who would contribute to the pension fund. Investment trustees may consider the benefits to their funds of job creation in making investment decisions.

EXAMPLE: A worker pension fund is considering two investments that their analysis indicates will generate the same return on investment at the same level of risk. One of the investment options is deemed to have a detrimental environmental impact and invests in a company that has questionable workers' rights practices and is participating in a major initiative led by a government that suppresses basic human rights. This legislation would preserve the right of the investors to consider these factors, provided that there is an assessment that return on investment between the two options is equal.

E. Real world consequences

A minimum of $10 trillion in retirement assets are governed by the exclusive purpose rule. An additional $4 trillion are governed by a largely similar version of the rule in state pension codes. Adopting

the proposed amendment would empower pension funds and other ERISA money managers to use their power as stockholders to support investments and investee actions that increase wages, add jobs, and further progress on environmental, social, and governance issues, rather than simply focusing on stockholder returns.

F. Legal Support

Legislation is needed because of a prevailing misperception that the existing statutory language means that fund managers should focus exclusively on investment returns. There are also some cases that support the broader view of fiduciary duty embedded in this legislation. *See, e.g, Brock v. Walton,* 794 F.2d 586 (11th Cir 1986) (rejecting the argument that a retirement fund breached its fiduciary duty to its beneficiaries by using some of its assets to make below-market loans to fund participants); Bandt v. Board of Retirement, San Diego County Employees Retirement System, 136 Cal. App. 4th 140 (Ct. App. 2006) (holding that retirement fund acted properly in allowing city to make lower than required contributions to fund in an effort to save jobs).

Legislation is also needed to enshrine the "all things being equal test" permitting consideration of environmental, social, and governance factors (also known as "economically-targeted investments, or ETIs) when choosing between investments, if the ETI has an expected rate of return that is commensurate to rates of return of alternative investments with similar risk characteristics that are available to the plan. Such legislation would enshrine into ERISA DOL Interpretive Bulletins 94-1 and 2015-01, except insofar as those interpretive bulletins conflict with Section 404 as amended by this legislation.

CONCLUSION

This piece identifies the structures of worker retirement funds that are best designed to amplify worker-shareholder voice. Those features include worker representation on retirement fund boards,

mirroring the debate on the corporate side. These include the importance of pooling of retirement fund assets in ways that can be wielded collectively on behalf of workers. In this piece I outlined one legislative proposal for advancing worker shareholder voice: The Investing POWER Act. There are plenty of other approaches that would further amplify worker-shareholder voice. These include protecting traditional pensions, collectivizing 401(k)s to retain pooling and worker influence or control, and barring investment managers from voting their investors' shares without instructions from the investors on how their shares should be voted.[5] This last principle became law in Switzerland in 2013 after a nationwide referendum. Giving 401(k) holder voice in the governance staffs of investment managers would also advance such goals.

The principal takeaways are that pooled investment vehicles with boards of trustees elected at least in part by workers, and with the legal flexibility to pursue worker interests, are superior mechanisms for vindicating worker-shareholder interests than the individually-managed 401(k).

[5] Ewan MacGaughey.