OPSEU POLICY STATEMENT

WITH RESPECT TO

UNION APPOINTED TRUSTEES AND SPONSORS

FOR JOINTLY TRUSTEED PLANS

Section I: Setting the stage – The power of the purse 4
1. The power of workers' capital in Canada and internationally 4
2. History of the inter-relationship between unions and pension funds 8
Section II: OPSEU and its pension funds 14
3. OPSEU's struggle for control over pensions 15
4. Governance – OPSEU's model 20
5. OPSEU's programs, policies and objectives 24
Section III Unions and fiduciary responsibility 27
6. History of the 'prudent man' and fiduciary responsibility 28
7. British and U.S. case law to date 30
8. Union and employer accountability 37
9. Maximum rate of return and diversification 39
10. Impact of Prudence Rule on Union Trustees 41
11. Prudence, social responsibility and union trusteeship 43
Section IV: Unions, social investment and corporate accountability 45
12. Definition of social investment 46
13. Ethical Screens 46
14. Definitions and frameworks for shareholder activism 53
15. Shareholder activism and the structure of markets 56
16. Shareholder action - barriers and opportunities 59
17. Shareholder action and rate of return 64
18. Economically targeted investment 65
19. Debates Around ETIs 68
20. Collateral Benefits 70
21. Economic Development 72
22. Pension funds, unions and economic development in Canada 74
Conclusion 79

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Canadian pension fund assets are estimated at just over $500 billion and are second only to the combined financial assets of the major banks in Canada. These pension funds have become a critical source of capital for national and international markets. They are controlled by an intricate web of financial and legal standards such as fiduciary responsibility. The workers, whose deferred wages make up the assets of pension funds, and their unions have little say in how these funds are used.

Collectively, the trade union movement could have a financial clout to rival that of the banks. To exercise this clout, trade unions and their trustees must develop new areas of expertize in capital market strategies, investment and economic development. Inevitably, as unions take more control over their pension capital, they will encounter criticism and resistance. This will come primarily from the financial industry, which has to date enjoyed unchallenged control of this capital.

This paper represents the perspective of one union, the Ontario Public Service Employees' Union (OPSEU) - a Canadian leader in union control of pension funds. The paper places workers' pension capital in a national and international context. It traces the history of the Canadian trade union movement’s interest in pension funds, the development and growth of pension funds and their impacts on the capital markets. The paper then examines the issues of fiduciary responsibility and financial management practice, faced by union trustees. An examination follows of the three most prevalent

forms of social investment (or socially responsible investing - SRI) practices that have been used by unions and allied organizations. These will give trustees a foundation for a more innovative and proactive pension fund investment practice. It will present our opinion of best practices for union trustees. Finally, the paper will address the next steps that may be undertaken by OPSEU in capital market strategies and internal union development to support these strategies.

Section I: Setting the stage – The power of the purse

Pension funds are generally viewed as the savings of employed workers that will provide them with a steady income upon retirement. They are the deferred wages earned while working but paid upon retirement. However, in addition, these vast pools of capital are a primary source of equity for the largest Canadian and multinational corporations. The first part of this section introduces the role of workers' pension funds in the economy and the nature of the control exerted by the financial industry. The second part examines the history of the struggle of workers and their unions for an adequate pension in their retirement years.

1. The power of workers' capital in Canada and internationally

The most recent data from Statistics Canada (2002) indicates that the assets of trusteed pension funds for the third quarter of 2001 were $541.6 billion. As at December 2001, the OPSEU Pension Trust totalled $9.4 billion, the CAAT Pension Plan totalled $3.8 billion

and the Hospitals of Ontario Pension Plan totalled approximately $17 billion. Within Canada, these huge pools of capital are second only to the total financial assets of the major banks.

Internationally, the story is similar; by the end of 1994, pension fund assets were estimated at U.S. $10 trillion (World Bank, 1994). As Minns (1996) points out, this figure is greater than the combined total market value of all the world's industrial, commercial and financial corporations quoted on the three largest world stock markets (New York, Tokyo and London). Pension fund assets alone are ten times the size of all foreign currency reserves of the fifteen largest 'Western' economies – the European Economic Union, the U.S., Australia, Canada, Japan and Switzerland (Minns, 2001). Where is this capital invested? Pension funds in the U.S. control 47 percent of all U.S. equities; in Canada, the comparable figure is 35 percent, with 40 percent of pension fund assets invested in equities (Patry and Poitevin, 1995).

Most pension funds are invested in the markets primarily through fund managers employed by the major financial institutions and retained by the pension fund. In its survey of fund managers, Benefits Canada (Press, 2001) reports that pension assets under management as of June 2001 were $497.7 billion. The total market value of pension fund assets, reported by Statistics Canada for the same period, was $580.2 billion. Based on these figures, the financial industry controls approximately 85.78% of all pension assets in Canada. The top ten companies controlled $256.2 billion - 51.47% of these assets - and their control over pension funds is growing. Professional fund managers have almost total discretion over the investment of funds (Rifkin and Barber, 1980; Deaton, 1989; Roe,

1991; Minns, 1996). The values and belief structures of fund managers infuse their investment practices. Even though workers own the assets being managed, the workers who provided the capital have little say in what is done with their money. Investment decisions are made by a small, concentrated group of fund managers who decide where the money goes. They retain the privileges of capital through the exercise of proxy votes on decisions to purchase companies, on take-overs, on corporate policies including privatization and downsizing, on corporate behaviour such as health and safety and environmental standards, and finally on corporate structures and compensation (Carmichael, 1996).

These investment managers often have a direct financial interest in the take-overs and privatization of public services financed by the pension assets they manage. In 1994, in the U.K., eight out of the top ten pension fund management companies were involved as advisors in take-overs. Of eight U.K. banks involved in privatization sales, four were among the top ten pension fund managers. Financial institutions involved in pension fund management have a ‘clear commercial interest' in the take-over business, privatization of public services, and the privatization of state pension systems (Minns, 1996, p.386).

The trade union movement in Canada has noted the connection between pension fund investment, privatization and workers' employment insecurity. The Canadian Labour Congress (1990) has stated that:

> The largely private nature of the investment process makes workers, communities and governments the hostages of those who control the investment process (p. 3).

The Canadian Union of Public Employees (CUPE) in a recently published newsletter "Pension Talk": Bringing union values to pension investing (2002) points out that the impact of privatization has graduated from smaller services to very much larger enterprises and sectors such as electrical utilities, schools, hospitals, highways and municipal water and sewage systems. Pension funds are being solicited and used for such projects. Where there is no union control of the pension fund, unions are defenceless in preventing their members' deferred wages from being used against their interests and, ultimately, the interest of the pension fund itself.

Today, unions have very little control over the investment of these vast pools of pension capital. Control over investment will only be a reality once unions have some measure of control over their members' pension plans. Unions in eighteen of the top twenty-three funds in Canada are in the process of winning, or have won joint trusteeship (Carmichael, 1998). These struggles have been achieved largely in isolation from one another from the early 1990s until fairly recently[1]. Therefore, trusteeship models vary considerably and do not always include effective control over the investment arm of the fund (Carmichael, 1998).

Once trusteeship is won, the learning curve for union trustees is enormous. Many report difficulties dealing with fund managers. The undermining of union trustees is not unusual. Fund managers will stress their own professionalism and objectivity in contrast to the lack of expertize and supposed bias of 'lay' or union trustees. William Dimma,

[1] In January 2001, the CLC held its first pensions conference.

Chairperson of several Canadian companies, in a report presented to the Standing Committee on the Governance Practices of Institutional Investors of the House of Commons, displays this paternalistic approach:

> While many plans are managed professionally, their boards are sometimes stocked with persons whose principal merit is that they are members ….[who] have been elected by their fellow employees. While this is laudably democratic, it does not always produce the quality of direction and oversight necessary in today's bewildering world (Report of the Senate Standing Committee on Banking, Trade and Commerce, 1998. p. 6).

To understand the struggle faced by unions to gain some control over pension plans and the resistance of the Canadian corporate sector and financial industry, it is helpful to consider the history of trade unions and pension funds.

2. History of the inter-relationship between unions and pension funds

Workplace pension plans have existed in Canada for 140 years, having developed largely in response to labour unrest, the rise of unionism and demands from working people for a national social security pension for the elderly (Morton, 1981; Stafford, 1987; Palmer, 1992; Heron, 1996). Pension plans were originally introduced in the late 1800s by the banks, railroad companies, the federal and later the provincial governments to provide for their large workforces, and, incidentally, as a means of workplace control. Pensions were a form of patronage by government employers and a reward for 'good service' by other employers. This led to arbitrary and discriminatory treatment of workers. For example, unionizing and community organizing often would not be considered good service; nor was illness, pregnancy, or getting older and slowing down. Workers and their unions

consequently were suspicious of employer-sponsored pension plans; this fueled campaigns for a national, universal pension system.

The general public was also suspicious of workplace pensions. In 1920, when the Ontario government introduced a pension plan for its employees, the plan was controversial enough to be a factor in the downfall of the government in the next election. The plan was introduced after discussions with the newly formed Civil Service Association of Ontario (the precursor of the Ontario Public Service Employees' Union). It provided benefits to men over 70 years in exchange for 'good and faithful service'. This was widely viewed as patronage.

The Canadian government eventually introduced a universal benefit in 1927. The Old Age Pensions Act provided for a means-tested benefit that was hopelessly inadequate to meet the needs of the elderly. It was designed as a subsistence benefit for those in need. Meanwhile, from 1919 to 1937, workplace pension plans proliferated across Canada in the form of employer allowances for good service (Dominion Bureau of Statistics, 1947). The introduction of income tax in 1917 to raise funds for the war effort had incidentally given employers tax exemption for pension funds. Given the voluntary nature of benefit payments, and with no proscribed system of accounting, it is likely that pension funds were an important source of additional capital for employers (Stafford, 1987). However, in the early 1930s after the onset of the Depression, employers were short of capital. Government therefore made pension contributions tax deductible and extended employers' tax exemption retroactively by ten years. This was an astonishing boon to

employers, underlining the point that pension funds had already become an important source of investment capital (Greenough and King, 1976).

During the Second World War, taxation became the primary regulatory tool to raise funds for the war effort. In 1938, the corporate tax yield was only $85 million, but within five years it had increased to $740 million (O'Grady, 1991). Because of the government's need for greater income to finance the cost of the war, the tax-exempt status of pension funds came under closer scrutiny. In 1942, the federal Ministry of National Revenue decreed that employer contributions to a plan would only be tax-deductible if they were supported by an actuarial statement attesting that a pension fund was in place. While this was primarily intended to prevent tax evasion, it also had the effect of making both employer and employee contributions deferred income, as opposed to an allowance for good service that could be revoked (O'Grady, 1991).

A survey conducted in 1947 by the Department of Labour recorded that over 70% of all Canadian pension plans at the time were introduced during the period from 1938 to 1947 (Dominion Bureau of Statistics, 1947). Despite government need for extra capital during the Second World War, there were few restrictions placed on the corporate sector's accumulation of private capital through pension funds. In fact, state encouragement and support of employer accumulation of capital through pension funds continued.
Today, in most industrialised countries, pension fund capital remains tax exempt. Contributions are also exempt but benefits are taxed (Davis, 1995). In the immediate post-war period, the Mackenzie King government introduced the Industrial Relations and

Disputes Investigation Act. This law pulled together much of the ad hoc industrial relations regime that had been in effect during the war. It provided unions with a permanent collective bargaining framework for industrial relations. Union members therefore turned to their unions to negotiate pension plans. Given the inadequacies of old age security, unions continued their agenda of lobbying for better universal security for the elderly, but decided reluctantly to bargain for workplace pension plans and for improvements in benefits. In 1947 less than 3% of plans covering fewer than 20,000 workers were actually part of collective agreements (Department of Labour 1958).

In 1948, the Canadian Congress of Labour adopted a resolution encouraging affiliates to bargain pension benefits. This resolution was based on a grudging acceptance that many of the more obvious employer abuses were prevented through state intervention, and it was now difficult if not impossible to oppose workplace pension plans. The new reality was that, in a collective bargaining environment, employers would push to minimise benefits and maximise productivity by pushing such issues as mandatory retirement (Mosher, 1952). Private sector unions had no choice but to go to the table.[2] Further, the absence of a universal pension plan put pressure back on unions to beef up the benefits in private plans. Unions of the day emphasised bargaining plan improvements to the exclusion of joint administration of pension funds.

In 1952, through lobbying by the trade union movement and social reformers, the long overdue reform of the national system became a reality. The Old Age

[2] The first pension plans to be bargained in Canada were in 1950 between the UAW and Ford Motor Company, and General Motors (Yates, 1993).

Security Act (OAS) was introduced providing the first universal pension plan in Canada. Monthly payments were established as a right and all those over 70 received $40 a month. The means test to qualify for up to $40 per month only applied to those who could prove destitution and were between 65 and 70. Mandatory retirement was reduced to 60 for women and 65 for men. The new program was to be funded through general tax revenues set aside in an old-age security fund.

In 1951, 308,825 people received pensions under the 1927 law; under the new law, this number doubled to nearly 700,000 (Finlayson, 1988). However, within five years, inflation had eroded the new benefits levels, and lobbying began again for an increase in benefits.

By 1964, a million Canadians were drawing OAS benefits and a further two and a half million had incomes so low they paid no income tax. Together, this amounted to half of the Canadian electorate (Finlayson, 1988). There was enormous pressure on government to bring in more increases in OAS benefits (in the absence of inflation protection), and, at the same time, to bring in a contributory, universal pension plan. The corporate sector and government were alarmed at the amount of revenues going to social security; the idea of a contributory plan appealed across the board. The federal government entered into negotiations with the provinces, and by 1966 there was agreement on a plan for Quebec, and the

CPP for the rest of the country. The CPP had a contribution rate of 3.6% of pensionable earnings shared equally between employer and employee. Benefits would be partially indexed, and a ten-year transition period ensured that older Canadians could get help from the plan in the near future.

Under strong pressure from Ontario, which was threatening to set up another provincial plan (because Quebec had its own), Ottawa was to administer the plan, but the provinces could `borrow' surpluses from the "fund" at advantageous interest rates. What had started as a pay-as-you-go scheme, was transformed into a partially funded plan. What followed was predictable; in the four years prior to March 31, 1974, the Plan had provided the provinces with $4.67 billion, 38% of all provincial borrowing, at favorable rates of interest. While more money had been coming in as contributions, less was going out in benefits, thus encouraging the provinces to view the CPP as a convenient slush fund to fund provincial initiatives (Calvert, 1975).

The CPP was enacted much later than national plans in many other industrialized countries. To this point the Canadian government had avoided providing a mandatory, universal, publicly-funded pension plan, despite almost 100 years of organizing by workers and their unions. Both the OAS and CPP systems became outdated fairly quickly, as they were not indexed, and failed to keep up with inflation.

This section has provided a backdrop for OPSEU's activism in the pension arena, to be described in the next section. The first part of the section described the present role played in the economy by pension funds. It has shown that while pension funds constitute an enormous pool of capital, workers and their unions have little control over their investment. Instead, pension funds are viewed as a primary source of equity for the largest corporations in Canada, and internationally, for the largest corporations in the world. As such, at present, pension fund investment tends to work against rather than for workers' interests. This is not surprising given the history of the development of pensions, described in the second part of the section. In Canada, while union struggles for adequate pensions were focused on winning universal, adequate pension coverage through a national program, governments deflected the pressure by offering employers the inducement of capital funds to encourage them to set up workplace pension plans. Workplace pension funds, historically, have represented ready access to capital surplus for employers. The next section continues the history of unions and pensions on a provincial level by reviewing the history of OPSEU and its struggle for pension control in Ontario.

Section II: OPSEU and its pension funds

This section will review the more recent history of unions and pension funds through the experience of OPSEU and its struggle for greater control over its pension funds, paying particular attention to the development of the OPSEU Pension Trust, the pension plan for OPSEU members in the public service.

3. OPSEU's struggle for control over pensions

In sixty years since the beginning of the twentieth century, the gains in pension reform for Ontario's workers had been modest. While national standards were established in principle through the OAS and the CPP, the actual benefits both acts provided to workers were inadequate. Workplace pension plans were still heavily controlled by employers, and remained a vehicle for investment purposes. They also covered a relatively small sector of the population. Trade unions had emerged in the first part of the century as the only way for workers to make gains in pension reform. Resistance from the corporate sector, individual employers and all levels of government was strong. Federal and provincial governments responded with commissions, task forces and committees.

While Peter Drucker had coined the misleading term `pension socialism' as early as 1976, in fact, by 1980, employer-sponsored pension plans still accounted for only fourteen per cent of the total income of Canadians over the age of sixty-five. And more than 53% of retired Canadians lived in poverty (Finlayson, 1988). But private sector employers continued to lobby the federal government strenuously against raises in benefit levels for the state plans, and, at the same time, resisted reform of employer pension plans. The universal social security programs for the elderly, the OAS and CPP, were in trouble; benefit levels were too low, and the plans were going broke[3]. Employer pension

[3] Not only were benefits too low for the `average man', but for women they were nearly non-existent. As Ann Finlayson (1988) points out, pension plans, public or private, still described the average worker as working full time from age eighteen till sixty five, working for one employer after thirty five, receiving steady salary increases [and pension entitlements) till age sixty five.

plans were weak because of low coverage rates, mismanagement of the funds, employer contribution holidays, discriminatory impacts on women, no inflation protection and employer paternalism.

OPSEU's presentation to the Royal commission on the Status of Pensions in 1981 marked the beginning of a fourteen-year campaign for control of pension funds. It was one of the first unions in Canada to make pension reform a priority and remained one of the leaders in the field for many years (Finlayson, 1988). Sean O'Flynn, OPSEU's President said:

> I would like to introduce a concept which has some relevance, the concept is property…It is time to make those pension plans negotiable and it is time for the question of control of those pension funds to be placed at the top of the agenda (Sean O'Flynn, 1981, p. 35).

The Haley report, released by the Royal Commission of the Federal Government in 1982, concluded that an expanded CPP should replace the private pension system. At the same time, Monique Begin, Federal Health and Welfare Minister delivered an ultimatum to employers: reform private pension plans, or face either an expanded CPP or mandated private pension plan coverage. The federal government, led by Pierre Trudeau, set up a Parliamentary Task Force on Pensions, chaired by Douglas Frith. Its report, issued in 1983, insisted on keeping universal benefits safe from political tampering. Provincial governments were warned not to use CPP\OAS funds to pay down deficits. Workplace pension plans under federal jurisdiction were to provide vesting after two years and be extended to cover part-time workers. This task force came under heavy pressure from the

business sector and insurance companies and backed off a recommendation on inflation protection.

In the 1980s, surplus grabs were popular with employers because there was double-digit inflation and over-heated stock markets. Pension funds were a ready source of capital for investment purposes. At the same time pensioners were devastated as their un-indexed pension benefits shrank in value with each increase in the CPI. Members with defined contribution plans were doubly affected by having neither a guaranteed benefit nor indexing. While employers took contribution holidays and used surplus funds for their own purposes, retirees sank into poverty.

Pension funds were being used to transfer wealth from workers to employers, and it was completely legal. Further, employers were arguing that since the assets and liabilities of pension plans were now comparable `in size [to] those of the main-line businesses of the sponsor corporations', they should be managed for the benefit of the corporation and its shareholders (Ambachtsheer, 1988).

Public sector plans faced the opposite problem. Since government employers had borrowed from pension funds at extremely low rates of interest, the funds were not keeping up with inflation and were unable to keep benefits in step with inflation. It was sometimes impossible to tell whether government employers were actually meeting their obligations to contribute. Therefore unfunded liabilities were growing and there were

indications that public sector plans like the Ontario Teachers' Pension Plan were in trouble.

The defeat of the provincial Tories in Ontario 1985, and the Accord between David Peterson’s Liberals and the NDP, put pensions at the top of the agenda and resulted in amendments to the Pension Benefits Act similar to the Federal legislation. A moratorium was declared on surplus withdrawals until a decision was made on inflation protection. But how could inflation protection be introduced without upsetting the corporate sector? A landslide election victory for the Liberals followed with still no action on indexing of pensions. Yet another pension taskforce was appointed, headed by Martin Friedland, University of Toronto professor.

OPSEU’s presentation to the task force reflected a growing impatience with private sector employers who continued to resist indexing public sector pensions as an expensive privilege. During the hearings, the CAW negotiated indexing of pensions, forcing Chrysler, Ford and GM to reverse their positions. OPSEU also drew attention to the con games of successive governments being practised with in-house pension funds by lending the public service pension fund back to itself (OPSEU, 1987). The taskforce in its recommendations supported indexing but there was no redress for the workers who had suffered terrible losses of benefits because of inflation.

OPSEU’s concerns about the interests of beneficiaries and taxpayers in the governance of public sector pension funds touched nerves in the Peterson government. Yet another task

force was set up to deal with the control and governance of pension funds. Malcolm Rowan recommended that public sector pension funds be governed by independent boards of trustees to protect against political interference and protect ‘taxpayer interest’ but that plan members should have a minority interest only. He failed to address the issue of negotiability. OPSEU retorted that the risks and rewards of trusteeship must be within a context of negotiability (OPSEU, 1988).

Furthermore, OPSEU took a pro-active position on the investment practices of the public service pension fund. The government's policy of investing exclusively in its own non-marketable debentures was denounced by the union as serving only the employer's interests and inappropriate since the returns were well below market rates and did not provide a sustainable fund in the long run. However, some investment in government of Ontario bonds should continue as part of a more diversified strategy. OPSEU also suggested other investment strategies such as making residential mortgages directly available to members of the plan, and indirectly through the financing of housing projects:

> In general, it should be possible for us to address important social and economic concerns through the investment of the fund. But investment strategies should reflect the interests of all of those with a stake in the security and economy of the plan. For this reason there should be a well-established process for considering investments other than those indicated by conventional, technical factors. This process should include equal representation of the employer and the employees (OPSEU, 1988. p. 25).

OPSEU then launched a major campaign on pensions and linked it to the next round of bargaining. OPSEU was offered a separate fund if it would agree to take half the responsibility for the unfunded liability accumulated by the government's past practices.

OPSEU refused, but in similar bargaining with the Teachers' unions, the government reached an agreement. The teachers unions were concerned that their whole plan was at risk and saw inheriting the unfunded liability as a small price to pay in exchange for joint trusteeship and the opportunity to invest in equities beyond government bonds.

In December 1989, the Public Service Pension Plan was enacted, contribution rates were increased, an arms-length agency was set up and OPSEU was given no say in pensions. However, within the year, the Liberals were defeated in a provincial election and the first NDP government in Ontario came to power with a majority government.

4. Governance – OPSEU's model

The NDP government's first budget, a growth, expansionist budget proclaiming a short recession and swift recovery, went against all prevailing wisdom and raised the deficit substantially. The government had to come up with an economic plan with a social democratic slant, anticipating an economic recovery through structural reform of training and job growth in the private sector, as well as reducing the deficit. The government was prepared to negotiate a trusteeship agreement with OPSEU in exchange for access to pension funds.

But first, the union and the government entered into negotiations to provide a collective bargaining regime for the Ontario Public Service including the right to strike. In December 1993, the reformed CECBA was proclaimed giving OPSEU the right to

negotiate pensions for its OPS bargaining unit. So, after fourteen years of negotiations and confrontation with three provincial governments, OPSEU had overcome a major hurdle in the struggle for workers' control of deferred wages. It had won the right to negotiate pensions for its public service members and, further, to negotiate a pension plan over which it had some control.

Now it had to negotiate the best deal possible to retain control over its largest pension plan in the future. OPSEU's transition, in 1994, to a jointly sponsored pension plan for its Ontario Public Service membership was, as negotiators say, a win-win situation for both government and union.

The OPSEU Pension Plan Sponsorship Agreement was tentatively agreed to in late April 1994, and ratified by a vote of the membership in May. The vote was overwhelming, laying to rest the doubts of those who had wondered whether trade unionists would be comfortable with their unions looking after their money. The Government and OPSEU agreed to be joint sponsors of the pension plan and the fund, both of which were to be managed by a single Board of Trustees, to which each sponsor was to have five appointments. The OPSEU Pension Act was enacted as part of the Budget debates that April.

The union now had bargaining rights with respect to the plan, and may amend the [sponsorship] agreement, the Trust agreement, the Plan or any plan documents' by mutual agreement. Almost immediately significant benefits were given to plan members such as

the "factor eighty" voluntary exit program being extended to the year 2000, a key gain given impending layoffs in the Public service, and a 1% contribution holiday for three years - a welcome relief from three years of no wage increases and other penalties incurred under the social contract.

In total, the government saved almost $1 billion. The government was still to be responsible for total payment of the unfunded liability inherited from the old plan from its share of the gains. However, it retained the right to have 40 years to pay it back (rather than 15 years under the Pension Benefits Act) at a cost of approximately $17.9 million per month under a special payment plan beginning in 1997.

The OPSEU Pension Trust began operating on January 1, 1995. The OPT Board of Trustees is responsible for the administration of the OPSEU Pension Plan and the investment of the fund. Five trustees represent the union and five the employer. The Chair and Vice Chair were to be selected by the trustees themselves, with both sponsors represented. The Chair was to rotate from one sponsor to the other, with each individual sitting for only two years. Both Chair and Vice-Chair were to be volunteer, not salaried, and receive compensation for expenses only from the OPT. In the event of disagreement amongst the trustees, a process was designed to select an eleventh trustee for the sole purpose of breaking the tie.

The Union was also accumulating experience in trusteeship through its legal victory with other unions of control over the Hospitals of Ontario Pension Plan (HOOPP). In 1993,

OPSEU, with the Canadian Union of Public Employees, Service Employees International Union and the Ontario Nurses Association reached a settlement with the Ontario Hospital Association for joint trusteeship of the HOOPP fund. This had arisen out of a legal challenge launched by the unions under section 8(1)e of the Pension Benefits Act to meet the requirements of a multi-employer pension plan by having a minimum of 50% member representation on its board of trustees.

HOOPP is now governed by a Board of Trustees made up of 16 voting members. Eight trustees are appointed by the OHA and two are appointed by each of the four unions. In November 1993, representatives from the OHA and the unions signed the Agreement & Declaration of Trust, establishing HOOPP's existing governance structure. The Board is responsible for all aspects of the Plan and the multi-billion dollar HOOPP Trust Fund.

This model was essentially reproduced in another union initiative to negotiate for trusteeship of the College of Applied Arts and Technology Pension Plan, now the twenty-fifth largest Canadian pension fund with assets as of May 31, 2002 of $3.770 billion. The original plan had been set up in 1967, following approval of an Order-in-Council by the Lieutenant Governor of Ontario, and administered under the umbrella of OMERS, the Ontario Municipal Employees Retirement System, which itself came into existence in 1963. Members in the community colleges were dissatisfied with the investment of their pension fund and correctly assessed that joint trusteeship of OMERS was not likely in the immediate future. In 1994, OPSEU therefore succeeded in splitting off the CAAT plan by negotiating with government and Council of Regents representatives for joint trusteeship.

The CAAT Plan became effective in January 1995.This agreement was endorsed by a 90% vote of the community colleges faculty and support staff. Again, there was no doubt about the wishes of OPSEU members to have control over their own pension funds.

The governance structure includes the Sponsors' Committee and the Board of Trustees, as well as a Plan Manager/Chief Executive Officer and an administrative staff of 23. Ten money management firms manage the Plan's assets.

By this time, OPSEU had also begun the work to set up a BPS Pension Plan as a vehicle for pension coverage for its members in the broader public sector where coverage traditionally had been very poor. All negotiations throughout the sector would, from 1995 onwards, contain union proposals for pension coverage under the BPS Plan. OPSEU was to be the sole sponsor and trustee of the plan.

5. OPSEU's programs, policies and objectives

Over the years, OPSEU's policy and objectives with respect to control of pension plans has been reflected in its internal pension plan with its own staff. The OPSEU Staff Pension Plan is a small plan with assets of approximately $50 million and is jointly trusteed by OPSEU and the staff union, the Ontario Public Service Staff Union. It is one of the few pension plans in Canada that has implemented a screen to evaluate investments based on a variety of criteria. Screens were originally established as part of a boycott of companies with investment in South Africa and were decided after a vote of support from

members of the plan (OPSEU bargaining unit staff). The economic impact of the screen was tracked and was found to actually benefit the plan with higher rates of return (Interview with Terry Moore, 1996).

With such a focus on pension plan activism, the OPSEU Board decided, in 1997, to set up a task force to recommend how the union should approach issues of trusteeship. In particular, controversial conflict-of-interest issues had surfaced when a union trustee had applied for and been appointed to the staff of one of the plans. However, in general, it was recognized that with a growing number of joint trusteeships, there was a need to develop a consistent union approach to:

- accountability of trustees,
- expense allowances,
- procedures for appointments,
- removal of trustees, and
- trustee training

A Board committee took on a number of highly controversial areas of the relationship between a union and its trustees. It produced procedures for selection of trustees in each sector. All trustees were to understand the union's policies and goals and to sign a letter - prior to their appointment - covering their relationship to the union and ethical principles governing their behaviour. For the OPT, positions were to be posted, and a competition process implemented. For HOOPP, recommended candidates names were to be forwarded to the health sector chairs for review prior. The community college sector appointment process was by vote at a Division meeting of all delegates. The Unoin’s

Executive Board retained final authority over all appointments. Continuity of trusteeship was ensured in all four plans by staggering terms of office so that there was never a complete turnover on the union side.

A standing committee of the Board was struck - the Pension Liaison Committee - to continue the work of the task force. Its mandate is to recommend policies and procedures for union-nominated trustees. These policies would include conflict-of-interest guidelines, expense allowances and appointment practices, but would extend to monitoring trustee conduct in line with OPSEU's goals, interviewing prospective trustees, determining education needs and facilitating communication between the union, membership and trustees. It is also the Board liaison on pension policy.

This committee is probably the only one of its kind in unions in Canada. It has broken through the "chill" that has existed between unions and their trustees as a result of the Cowan and Scargill case (which will be described in a later section). Through its existence it acknowledges that trustees - as fiduciaries - are not independent agents, but are accountable to both plan members and the union. The Union makes it clear to potential trustees that it is the expectation of the Union that trustees will follow union policy. This includes policies such as training, attendance, expense and conflict of interest policies, codes of conduct and all other policies of the union.

Furthermore, before a person is accepted as a union trustee the potential trustee must commit in writing that they are prepared to follow union policies. So although trustees

may not be legally the agents of the union all trustees know that they are expected to assert the Union's agenda. In return the Union takes on the responsibility to support and train trustees for their work on pension boards. Ultimately, in the event that they fail to perform their duties, the Union has a responsibility to remove them.

If a trustee, in a particular instance, feels that their primary duty as fiduciary is in conflict with their commitment to advancing the policies of the Union, the trustee must initiate a discussion with the Union sponsors with a view to resolving the conflict.

This section has documented OPSEU’s history to win negotiability and trusteeship of its major pension funds through three successive Ontario governments. It was one of the first unions in Canada to make pension reform a priority and remained one of the leaders in the field for many years (Finlayson, 1988). It fought successive attempts by governments to appropriate pension fund surpluses, to take contribution holidays, to ‘borrow’ pension funds through investment in low interest government bonds and, in general, to mismanage their employees’ pension funds. OPSEU eventually negotiated a ground-breaking model of joint trusteeship, giving union and employer trustees equal responsibilities for investment of the fund.

Section III Unions and fiduciary responsibility

This section of the paper challenges the barriers faced by union trustees as they learn investment strategies, deal face-to-face with fund managers, and attempt to develop union approaches to investment. Of primary interest is the argument that the obligations of

fiduciary responsibility which bind all trustees legally bar trustees from considering innovative approaches to more productive investment of pension funds.

In fact and in law, workers and their unions have been guaranteed that their pension money would be safe and secure, because their funds are held ‘in trust’ for their retirement. Historically, this has meant that the person entrusted with their funds - the trustee - is a person who must behave prudently with respect to funds and be loyal to fund members' interests alone. The philosophy underlying pension investment policy and trusteeship of capital is based on fiduciary responsibility, or the so-called ‘prudent man’ rule. This section analyses the history and development of this rule through an examination of the significant cases in American and British law. It further examines the ways in which this rule has worked against the interests of workers and their communities and continued to enable the accumulation of capital by employers and the financial industry. Finally, it assesses the ability of union trustees to reclaim an interpretation of fiduciary responsibility and, working with their unions, undertake social investment initiatives more in tune with the interests of their members and their communities.

6. History of the ‘prudent man’ and fiduciary responsibility

The prudence rule is a central concept of trust law and a legal requirement of the management of pension fund assets in Britain, the United States, Canada, and most other industrialized countries. The trust concept has its origins in the Middle Ages, and has a history of jurisprudence and litigation covering several centuries. The concept of the

'prudent man' is central to the accumulation of private capital through the protection of family wealth. The roots of trust law are patriarchal, lying in the remnants of feudal society where wealth was passed on through the male heads of households. In the absence of the male head of the family, the prudent man was essential in keeping the wealth of the family secure for the benefit of the male heirs (Longstreth, 1986). The trust ensured that trustees would act only in the interests of the family (the male heirs) and not in their own interests. Trustees, in effect, control the wealth on behalf of the family, but cannot access it for their own use. Trusteeship embraces the responsibility of ownership, without the ownership itself. Trustees must not act out of self-interest or personal bias (Longstreth, 1986; Mercer Ltd. 1997; Minsky, 1988; Scott, 1987; Waitzer, 1990).

Prudence is the antithesis of speculation; according to the prudence rule careful investments have been characterized as low risk ones. With the development of stock exchanges in the early part of the century, lists of investments were published for trustees as well as other cautious investors. Everything else was classified as speculation. However, the stock market crash of 1929 and the Depression of the '30s brought a re-examination of lists. Nevertheless, lists persisted as a prescription for investment up until the 1970s.

U.S. trust law originates from an 1830 case in Massachusetts, Harvard College v. Amory. The ruling states that the trustee's duty is to:

> conduct himself faithfully and exercise a sound discretion, observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering

> the probable income as well as the probable safety of the capital to be invested (26 Mass (9 Pick) 446, 1830).

In a similar manner, the Supreme Court of Canada more recently stated:

> Where. . one party has an obligation to act for the benefit of another and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary. Equity will then supervise the relationship by holding him to the fiduciary's strict standard of conduct (Guerin v. The Queen, 1984).

Even more recently, the Supreme Court identified the following criteria for a fiduciary relationship:

1. The fiduciary has scope for the exercise of discretion or power.
2. The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.
3. The beneficiary is peculiarly vulnerable to, or at the mercy of, the fiduciary holding the discretion or power (Frame v. Smith, 1987).

7. British and U.S. case law to date

There have been several significant cases in the U.S. and U.K. courts that are helpful in understanding fiduciary responsibility. There has been no decision in a Canadian court addressing the issue of the role or duty of union trustees in investment strategies. A summary of the central cases follows. U.S. case law supports several points:

- First, union trustees cannot act as union officers in the interests of the union. They must act clearly as trustees responsible for the fund, and in the interests of the fund members. Otherwise they are in a conflict of interest.

- Second, the long-term interest of the fund and its members is a legitimate investment concern, even where the rate of return may be lower and risk to the investment may be higher.
- Third, the investment decision itself must be based on independent financial advice. If the trustees are fully informed, then they are not liable for a lower rate of return.
- Finally, trustees do not violate their duties of prudence by considering the social consequences of investment, providing the costs of considering such consequences are minimal. In fact, they are encouraged to do so given the power of pension funds.

<u>Blankenship v. Boyle</u> (1971) is an American case of some significance. The United Mineworkers of America had a major campaign to encourage electrical utilities to use union-mined coal in order to maintain and increase the number of jobs in the coal industry. One feature of the campaign was to have the United Mineworkers of America Welfare and Retirement Fund invest in electrical utilities that used union coal. The shares of the stock subsequently decreased in value. The court judged that these investments were made in the interests of furthering the union campaign rather than the interests of the beneficiaries and noted the close relationship between the trustees and the union. Some commentators have interpreted this as a warning to trustees that they should not engage in social investment (Langbein and Posner, 1980). However, the court actually required both employer and union to refrain from self-dealing. The decision enjoined ‘the trustees from operating the fund in a manner designed in whole or in part to afford collateral advantages to the union or the employers’ (p.1113). One finding of the court

was that the union conspired to benefit from the breach of trust in that not only was collateral advantage part of the consideration but that the Union's campaign was put ahead of the interests of the plan members. In this respect the case was really about conflict of interest, self-dealing and breach of trust rather than social investment. The narrow view on social investment and collateral benefit to the union in Blankenship v. Boyle have either been overturned or significantly modified by subsequent rulings.

In Withers v. The Teachers' Retirement System of the City of New York (1978), a group of retired teachers sued their pension fund after the trustees invested $860 million in New York municipal bonds to prevent the city's bankruptcy. The trustees took this extreme action, only after having sought independent advice, to secure the assets of the fund (which were employer contributions from the City of New York) and protect the interests of all beneficiaries, given that the fund was not fully-funded. This case corroborates and relies on Blankenship v. Boyle in finding that the duty of trustees is to act in the best interests of all beneficiaries, not of the union or the employer, even if it means making investment decisions that may appear on the face of it to be imprudent. The court went so far as to endorse Blankenship because 'neither the protection of the jobs of the city's teachers nor the general public welfare were factors which motivated the trustees in their investment decision' (p. 1256). Further the court said:

> The extension of aid to the city was simply a means – the only means, in their assessment – to the legitimate end of preventing the exhaustion of the assets of the [Teachers Retirement System] in the interests of all the beneficiaries. Notably, the importance of the solvency of the city to fund lay not only in its role as the major contributor of funds but also as the ultimate guarantor of the payment of pension benefits to participants (p. 1256).

This decision confirms the portion of Blankenship that addresses the intentions of the trustees in making an investment decision. In Blankenship the decision was based on the Union's campaign objectives whereas in Withers it was based on the interests of the beneficiaries. In Withers the trustees included independent advice in the decision making process - this was a key component in their defence against charges of violating their fiduciary obligations.

In Donovan v. Walton, (1985), another American case, trustees financed, built and leased an office building with the union as principle tenant. They based the project on detailed research and analysis aided by independent consultants at every step of the way. The union could be described as a partner in the project. While this project benefited the union because of the reasonable leasing costs and clearly took the interests of the union into account, the court decided that trustee investment decisions were made with the interests of the beneficiaries paramount. Most clearly articulated in Donovan v. Bierwirth (1982), and known as the *exclusive benefit rule* under the Employee Retirement Income Security Act (ERISA), the rule requires trustees to never put themselves in a position of divided loyalty and always to act solely in the interests of beneficiaries, whether or not others benefit. This, of course, allows for the notion of collateral advantage that had been banned by Blankenship so long as there is no divided loyalty.

Board of Trustees v. City of Baltimore, (1989) is the most significant of U.S. cases. The City of Baltimore passed an ordinance supporting a South African boycott that would force the pension plan to divest holdings in South African companies. The trustees

opposed the ordinance on the grounds that it would impair trustee activities and performance of the funds. The ordinances - which dealt directly with the issue of rates of return of the pension funds and divestiture - were declared to be valid in not impinging on trustee responsibilities of prudence. The obligation on trustees to consider social factors was found to not violate case law standards. It further stated that prudence standards were not threatened as long as the costs of considering and acting on social consequences are minimal. In fact, the court commented that, given the power of pension funds, trustees should be encouraged to consider social consequences.

These decisions leave open a broad conception of prudent investment, encompassing the job security of pension plan members and the health of their union and communities, as long as the (union) trustees are informed, responsible and hold the interests of beneficiaries paramount. In fact, social criteria for investment should be encouraged in the general good as long as the costs are minimal.

These decisions are supported by legal commentary from Professor Scott, a leading American scholar on trust law, who says:

> trustees in deciding whether to invest in, or to retain, the securities of a corporation may properly consider the social performance of a corporation. They may decline to invest in, or to retain, the securities of corporations whose activities or some of them are contrary to fundamental and generally accepted ethical principles. They may consider such matters as pollution, race discrimination, fair employment, and consumer responsibility... a trustee of funds for others, is entitled to consider the welfare of community and refrain from allowing the use of funds in a manner detrimental to society (Scott, 1988, p. 277).

During this period in the U.K., however, one case in particular has been claimed as not supportive of social investment issues. In Cowan v. Scargill (1984), the British Chancery Court had to decide whether the union trustees of the Mineworkers' Pension Scheme were in breach of their fiduciary duty in seeking to prohibit overseas investments and any investments supporting an industry in competition with the coal industry. The five trustees for the National Coal Board (the employer) successfully opposed union policy. The Judge, Sir Robert Megarry, held that the best interests of the beneficiaries were based on the best financial interests:

> The power [of investment] must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investment in question; and the prospects of the yield of the income and capital appreciation both have to be considered in judging the return from the investment (p.760).

The future of the coal industry, he maintained, did not affect most beneficiaries - the widows and orphans of miners who had died. Instead, such an investment strategy constituted a union agenda rather than a 'policy directed to obtaining the best possible results for the beneficiaries'. Trustees must not narrow the range of investments, but diversify as much as possible to mitigate the risk to beneficiaries.

In subsequent commentary, Megarry maintained that it was union leader Scargill's uncompromising position on certain types of investment and his ideological approach that made a more balanced decision difficult. Other commentators have found this decision confusing and incomplete (Yaron, 2000; Lane, 1991; Farrar & Maxton, 1986). However, it is generally acknowledged that the breach of fiduciary duty resulted from the lack of due diligence in not considering the impact on retired members rather than targeting investments per se.

This case has maintained a level of influence with trustees in Canada and Britain out of proportion to its place in case law and to subsequent cases in both the U.S.A. and the U.K. It has also been promoted heavily by the financial industry as well as by trustees who oppose social investment and union involvement in setting investment criteria.

Other legal commentators disagree with this characterization and argue that, within the context of prudent decision-making and with the interests of the beneficiaries paramount, there is a right to make investment decisions based on social and political criteria (Ravikoff and Curzan, 1980; Campbell and Josephson, 1983; Pearce and Samuels, 1985; Farrar and Maxton, 1986; Lane, 1991; Scott, 1987; Waitzer, 1990; Yaron, 2000; Jantzi, 2001).

Decisions in the U.K. subsequent to Cowan v. Scargill have moderated Megarry's decision. In Martin v. City of Edinburgh District Council, the court said that trustees may have a policy on ethical investment consistent with general standards of prudence and pursue it 'so long as they treat the interests of the beneficiaries as paramount' (Trades Union Congress, 1996. p. 86). This brings British case law on trusts more into line with the U.S. cases to date. It also echoes the standard set by the Goode Committee, established in 1992 by the U.K. government to make recommendations on legal frameworks for pension funds, given the huge losses suffered by pension funds under the control of Robert Maxwell. The committee said:

> This means trustees are free to avoid certain kinds of prudent investment which they would regard as objectionable, so long as they make equally advantageous

> investments elsewhere, and that they are entitled to put funds into investments which they believe members would regard as desirable, so long as these are proper investments on other grounds. What trustees are not entitled to do is subordinate the interests of beneficiaries to ethical or social demands and thereby deprive the beneficiaries of investment income opportunities they would otherwise have enjoyed (TUC, 1996, p. 86).

8. Union and employer accountability

Union

Underlying Cowan v. Scargill, is a suspicion about a union's right to represent its members, about a trustees right to wear a union hat and a denial of the impact of investment practice on workers' lives. According to this ruling, even though the membership of the union and the union trustees may be in agreement on utilizing social criteria in investment decisions, union trustees should not represent their members' desires or interests in this regard. Further, Megarry denies any connection between the general prosperity of the coal industry and financial benefit to the fund, calling it 'speculative and remote' (p. 751). This opinion was in spite of union arguments that members of the pension plan were dependent on the coal industry for their own job security as well as the prosperity of their communities. (Similar arguments were put forward successfully in the Withers case, where the welfare of New York teachers as well as the viability of the pension fund depended on the welfare of New York City.) In the Megarry ruling, the general prosperity of the coal industry is characterized as the 'personal interests and views' of the trustees (p. 761). Based on these arguments, the Megarry case establishes the concept of the maximum rate of return as *the only* principle for investment.

U.S. case law broadens the concept of fiduciary responsibility to take into account who makes the investment decision, how it is made and in whose interests, as opposed to evaluating the decision solely by the rate of return. It also attempts to align workers' interests with the investment, so that the investment can actually support rather than undermine their livelihoods. Furthermore, it exhibits a tolerance of a strong role for union trustees as long as the trustees seek independent advice.

Employer

While trustee law has set a high level of accountability for union trustees, standards for employer trustees are substantially weaker. It is fully accepted that trustees must be permitted to invest pension assets in the employer's enterprise so that employers are not discouraged from continuing to have workplace pension plans (Scane, 1993). In fact, a pension fund may be a source of economic advantage to a sponsoring employer, in which case 'the opportunity to earn exceptional returns may itself be a part of the sponsor's purpose' (Ambachtsheer and Ezra, 1998, p. 37). It is not surprising then that many employers regard their company's pension plan as an important source of capital for their business.

Employers wishing to invest fund capital in their own business have not been viewed as using personal bias, as long as they proceed under self-imposed guidelines. If an investment is made in an enterprise where a trustee is an officer of the company, or has some conflict of interest (or dual loyalties), a trustee's 'independent investigation' into the basis for the investment must be 'both intensive and scrupulous'. In Ontario,

investment in an employer's securities is lawful, where the securities are publicly traded (Scane, 1993).

9. Maximum rate of return and diversification

It is clear that Cowan v. Scargill has been responsible for establishing the maximum rate of return as the standard. Many commentators have noted the irrationality of this notion in the context of portfolio diversification. An underlying issue is how, and over what period of time, investment returns should be measured. In Canada, the Ontario Teachers' Pension Plan Board has as its goal to maximize rates of return. In the U.K., the Trade Union Congress – clearly cowed by Cowan v. Scargill - concedes that the ultimate responsibility of the trustee is to maximize return, and that prudence attaches to each investment (Trades Union Congress, 1996, p. 51).

But the maximum rate of return is not a standard for all plans. The OPSEU Pension Trust, for example, has an investment policy to achieve 'reasonable rates of return' (OPT, 1996). Nor is this standard of the maximum rate of return reflected in U.S. case law. In fact, Cowan v. Scargill reflects the tail end of a trend in British case law based on the old investment practice of lists where the financial rate of return was the standard by which the individual investment remained on the list. One can only assume that this was – or could be - regardless of risk. Since modern investment practice is based on the diversification of asset classes in terms of their asset class benchmark and risk/return ratios, a maximum rate of return for each investment clearly does not make sense and may encourage imprudent investment to maximize return as well as more short term

investment strategies that threaten the long-term viability of a fund. The primary obligation is to fund the pension promise regardless of the particular plan. Pension plans are different from speculative or mutual funds in that they are concerned with long term investments and a somewhat lower return in order to avoid the volatile nature of high risk/return investments.

The Department of Labor, the regulatory body for pension law in the U.S., does address the issue of portfolio diversification and returns. It stipulates that trustees must consider:

- the composition of the portfolio with regard to diversification
- the liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan
- the projected return of the portfolio relative to the funding objective of the plan

A fourth standard compels trustees to consider expected returns. The Department of Labor states:

> Because every investment necessarily causes a plan to forego other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate rates of return (U.S. DOL Interpretative Bulletin 94-1 1994).

As Zanglein (2000) points out, this addresses the issue of investments within an asset class not the level of riskiness. It is therefore neither an exhortation to be conservative nor a duty to maximize benefits. The first is not in the interests of portfolio diversification. The second would be too onerous on trustees and is not supported by American courts. Rather it says that trustees may not select an investment with collateral benefit but lower returns than can be found with another investment in the same asset class with similar risk/return ratios. Benchmarks are therefore critical.

10. Impact of Prudence Rule on Union Trustees

Trustees therefore should be mindful of the overall investment strategy and asset allocation, rather than individual investments. The interests of beneficiaries are paramount. What would beneficiaries want if they were investing this money themselves and knew what informed trustees know? Trustees must always seek independent advice and their process for making investment decisions should reflect whose interests are being considered and pursued. The interests of the union may be considered and may even be integral to the investment project as a partner, but the union's interests must not dominate. Divestment, essential to union boycott campaigns, is not prohibited but must be handled carefully because of the potential for lower rates of return from untimely and therefore potentially costly withdrawal of investments. However, divestment can be planned with alternative investments designed to minimize costs.

There are several significant legal commentators with a Canadian perspective. The prevailing legal view in Canada is reflected by Waitzer, a former Chief commissioner of the Ontario Securities Commission and lawyer practising in both Canada and the United States:

> If ethical choices do not lower investment returns, the practical (and legal) reality is that trustees are unlikely to face judicial interdiction, regardless of their motivation. If investment returns are lowered, trustees are in trouble (Waitzer, 1990, pp. 10-11).

Patricia Lane, a British Columbia lawyer in and one-time research director of the B.C. Federation of Labour, while reflecting the undue influence of the British case, argues that first, social investment can be defended even if its sole concern is not to maximize the rate of return. Second, using financial criteria alone hurts the growth of fund assets since there is evidence that the rate of return is not damaged and may be increased by factoring non-financial criteria into investment decisions. Finally, unions may make decisions about which guidelines to apply in the investment of their members' funds. She advises union trustees to amend trust documents to encourage engagement in socially responsible investment; if this is not possible, she continues:

> [union trustees] should consider how they may be able to show that the decision they took was in the best interests of the beneficiaries. To this end, it would be wise to seek and rely on independent advice. At least one of the large investment houses in Vancouver now offers advice to clients interested in this investment concept. More will follow as the market grows. There is no need to lose money simply because of the application of some ethical guidelines to one's investment portfolio. If the decision does require a short term loss: for example, the sale of shares at a poor level because of the desire to honour a boycott or to divest from a country with a repressive regime, or to apply leverage to assist another union in a dispute. It would be a good idea to canvass the beneficiaries and potential living beneficiaries in some way. Finally there is growing indication that all trustees should establish ethical guidelines because of the performance of these funds (Lane, pp. 181-182).

Finally,Yaron, Director of Law and Policy for the B.C. based Shareholder Association for Research and Education (SHARE) has most recently (2000) published an extensive legal commentary where he finds that:

> in the context of socially responsible investment, consideration of non-financial investment criteria does not violate the principles of prudence and loyalty provided that the investment decision adheres to the pension plans' investment policy and independent expert advice (p. 36).

This view, he points out, is supported by the Pension Commission of Ontario (now subsumed under the Financial Services Commission). He notes that trustees need to know

that corporate social and environmental behaviour may have an impact on the bottom line, that favorable rates of return can be associated with social investment, and, finally, that plan beneficiaries are members of communities that rely on corporate investment and good behaviour.

11. Prudence, social responsibility and union trusteeship

Interestingly, there are few union pension funds that have social investment in their statements of investment policy (Yaron, 2002; Quarter, Carmichael, Sousa and Elgie, 2001). The Hospitals of Ontario Pension Plan (with union joint trustee representation from the Ontario Public Service Employees' Union, the Canadian Union of Public Employees and the Service Employees International Union) and the OPSEU Staff Pension Plan are two of the few. In fact, the presence of unions as sponsors or trustees is no guarantee of socially responsible investment policies (Quarter, Carmichael, Sousa and Elgie, 2001). SHARE, sponsored by the CLC, has recently undertaken a study of pension fund investment policies to educate trustees on models of investment policy guidelines (Yaron, 2002, forthcoming).

Many trustees still maintain that there is a scarcity of investment managers with expertize in various types of alternative investment strategies. A recent survey of pension officials in Canada, sponsored by the Canadian Labour and Business Centre (CLBC) and the Pension Investment Association of Canada (PIAC), reported that 73% complained of the shortage and cost of investment specialists. A further 69% said that there was too little

expertize in private capital markets (that would enable economically targeted investment) (Falconer, 1998).

Union trustees frequently complain of the lack of union-sympathetic, progressive fund managers with experience in socially responsible investment strategies (Carmichael, 1998). Rather than a shortage, this may reflect a need for more coordination and networking between trustees and their unions as well as education for trustees on how to deal with their fund managers. Better coordination and networking is facilitated by conferences being held by the CLC and the Canadian Labour and Business Centre, publications from SHARE and academic research as a basis for educational strategies being pursued by the University of Toronto and Carleton University in Ottawa. Canadian unions are beginning to publish their own pension investment materials for members and trustees. The Canadian Union of Public Employees has recently published an impressive fact sheet for trustees: Questions for money managers. A more collaborative approach within and between unions would facilitate a more universal approach to research and educational publications.

This section has analysed the case law governing the prudent behaviour of union trustees. It contrasts the good intentions of trust law with the realities of control and accumulation of wealth. We can conclude that union trustees who represent and are ‘of’ the membership may be better fiduciaries in that they may be more in touch with the best interests of the beneficiaries than many fund managers. This is in spite of comments to the contrary by many fund managers. Case law in the U.S and the U.K. has highlighted

the role of the union trustee and the relationship between the union and the trustee while acknowledging the paramount duty of loyalty that the trustee has to beneficiaries. The long-term interest of the fund as well as its members is a legitimate investment concern, even where the rate of return may be lower and risk to the investment may be higher. The investment decision itself must be based on independent financial advice. If the trustees are fully informed, then they are not, a priori. liable for a lower rate of return. Finally, trustees do not violate their duties of prudence by considering the social consequences of investment, providing the costs of considering such consequences are minimal and providing that where there is choice within the asset class the chosen investment has the higher rate of return. In fact, they are encouraged to do so given the power of pension funds.

Section IV: Unions, social investment and corporate accountability

This section defines and describes several different types of socially responsible investment (SRI) – ethical screens, shareholder activism and economically targeted investment. This section follows on from Section III where it is established that social investment strategies can be practised without violating principles of fiduciary responsibility. It describes some of the debates around each type of investment strategy within as well as outside the trade union movement. It examines each strategy in turn and any evidence of impact on rates of return and barriers to implementation.

12. Definition of social investment

'Social investment' or 'socially responsible investment' (SRI) is a term that can cover the ongoing management of assets as well as conventional and innovative asset allocation strategies. It is usually defined as the inclusion of various social standards in investment decision-making to accompany financial standards (Bruyn, 1987; Ellmen, 1996; Kinder, Lydenberg, Domini 1998). Social investment is often further defined to include its purpose as a tool to challenge conventional corporate behaviour (Bruyn, 1987; Lowry, 1991; Zadek, Pruzan and Evans, 1997) particularly when the interests of workers, their families and communities are affected (CUPE, 1992; Lane, 1991; Carmichael, 1998).

13. Ethical Screens

Ethical screening, often called social screening, involves the application to an investment of social or ethical screens – either negative or positive. Certain features can be screened in or out of an investment portfolio. For example, companies with good labour standards can be screened in; and companies with a poor environmental record can be screened out. While ethical screens are new for pension funds, they have been used in mutual funds, and have been shown not to damage the rate of return. Given the prevalence of ethical investing in the U.S., most studies regarding the rate of return of ethical funds are based there. One of the earliest studies (Grossman, Blake and Sharpe, 1986) compares the returns of an unscreened New York Stock Exchange portfolio (including South African stocks) to the returns of a portfolio with South African investments screened out. The

study found that the unscreened portfolio did not outperform investments free of South African holdings.

For the 1986-1990 period, Hamilton, Jo and Statman (1993) found that 17 socially responsible mutual funds, established prior to 1985, marginally outperformed traditional mutual funds of similar risk, but the out-performance was not statistically significant. In that study, mutual fund data (ethical and otherwise) are unidentified as are the social criteria for the ethical mutual funds. Luck and Pilotte (1993), using Domini Social Index performance measures (developed by Kinder, Lydenberg and Domini and used widely by ethical funds in the U.S.), found that the social index out-performed the Standard & Poors 500 index during the period of May 1990 to September 1992. However, as they point out, this period was characterized by the out-performance generally in the market of smaller stocks over larger stocks, and the DSI has a larger proportion of smaller stocks. Still, active returns of 9 basis points per month over and above the S&P 500 remained unexplained. This was the first study to show an unexplained benefit. Kurtz and DiBartolomeo (1996), for the period of May 1990 to September 1993, found that the DSI out-performed the S&P 500 by 19 points per month, which they attributed to the higher price of the DSI stock and their higher price-to-book ratios. In his review of 159 securities, using social data from the Council on Economic Priorities, Diltz (1995) finds no statistically significant difference, during the 1989-1991 period, between the returns of two sets of 14 screened and unscreened portfolios, with the exception of the environmental and military business screens which had a positive impact on portfolio returns. Finally, Guerard (1997), for the period 1987-1994, finds no statistically

significant difference between screened and unscreened portfolios, and further finds that during some sub-periods screened portfolios may have yielded higher returns.

There is one Canadian study – recently released – done over a five-year and a ten-year period (Asmundson and Foerster, 2002). The study compared Canadian Equity funds and the TSE300 Total Return Index (the "benchmark"). The study considers two different time frames, a five-year period (January 1995 - December 1999) and a ten-year period (January 1990 - December 1999). The results indicate underperformance of most of the SRI mutual funds relative to the benchmark, but lower risk exposure. However, in all cases, any underperformance is not statistically significant (at the 95% confidence level). The performance exception is the Investors Summa fund, for which all statistics indicate outperformance.

During the period from January 1990 to December 1999, the annualized compound returns for the two Canadian SRI mutual funds were 9.45% for Ethical Growth and 13.26% for Investors Summa, with the composite earning a return of 11.34%. Over the same time period, the annualized compound return for the benchmark was 11.74% and, for 91-day Government of Canada T-bills, was 6.43%. Of the two funds with ten-year histories, Investors Summa outperformed and the Ethical Growth underperformed the benchmark on the basis of mean excess returns though for both funds the results were not statistically significant.

The results suggest that those who engage in SRI through investing in Canadian SRI mutual funds, on average, are neither giving up anything nor gaining anything in terms of financial returns. However, it appears that the screens may actually decrease risk exposure, although such a conclusion depends on the extent to which the funds were fully invested in equities.

A recent study of pension funds in Canada has shown that there are few examples of pension funds with ethical screens to screen out or screen in investment in Canada (Quarter, Carmichael, Sousa and Elgie, 2000). The United Church of Canada and the OPSEU Staff Pension Plan both have comprehensive screens. Nevertheless, screens are under consideration in several other union pension plans and, in general, they seem to be gaining in popularity with unionists across the country. There are indications that union pension trustees are beginning to view ethical screens as one of several strategies in social investment.

However, the implementation of ethical screens in investment portfolios remains problematic. Diversification tends to require that all sectors be represented in equity portfolios; implementing a screen may rule out some sectors altogether if the same standard is used across the whole portfolio. For example, an environmental indicator could rule out all of the mining industry, thus reducing portfolio diversification. Recent ‘best-of-sector’ approaches have experimented with the implementation of different standards for different industries so that all sectors of the economy are represented.

The best-of-sector approach is gaining ground among labour-sponsored investment funds in Canada, on the grounds that it can raise standards in a sector by increasing the market share of companies that are maintaining the preferable standards. These decisions have been difficult and controversial for trade unionists and community activists as the following example might indicate. The Crocus Fund in Manitoba used the best-of-sector approach in a social audit to evaluate potential investee companies in the hog industry. Manitoba has experienced a dramatic increase in hog production from one million to nine million hogs in the past six years; a number of hog producers approached the Fund for investment. The Fund's social audit suggested that if the environmental practices being utilized by many of these companies were maintained the industry would not be environmentally sustainable. But one company, Dynamic Pork, reflected a different approach to environmental compliance by committing to the construction of new facilities, immediate compliance with and constant monitoring of environmental regulations - to be implemented by the Province four years hence – as well as sub-contractor compliance. Crocus believed that if these practices were implemented across the industry, growth could be sustained at the anticipated levels without creating permanent long-term environmental damage. The Fund therefore made a decision to invest in Dynamic Pork as the best-of-sector operator and to try to increase that company's market share, putting increasing pressure on other competitors to raise their performance to the environmental bar set by the Fund's investee company.

The need for rigorous, consistent and verifiable standards for screens often brings some surprises. For example, banks tend to do well on labour standards, as defined by many

ethical funds, because they have strong training and promotional programs for employees and few occupational health and safety hazards compared to – for example – the mining industry. This often means that the banking industry does well on the screens and ultimately - because of its high profits - boosts returns to ethical funds. Yet their investment strategies often support the very practices that the screens are designed to screen out. Practitioners claim that it is difficult to get the detailed information required to rate the banks more appropriately. For these reasons, ethical screens have attracted controversy in the U.S. and Canada on the grounds that claims of principled investment are a 'hoax' (Stanford, 1999; Entine, 1995; Hayden, 1998).

The most interesting example of positive screening has just been developed by CalPERS (the California Public Employees' Retirement System) and might address some of this criticism. With assets of about (U.S.) $170 billion, CalPERS has instituted a comprehensive screen for international investment (emerging markets) based on the Global Sullivan Principles (Sullivan 1999) and ILO principles. An underlying sentiment is that these principles contribute to economic growth (although economic growth is equated with high returns). There is considerable interest in this screen since it may provide a complimentary strategy to global activism to challenge corporate behaviour and set labour standards. The screen is actually an evaluation framework using country and market factors to assess emerging markets.

All factors are weighted and country and market factors are each 50% of the total. Country factors are political stability (17%), transparency of government (16%) and

productive labour practices (17%). Market factors are market liquidity and volatility (10%), market regulation/legal system/investor protection (15%), capital market openness (10%), settlement proficiency (10%) and transaction costs (5%). Each factor is defined and has sub-factors which are also scored. Productive labour practices are defined as ratification and adherence to the ILO principles. Countries are then assessed as ‘permissible’ countries for investment. Active rather than passive investment will be used and fund managers will be expected to refer to the Global Sullivan Principles and the ILO Fundamental Principles and Rights in the solicitation process and in annual reporting. As of February 2002, plans were being made to assess and mitigate the transaction costs by ‘transitioning the assets’ over a period of time. Implementation of this screen will provide more information on the efficacy of ethical screens particularly with respect to labour standards. One question that is not dealt with is how the level of acceptance is set. Is the cut off line for permissible countries set by the standards of what is acceptable, or is it set by the demands of asset allocation in the emerging markets class?

Negative screens are often established around one issue such as child labour. They can be introduced and monitored carefully over the long term and can be responsive to the concerns of pension plan members. The disadvantage of ethical screens are that the `power of the purse' is not necessarily felt by the companies who are screened out. Screens are not boycotts unless done collectively by a large number of pension funds. However, screens have been used as part of a successful boycott strategy. For example to bring apartheid to an end in South Africa prior to the African National Congress taking power.

Boycott strategies using negative screens, are not out of the question for pension funds; given the concentration of workers' pension assets in a small number of plans, it is easily conceivable that – at the very least – OPSEU pension plans could coalesce around ethical investment strategies. Ethical investment, therefore, may be a first step in a social investment program, but, in the absence of collective pension power muscle, it is not sufficient to ensure that workers are making full use of their investment power.

14. Definitions and frameworks for shareholder activism

'Shareholder activism' is used to describe a whole range of approaches towards the corporate sector and includes actions ranging from writing letters, to drafting resolutions for annual meetings, to pulling shares – all in an attempt to hold corporations accountable. For this reason, it may be a tool to encourage corporations to adopt principles that work in the interests of working people. 'Shareholder activism' that could link trade unions and community activists in common cause is used by SHARE, the Shareholder Action and Education Centre, backed by the CLC. In Canada, the Taskforce for Churches on Social Responsibility has also pursued shareholder action strategies that challenge the social and economic impact of corporations on the larger community (Blair, 1995; O'Sullivan, 1999).

On the other hand, the corporate sector has responded by limiting shareholder activism to issues of 'corporate governance', a term coined by the corporate sector itself. It is defined by the Toronto Stock Exchange as:

> The process and structure used to direct and manage the business and affairs of the corporation with the objective of enhancing shareholder value, which includes ensuring the financial viability of the business...(The Toronto Stock Exchange Committee on Corporate Governance in Canada, 1994).

This definition suggests a narrower approach based on financial concerns alone. Pension funds in Canada have historically used ‘corporate governance’ to mean the exercise of rights as responsible shareholders and fiduciaries to engage in the affairs of the corporation. Proxies - the votes shareholders cast each year on the business of the corporations in which they own shares - are a significant, but often ignored, pension fund asset. The guidelines of the Office of the Superintendant of Financial Institutions (OSFI), governing federally regulated pension plans in Canada, asserts that proxy votes must be voted in the best interests of plan members. Furthermore, some federal and provincial pension regulations require that statements of investment policy include processes for the responsible delegation of the voting rights attached to investments (Yaron, 2002).

Many pension trustees pay little heed to proxy voting for several reasons. First, there are so many votes attached to corporate shares that they seem impossible to monitor effectively. Many trustees are unaware that there are companies in Canada and the U.S. whose main function is to monitor votes on behalf of the board of trustees. Second, since the proposals generate from management and are most often related to management of the company, they have been seen to be irrelevant to the largely social and local economic concerns of a union agenda. However, as corporate mismanagement of some high-profile companies affect employment stability and the environment as well as returns, unionists are beginning to pay more attention to corporate management issues

and the voting of proxies as they see a link between corporate behaviour and financial performance.

Influencing corporate policy - through voting shares - can cover a variety of variables such as CEO compensation, representation and rotation of board members, management pay, as well as take-overs and mergers. These issues may be considered simply in relation to shareholder interest. Or broader social economic interests may be reflected, such as employee working conditions and environmental and human rights impacts of the corporation.

Taking action as shareholder activists on this latter set of issues could re-fashion the link between ownership and control, challenge social economic performance and provide a way of monitoring corporate conduct (Waitzer, 1992). For example, the shareholder campaign led by the AFL-CIO against Talisman, a Canadian company, mining for oil in the Sudan has reduced investment by institutional investors in Talisman and resulted in the sale of the Sudanese operation. This campaign was based on considerable evidence that the company violated human rights in the Sudan. However, some do not agree that companies should be held accountable for their behaviour beyond the company's financial performance. Bertram, the vice-president of the Teachers' pension plan in Ontario, says:

> When we buy shares in a company, we treat it as though we're the owners of the company. We believe the board of directors is representing us as owners and they have a duty to maximize the share value for us. If it's not going to be looking after our interests first and foremost, then we will invest elsewhere (Ip, 1996, p. B1).

He continues by saying that 'companies aren't put together to create jobs. The number one priority is creating shareholder wealth' (ibid. p. B1). However in contrast, John Manley, Industry Minister in the Federal Government of Canada at the time, expressed concern that 'business .... reinvest a good portion of its earnings into expansion, growth and the creation of jobs' (ibid. p. B4). Surprisingly, Peter Godsoe, Chairman of the Bank of Nova Scotia, said:

> Scratch me deeply and I believe the mandate of business to only maximize shareholder value is wrong. It ignores too many other realities (ibid. p.B4).

Ken Georgetti, President of the CLC, says:

> Workers' pension funds should be managed for the greater benefit of pensioners and for society at large. These are not mutually exclusive goals. Workers and pensioners want their investments to protect and strengthen their families and communities (SHARE, 2002).

15. Shareholder activism and the structure of markets

Shareholder activism is a relatively recent phenomenon for pension funds in Canada, but has a much stronger tradition in the U.S. for several reasons. First, Canadian corporations are more tightly controlled than American corporations so that a minor shareholder has little impact on the major shareholder or shareholders who control the management of the company. In 1994, 60% of the Financial Post 500 largest Canadian non-financial corporations were wholly owned or effectively controlled by a single shareholder and only 16% were widely held. This is in stark contrast to the U.S. where 63% of Fortune 500 firms are, by the same standard, widely held (Patry and Poitevin, 1995; Daniels and MacIntosh, 1991). In a widely held company, where all shareholders are relatively small

but independent of management, the impact of a single small shareholder can be enormous.

Secondly, in Canada, there is a strong network of cross-ownership and shared directorships (Clement, 1975; Deaton, 1989). Again, this interconnectedness occurs to a lesser extent in the U.S. Third, again, in comparison to the U.S., there is very little liquidity in the Canadian markets, partly as a result of the interconnectedness of corporations (Patry and Poitevin, 1995). Only 5.3% of Canadian stocks are widely traded, and it is done predominantly by institutional investors. Further, these stocks are those of the larger companies, as opposed to those of the smaller companies which tend not to be traded to any great extent (Fowler and Rorke, 1988).

Canadian pension funds therefore trade in small, thin equity markets, where 'an excessive amount of capital chases too few investment opportunities' in a limited number of large corporations (Daniels and MacIntosh, 1991). The cost of exit is high, since the withdrawal of large investments can lower stock value. Corporate and fund managers tend to be well-entrenched. The control of companies by a few major players can be repressive, leading to a context where fund managers and pension fund officials are careful 'not to rock the boat':

> The extensive control and power yielded by a few large groups or families increases the severity of the penalty that a disgruntled management could impose on an unsettling institutional investor (Patry and Poitevin, 1991).

As a result, these larger, publicly-traded companies are over-capitalized. An investment strategy that concentrates on passive investment in equity markets merely compounds the problem of over trading and over-investment in a small market. Canada is an example of

a country with high capital accumulation but lower productivity because of the failure of fund managers to invest in new and small companies (Canadian Labour and Business Centre, 1993).

The structure of capital markets affects both shareholder activism and proxy voting. If pension funds are wary of pulling out shares because of the potential costs of exit, then perhaps they can make their presence felt and ‘bring value’ to their investments through becoming active share owners. One argument is that the higher the cost of exit the more critical it is to be an active shareholder (Coffee, 1991). The opposing position, however, is that institutional investors must have liquidity to back up ‘voice’ (Black, 1992). This is rather like the argument that the right to strike for unions may not be used but is a vital back-up to the right to challenge the employer. Canadian pension funds may exit but they must mitigate transition costs.

In the U.S., both shareholder activism and corporate governance have flourished more easily because of larger capital markets and more widely held corporations. In such a context, smaller shareholders can have a greater influence on some decisions affecting the corporation. However, as Daniels and Waitzer (1994) point out each structure brings with it a different set of governance problems. Accountability of management is an issue where shares are broadly held, a problem that tends not to be encountered in Canada where, as they say, a phone call from the majority shareholder will suffice. The problem encountered in Canadian corporations is accountability between majority and minority

shareholders to prevent 'bloated compensation arrangements, unfair self-dealing transactions or unanticipated changes in shareholder risk-taking' (ibid, p. 27).

16. Shareholder action - barriers and opportunities

In Canada, shareholder experience on the part of union trustees of pension funds is mixed. In a recent study of union trustees in the top 24 Canadian pension funds, unionists were 'unclear about what proxy voting entailed, whether their fund had a policy and who, if anyone, would exercise votes' (Carmichael, 1998, p. 20). Another study of institutional investors (Montgomery, 1995) reported an increased interest in corporate governance matters because of abuse of power by management. Further, the Globe and Mail has reported that issues of institutional investor governance will gain 'much more attention':

> institutional shareholders were once called the sleeping giants of capitalism because of their size and traditional docility. In truth, the real sleeping giants are the plan members and beneficiaries: teachers and municipal employees and the employees of companies like Canadian National Railways and Bell Canada, whose pension funds hold billions of dollars in corporate investment (Finlay, 1997, p. B2).

In Canada today, most pension fund trustees assign their voting rights directly or indirectly to their investment managers and do not submit proposals. Those managers, in turn, usually vote proxies according to the recommendations of corporate management. As has been noted in previous chapters, fund managers have considerable control over pension fund investment, particularly where assets are pooled into larger funds. For example, the Carpentry Workers' Pension Plan of B.C. was unable to join in the shareholder action on child labour, organized by the B.C. Federation of Labour, since its

equity is in pooled funds and hence under the control of fund management (Interview with Wayne Stone, 1999).

Fund managers actively seek to influence the behaviour of corporations in which they invest pension funds. Douglas Grant, the Chairman of Sceptre Investments, the fifth largest pension fund manager in Canada, reported that:

> [We] have private meetings with companies ..These meetings are valuable to us, in part, because we control the agenda and, in part, because it is important to us to know the character of the people managing the companies that we invest in. It is important to the companies, and they agreed to do it because they need to keep in touch with their shareholders and we are, typically, a big shareholder (Report of the Standing Committee on Banking, Trade and Commerce, 1998, p. 8).

However, the OPSEU Pension Trust has taken an unequivocal position on using its proxy votes where possible, even if it does not actively submit proposals. Colleen Parrish, Plan Manager, describes the process for instructing fund managers on how to vote proxies:

> We instruct all our investment managers and our custodian to bring forward issues that we then screen for those that should receive the attention of the Board of Trustees. . . Well, when a lot of pension plans do that, then there's a real sense out there that corporate governance matters. Slowly you start to have an impact because it changes the way the capital markets work (Parrish, in Carmichael, 1996, p. 108).

Following the model of the California Public Employees Retirement System (CalPERS), the Ontario Municipal Employees' Retirement System (OMERS) has registered its interest in actually pursuing active corporate governance strategies beyond proxy voting:

> OMERS approach is to work with companies privately to resolve concerns. If that doesn't work, the fund will introduce a resolution at a shareholders' meeting. That has never happened, [OMERS] said because the fund has been successful in resolving issues privately (Waldie, 1998, p. B7).

OMERS now (2002) has detailed proxy voting guidelines on its website, covering corporate governance as well as social and economic concerns about corporate behaviour.

The Ontario Teachers' Pension Plan Board also has face-to-face meetings with management, and consider these meetings as 'an integral part of our due diligence in selecting companies for major investment and managing those investments in the long-term' (Report of the Standing Senate Committee on Banking, Trade and Commerce,1998, p. 9). William Dimma, a director of several public companies, believes that the preferred way is the 'quiet and private' way. In fact, he maintains that this is the 'Canadian way … the way to get things done' (ibid., 1998, p. 9).

American law, through the Department of Labor, has confirmed that voting rights are, in fact, pension plan assets; therefore, it is the duty of fiduciaries to ensure that such assets are voted solely in the interests of the plan members (McCritchie, 1996). Canadian law, it has been argued, also supports trustees as active shareholders submitting proposals of their own. Trustees must, under the standard of prudence, be informed in making investment decisions and seeking out information that allows them to assess the financial performance of the company in which they have invested; further they should oppose mismanagement or other inefficiencies (Waitzer, 1990).

This legal perspective can be applied to decisions based on social concerns about corporate performance. A company may be inefficient, less productive and therefore less profitable because of its labour relations, its hiring practices, its poor environmental standards, or its negative relationship to community. One legal view suggests that trustees must proactively pursue change in these areas where it is likely that such policies would not harm the investment, or may lead to increased economic return (Waitzer, 1990). In a

study of institutional shareholders, fiduciary responsibility to clients ranked as the second most important incentive in becoming active (Montgomery, 1996).

The Canada Business Corporations Act was reformed in 1975 to enshrine shareholders' information on votes and the right to communicate with other shareholders. This reform however provided little substance to shareholder rights. (More effective shareholder rights were introduced in the United States in 1942.) Management, prior to 1975, was able to control sparsely-attended shareholder meetings by holding enough proxy votes to outvote any challenges.

In 2001 reforms to the law reflected recent pressure from shareholder rights organizations. The new rules significantly change the requirements for preparing and submitting shareholder proposals. Now, any registered or beneficial shareholder can file a proposal provided that they have held at least $2,000 worth or 1% of the total value of all shares in the company for at least 6 months prior to submitting the proposal. The new rules also change the filing deadlines for shareholder proposals and the grounds under which a corporation may exclude a proposal. The definition of "solicitation" is also relaxed under the new regime making it easier for shareholders to communicate with each other about the substance of shareholder proposals. Most importantly, the clause permitting corporations to exclude a proposal from the proxy management circular if it was submitted purely to promote 'general economic, political, racial, religious, social or similar causes' has been deleted.

These amendments to the law reflect a growing awareness of shareholder rights in Canada. In 1997, Fairvest Securities, a proxy monitoring company, noted in its survey that a ‘significant minority’ of shareholders voted against management proposals at 27 out of 405 companies. In one case, shareholders defeated a management proposal. Its survey noted further that ‘the outcome of proxy votes must be disclosed in public filings in the U.S., but aside from a short verbal report at annual meetings, in Canada, voting results are rarely disclosed’ (Westell, 1997b).

In 1997, the Shareholder Association for Research and Education (SHARE), a national organisation sponsored by the trade union movement to help pension funds ‘build sound investment practices’ was founded. SHARE is a non-profit agency established by Working Enterprises. It works with pension trustees, plan administrators and plan members to provide shareholder research, education and policy. It aims to work as part of the international movement to hold the corporate sector accountable through submitting shareholder proposals. So far, SHARE has drafted and circulated proposals to be filed with the Hudson Bay Company and Sears concerning the use of sweatshop labour by suppliers. Its most recent resolution (2002), calling on the Hudson's Bay Company to put in place a process to end alleged sweatshop abuses in its supply chain, was supported by more than 36 percent of the shares voting at the company's annual shareholders' meeting. This resolution, sponsored by four institutional investors, also urged the board of directors to adhere to the International Labor Organization's (ILO) Declaration on Fundamental Principles and Rights at Work and report to shareholders annually on compliance. According to SHARE the result represents the largest vote in support of a

social resolution before a Canadian corporation, more than doubling the support received in last year's vote on a similar proposal.

17. Shareholder action and rate of return

Corporate governance assumes that taking a more proactive role in a corporation by exercising proxy votes will raise the financial value of the shares of a corporation, and, hence, the rate of return. CalPERS reports that corporate governance strategies improve share values dramatically. A study it commissioned (published by Wilshire and Associates of Santa Monica in 1994) examined the performance of companies targeted by CalPERS between 1987 and 1992. The stock price of these companies trailed the Standard and Poor 500 index by 66% for the five years prior to the campaign, and out-performed the index by 41% in the following five years.

Another independent study of CalPERS, (Smith, 1996), finds that when shareholder action is successful in changing governance structure, it also results in an increased rate of return. However, when the shareholder action is directed at improved operating performance, there is no statistically significant change in rate of return. Overall, during the 1987- 93 period, shareholder action in a small group of companies resulted in a net increase of US$19 million in CalPERS assets.

Romano (1993) and Wahal (1996), who in studies of the activism of six funds (including CalPERS) for the same period (from 1987-1993) found that while pension funds can be successful in changing governance structure it does not change the rate of return.

In Canada, there is ‘tentative evidence’ that institutional shareholders through monitoring increase firm value. Therefore limitations on shareholder action inhibit share value (MacIntosh and Schwartz, 1995). In conclusion, although the evidence is inconclusive as to whether shareholder activism actually increases the rate of return, there is no evidence that it causes rates of return to fall.

18. Economically targeted investment

Economically targeted investment (ETI) is carefully defined in a report sponsored by the Ford Foundation as:

> an investment designed to produce a competitive rate of return commensurate with risk as well as create collateral economic benefits for a targeted geographic area, group of people, or sector of the economy (Bruyn, p. 67).

ETIs are generally funds pooled by a group of investors and managed by an intermediary providing the knowledge, expertise and legal background to invest the funds. Pension fund staff rarely handle ETI investments themselves (removing a major barrier of lack of expertise, cited by pension trustees). In the U.S., the AFL-CIO has been a key player in providing the vehicles for investment in housing, mortgage and job creation projects.

Barber (1997, p. 2) identifies seven broad areas of ETI, or job creation initiatives:

- “bricks and mortar” investing (the AFL-CIO Housing Investment Trust); the Union Labor Life Insurance Company; Multi-Employer Property Trust;

- Responsible Contractor requirements;
- Regional development funds;
- Socially responsible investment funds;
- Union-friendly investment vehicles;
- Worker buy-outs; and
- Privatisation alternatives.

Any definition must exclude supposedly "ETI" strategies that undermine workers (members of the pension fund) and their communities. This disturbing trend has been described by the Canadian Union of Public Employees (CUPE) in their recently published newsletter on pension fund investment:

> funds which in the past may have been invested in a low-risk but reasonable rate-of-return provincial bonds are now being sought by private companies looking to take over the ownership and management of public infrastructure and services….It raises the prospect of one worker's pension fund financing a company which is actively seeking to privatize her job – or that of her neighbour (CUPE, 2002; p1).

Most notable is the OMERS creation of Borealis, a fund management company designed to coordinate investment in public-private partnerships resulting in the large-scale privatization of public services. Privatization results in loss of jobs and lowers workers' pay with dramatic consequences for surrounding communities. The real threat of privatization is the loss of unionized jobs, lower wages and the deterioration in services (Kelsey, 1995).

Under true ETI strategies, the interests of plan members and community coincide; for example, construction trades that have jointly-controlled pension plans have invested in building projects that use members of the plan to build moderate-income apartment units, and offer mortgage loans for those wishing to live in the apartments. The resulting job creation increases the contributions to the pension fund (Barber, 1982; Quarter, 1995).

In Canada, there are few examples of union pension fund investment in economically targeted investment. Therefore union trustees interested in economic development have few case studies to guide them with the exception of Concert, a real estate development company in British Columbia, funded by the pooled funds of 26 union pension funds (Carmichael, 2000). Nor, for the most part, do they appear to be in contact with experts with experience and advice in this area (Falconer, 1998). However, union trustees may learn from the investment practices of labour-sponsored investment funds, an innovative, home-grown Canadian model of economic development.

It is estimated that, in the U.S., about $30 billion of pension funds are currently placed in ETIs (Jackson, 1997). There are many examples of ETIs in the U.S. for a number of reasons. First, economic development has a stronger history and theoretical basis in the U.S. because of the need to rebuild many inner cities, restore regional manufacturing belts and provide suburban commercial space. Pension funds have been used since the 1970s to fund new commercial and residential real estate as well as mortgage trusts. The trade union movement has played an integral role in this development - often through the AFL-CIO - because of its interest in creating and maintaining jobs in the construction industry.

Second, ETIs are typically held in securities underwritten by the Federal government. Departments of the federal government provide guarantees for investments in housing and other real estate. This lowers the risk of the investment while maintaining a good

rate of return. The Institute for Fiduciary Education estimates that almost 64% of ETI funds are in real estate (Ambrose, 1993, in Levine, 1997).

Third, the Department of Labour issued an interpretative bulletin in 1995 allowing pensions to invest in ETIs with their collateral benefits, as long as the investment "has been carefully screened and selected to meet the prevailing rate of return". Further, if after careful selection of investments, the actual returns are low, this is not a failure of fiduciary responsibility, as long as the overall portfolio of the fund is prudent (Watson, 1995, p. 4).

19. Debates Around ETIs

ETIs in the U.S. are described as 'ubiquitous and diverse' by the Canadian Labour and Business Centre (1999). While they have evolved over the last forty years, they have been used as vehicles for investment in the 90s by large public sector pension funds in California, New York, Pensylvania and other smaller state funds. These funds are government-directed funds which are not jointly trusteed but may have employee and retiree representation on their boards.

They have been criticized on the grounds that they violate the prudence and the loyalty standards. Described by some as "socially dictated investment policies", they are:

> those investment practices and policies which either (1) permit the sacrifice of safety, return, diversification or marketability; or, (2) are undertaken to serve some objective that cannot be related to the interests of the plan participants and beneficiaries in their capacity as such (Hutchinson and Cole, 1980, p. 1346).

This definition is in contrast to so-called "totally neutral investment policies" which focus on the financial aspects of investment alternatives (ibid., p. 1344). These definitions also assume a continuum from the purely financial to the purely social. The U.S. Department of Labor established its standard in response to this type of criticism so that returns cannot be sacrificed in the interests of an ETI. In fact investigation of social factors in an investment can lead to more effective knowledge about company behaviour and therefore about possible returns (Bruyn, 1987, p.12).

A related argument levelled against ETIs in the U.S. is that they are a result of too much "political" involvement in investment:

> Public fund managers must navigate carefully around the shoals of considerable political pressure to temper investment policies with local considerations, such as fostering in-state employment, which are not aimed at maximising the value of the portfolio's assets (Romano, 1993, p. 796).

The assumption is that social or targeted investment is a conflict of interest for public sector employer trustees; they may feel equally beholden to taxpayers and beneficiaries, thus compromising their duty of loyalty and sacrificing a fair return in the interests of an expedient investment (Lawson, 1995).

Public sector unionists in Canada may sympathize with the view that governments have used pension funds for their own purposes. In 1988, the Rowan Commission set up by then-Premier David Peterson to examine the management of pension funds made no mention of negotiability of pensions and suggested a minority interest only for members of the plan. The Ontario Public Service Employees' Union (OPSEU) responded in a

brief entitled Our Pension, Our Future. For the first time, OPSEU took a pro-active position on pension funds investment. OPSEU stated that exclusive investment in non-marketable debentures issued by government, as the employer, was inappropriate since the returns were not good enough to provide for a healthy pension fund, and it was too self-serving of the employer's own interests. However, since bonds financed public services, investment in bonds should continue but in the context of a more diversified strategy. OPSEU suggested other investment strategies, like making residential mortgages directly available to members of the plan, and indirectly through the financing of major housing projects:

> In general, it should be possible for us to address important social and economic concerns through the investment of the fund. But investment strategies should reflect the interests of all those with a stake in the security and economy of the plan. For this reason there should be a well-established process for considering investments other than those indicated by conventional, technical factors. This process should include equal representation of the employer and the employees (p.25).

20. Collateral Benefits

"Collateral benefits" is a technical term used in American law. It denotes the social benefits of investment aside from the financial rate of return. It is used to describe an ETI as well as other forms of social investment. Under the Employee Retirement Income Security Act (ERISA), collateral benefits are not to be used in calculating the (financial) rate of return of an investment but can be *a* reason for the investment of pension funds.

Underlying this term is the question of whether the pension fund is for the benefit of beneficiaries only, or whether collateral benefit can be extended to other stakeholders.

Ghilarducci (1994) proposes that, to maximize the returns to beneficiaries, pension funds should rely on "employment growth" of beneficiaries' jobs as well as direct investment returns.

The "whole participant" approach goes beyond modern portfolio theory, taking into account the feedback effects of investment on employment continuity and growth of pension fund contributions. This approach targets investment and sets up specific expectations with regard to the returns and collateral benefits, as opposed to speculating for the best possible returns in a supposedly free market (Ghilarducci, 1994, p. 4). Quarter (1995) proposes a similar approach in interpreting the investments of the Carpenters' Pension Plan in B.C.

Deaton (1989) has argued that social investment strategies where the collateral benefits are restricted to plan members further exacerbate the historic, economic inequalities between those who are covered by occupational pension plans and those who are not. He points out that the taxable benefits for those covered by pension plans already creates an inequitable distribution of wealth. Therefore, further social investment policies that benefit members only increase these inequities (Deaton, 1989). Ghilarducci and Barber (1993) argue that, given the tax-exempt status of pension funds and their long-term horizons, there should be strong public policy on pension fund investment practice and its function in the capital markets.

This paper has argued that investment strategies based on long term economic growth are best matched with the long term nature of pension funds, taking into account the specific liquidity needs of the particular portfolio to meet its liabilities. This approach meets the test of fiduciary responsibility and prudence. Taking into account the interests of members of the fund means being mindful of their long term interests as workers, family and community members.

21. Economic Development

What kinds of questions need to be taken into account when considering economically targeted investment as a form of economic development? The AFL-CIO (1998), in an innovative educational publication, distinguishes the high road from the low road of economic development. This approach to economic development and pension fund investment was incorporated into the Heartland project (Fung, Hebb and Rogers, 2001). The table below shows the distinction between the two approaches. The AFL-CIO (1998) critiques Grant Thornton's Annual Study of General Manufacturing Climates of the Forty-eight Contiguous States of America (see the Low Road column in Table 1). In contrast, the AFL-CIO suggests the high road for each of Thornton's proposals.

People who live in a community affected by economic development are encouraged to ask the following questions:

- What are the jobs?
- What will it cost us?
- What are the benefits?
- What are the environmental impacts?

- What are the tax implications?
- What is the impact on other employers? (AFL-CIO, 1998, p. 32).

Two Roads for State and Local Economic Development

	Low Road	**High Road**
Goals	1. Create New Jobs 2. Retain existing jobs	1. Retain good jobs 2. Create good new jobs
Process	Closed	Open, democratic
Strategies	1. Recruit large employers 2. Improve "business climate"	1. Renew large and small employers 2. Improve quality of life in the community
Elements		
Wages	"Competitive" (i.e. low) wages	High Minimum Wage Davis-Bacon Living Wages
Unions	Support right-to-work laws	Partner with unions to move toward high road
Education	Under-funded, low quality	High standards; adequate $
Employment and Training Services	Customised training for recruitment; OJT as wage subsidy; lack of standards. Business is primary customer.	Broad training accessible to all workers; employment services for all. Both workers and businesses are key customers.
Benefits	Cut unemployment insurance taxes and benefits	Maintain adequate UI to support families temporarily
	Cut Workers' Compensation	Maintain Workers' Compensation. Increased Safety and health technical assistance
Taxes	Use tax incentives to lure new companies	Limit tax incentives and require public accountability
	Cut business taxes; increase income and property taxes	Equitable, progressive taxes on businesses, individuals
Regulations	Reduce environmental health and safety, zoning regulations	Regulations to maintain quality of life. Land use planning
Government	Shrink government; cut social programs	Invest in people – adequate health care, education, training, welfare
Infrastructure	Target to new companies as part of industrial recruitment	Invest in infrastructure that helps all companies and workers
Technology and Business Assistance	Deploy technology to eliminate jobs/de-skill work	Partner with workers and unions to deploy worker-friendly technology

Source: AFL-CIO, 1998, p. 24.

Table 1

22. Pension funds, unions and economic development in Canada

There are three leading examples of worker investment in economic development - the first is the Caisse de Dépôt et Placement du Québec, the second is labour-sponsored investment funds and the third is B.C.s Concert real estate development company.

The Caisse de Dépôt et Placement du Québec, which is the largest investment agency in Canada and the repository of Québec's pension and benefits funds as well as the Québec Pension Plan. Its net assets are $63.6 billion at the end of 1997. Originally set up in 1965 by the Québec Government to manage the Québec Pension Plan, the Caisse has provided a model in the management and investment of pension funds. (It has also provided survivor, death and disability benefits that are more generous than the norm.) In the rest of Canada, provincial governments used state pension premiums in excess of pay-outs to beneficiaries to fund budget deficits through low-yield provincial bonds. In Québec, excess funds were invested back into the Québec economy with a subsequently higher yield. In the expectation of future returns, funds have also been allocated to finance small knowledge-based companies.

The Caisse describes its objectives as "high returns, financial soundness and an unwavering commitment to the economic vitality of its milieu". Further, in its Annual Report (1998, p. 3), it states that since its creation by a special act of the Québec National Assembly in 1965, "it has had the objective of achieving optimal financial returns and

contributing, by its vitality, to the Québec economy, while ensuring the safety of the capital under management". It has thus combined social investment initiatives with the other more traditional rate of return objectives of pension funds in the rest of Canada.

The Caisse is most noted for its economic development initiatives in Québec. Through its private investment subsidiaries, it invested $3 billion in 1997. The total value of the 367 private investments is now $4.6 billion. One subsidiary of the Caisse, the Accès Capital network, provides a regional network of development funds across Québec. Another subsidiary, Capital d'Amérique CDPQ, invests in small, medium and large companies in various industries, in the amount of $2.6 billion in 1997. Other subsidiaries specialize in emerging, small- and medium-sized companies in communications, biotechnology, health and financial services development. For example, in 1995 with $500 million of the Caisse's assets, Sofinov was created as a venture capital company specializing in bio-technology; in 1997, another $500 million was infused into Sofinov to make it a leading venture capital company in Canada. Finally, the Caisse instigates joint ventures and syndications with other investment players in Québec like the Solidarity Fund, a labour sponsored investment fund, as well as the provincial government.

The second leading example - while not for the most part involving pension funds - are labour-sponsored investment funds. The idea of a labour-sponsored investment fund was first raised by the Québec Federation of Labour in 1982 at a summit economic conference in Québec organized by the Parti Québecois government. As an economic engine for rebuilding the province of Québec, labour-sponsored funds were to provide much-needed

capital from workers to fund small- and medium-sized businesses and consequently to create jobs in the face of high unemployment. As of 1998, they provide just under half of all venture capital in this country with assets almost $4 billion. Their returns are reported daily in the Globe and Mail. In the interests of prudent portfolio management, only a portion of their assets are to be invested in venture capital by law.

Since Solidarity's founding, labour-sponsored investment funds have been created in most provinces under the umbrella of the provincial federations of labour. Their mandate as venture capital funds has expanded to include providing capital to companies in the early stages of development, new technology and companies undergoing restructuring. Since these funds are viewed as patient capital, investors are required to invest for a minimum of eight years.

Pension funds could be partners with labour sponsored investment funds in specific projects or simply investors. Pension funds in some provinces have been cautious to invest in labour-sponsored funds, viewing venture capital as an unknown quantity. However, in Quebec, British Columbia and - now - Manitoba, there are growing connections. The Crocus Fund of Manitoba is beginning the process of working with pension funds and setting up fund vehicles for a variety of types of investment including economic development in native communities, commercial ventures based on university research and social housing. OPSEU has a policy encouraging the investigation of an initiative with labour-sponsored investment funds.

A third example of economically targeted investment is Concert, a real estate development company. Arguably, Concert is the outstanding example in Canada and one of the most outstanding internationally. In the early 1990s, 26 pension funds in British Columbia pooled a small proportion of their funds – $30 million – and created a real estate development company to provide rental housing. The project was initiated by the then president of the Telecommunication Workers of Canada, Bill Clark, and supported by the other unions. The development company only used union labour. Concert Properties is now the largest developer of rental housing in Western Canada. In the year 2000, Concert Properties had a $450 million asset base. The company reports returns of 7.51% on its residential income properties and 8.75% on its commercial/industrial properties (Concert, 2002). It works closely with local communities in its development projects.

To complement the work of Concert, a mortgage trust was created – Mortgage Fund One – that would provide a portion of the financing for each project. Typically, Mortgage Fund One finances from 30 to 50 percent of each Concert project, the remainder coming from conventional sources such as banks. Mortgage Fund One's own statement of purpose makes it clear that it is not simply to provide financing for real estate development in British Columbia but development "constructed by contractors whose employees are represented by approved unions under a collective agreement" (Mortgage Fund One, 1999). Mortgage Fund One now has 45 investments with an approximate value of $353 million. Its management company - ACM Advisors - is in-house, thus reducing substantially the management costs. Thirteen union pension plans in British

Columbia invest in Mortgage Fund One, with the Telecommunication Workers making 57.4 percent of the investment and the Carpentry Workers nearly 10 percent. From 1993 to 1999, the rate of return ranged from 7.69 percent to 10.02 percent and exceeded benchmarked returns for equivalent mortgage companies.

In a typical development, Concert provides 20 to 25 percent of the equity. Of the remaining financing, two-thirds comes from the banks and one third from Mortgage One. In total, Concert has produced 7.5 million hours of work. A study also shows that Concert has contributed over $500 million to Vancouver's productivity (Carmichael, 2000).

Concert and Mortgage Fund One had to find people with the necessary expertise – Bruce Rollick, an actuary, and David Podmore and Jack Poole, who are real estate developers – yet who were also union sympathetic and willing to work within the social investment mandate of the founding unions organizations. In Quebec, the Confédération des syndicats nationaux (CSN) faced a similar problem when in 1987, it set up its own consulting group to assist union locals who wanted to organize worker co-operatives and also various forms of employee ownership (Quarter, 1995). However, through its networks, it was able to find a partner in a large Montreal accounting firm, who in turn brought in others with training in business planning and financial analysis, but who shared the union's mandate. For both Concert and the CSN, good referral networks needed to be developed to access the right types of expertise.

Over Concert's ten-year history, representatives of the pension fund shareholders have worked closely with the experts they have hired to protect their investments, diversify risk through development of real estate projects and build a strong development company with a good record of returns and a holistic approach to collateral benefit.

Conclusion

The preceding sections have argued that while pension funds have become a critical source of capital for national and international markets, unions have little control over the investment of their funds. Instead, they are controlled by an intricate web of financial and legal standards, to the benefit of the financial industry. Given their tax-exempt status, pension funds can and should provide not only secure pensions for retirees but also supply the long-term capital needed to fuel economic growth and build a better country. Unions are ideally placed to influence the investment of pension funds through joint trusteeship so that investment can have a more direct impact on economic growth and on job creation to the benefit working people and their families.

Union trustees are often discouraged from a more direct involvement in investment of their members' pension funds by references to the 'chilling effects' of case law on fiduciary responsibility. But an actual examination of significant cases has shown that the fiduciary obligation of trustees requires holding the beneficiaries' interests uppermost. Investment strategies that contemplate ethical and social screens or are economically

targeted or that involve shareholder activism or that produce collateral benefit to third parties do not, by themselves, violate the fiduciary responsibilities of pension trustees. The evidence shows that these considerations, when properly implemented, do not harm the rate of return earned by pension plans and do not put the plan beneficiaries at risk. Pension plans must develop new investment strategies through a thoughtful, step-by-step process starting with new investment policies. Unions, too, should work in partnership with their pension funds, providing support to their trustees through research and education, as well as more directly on investment projects that provide direct benefit to members of the fund.

Economically targeted investment practices are used predominantly in real estate development, mortgage trusts and venture capital financing in both private and public equity. Pension funds can be used as development capital for new or existing businesses. The criteria of such investment strategies, besides a benchmarked rate of return, is that they provide collateral benefits for the community in long term jobs, healthy sustainable businesses and support for families through the provision of such services as accessible housing meeting community needs. In Canada, investment vehicles and expertise need to be connected with pension trustees so that pension fund capital can be used more productively. This may not happen without more collaboration between pension funds on social investment strategies. There should also be more collaboration with labour-sponsored investment funds. This model is admired worldwide by trade unions and

progressive investors, yet is under-utilized in Canada. Unions can be most helpful in enabling these collaborations.