Joint Economic Committee Republicans
Wednesday, June 7, 1995

Economically Targeted Investments (ETIs)

- **Faced with a huge debt and voters who have become increasingly dissatisfied with the growth of federal government, the Clinton Administration has targeted private pension funds as a new way to finance its social spending projects.**

  1. President Clinton's book, "Putting People First: A National Economic Strategy," calls for an $80 billion federal outlay for an array of social projects from public housing to infrastructure construction to political projects that would be leveraged with public and private pensions.
  2. Pension funds are very attractive to the President's advisors because those funds now total $4.8 trillion. This figure far exceeds the total bank assets of $2.1 trillion as of July 1994. The Federal Reserve estimates that one-fifth of all assets in the United States are held by pension funds, and a recent study indicates that pension funds represent 32 percent of the daily trading on the New York Stock Exchange.
  3. Private pension assets alone are worth $3.5 trillion, an immense pool of private wealth that is very tempting for those looking to finance the Administration's extensive social welfare program.

- **Massive increases in federal government control over the private pension market would not succeed in the face of public and congressional scrutiny. Therefore, President Clinton's advisors have devised a low-profile, incremental strategy using executive actions and administrative rulings to accomplish the Administration's pension funds objectives.**

  1. A key stage in President Clinton's pension-fund plan came last June when Labor Secretary Robert Reich issued Interpretive Bulletin #94-1 (IB 94-1). This bulletin defined ETIs in a way designed to make them seem consistent with the Employee Retirement Income Security Act (ERISA), a federal law that protects private pension funds.
  2. Another important stage in the Administration's pension-fund plan was the establishment of a clearinghouse intended to showcase ETIs and suggest federal government approval. The Labor Department, not needing congressional authorization, intends to spend $1.2 million to get the Clearinghouse up and running, then spin it off as a private operation, analogous to an underwriter's laboratory for ETIs.
  3. A further stage in the process is now unfolding. It has been widely reported in the press that the President will nominate Assistant Treasury Secretary Alicia Munnell to be the next Governor of the Federal Reserve Board. Not long ago, Munnell proposed a 15 percent federal tax on private pension funds to finance the ETI agenda. At the Fed and outside of the reach of Congress, Munnell will be well-situated to help the Administration execute its plan for private pensions.

4. Ironically, Munnell wrote a very serious critique of ETIs in 1983 while an economist at the Federal Reserve Bank of Boston. She concluded that "once they focused on social consideration" and took their eyes off the goal of maximizing returns, "pension fund managers failed to exact appropriate returns."
5. Many experts believe the ultimate objective of the Clinton Administration is to implement a five to ten percent quota on private pension funds. This would be possible only after ETIs have become a common, accepted part of pension investing, as has already happened to a great extent in the local and state pension market. Quite a few states have had legislation introduced that would mandate ETI quotas, and in February 1995 proponents of ETIs in the state of California introduced a typical ETI quota bill.
6. This gradual implementation of the Administration's social agenda through administrative edict parallels the way that President Clinton's Justice Department and Treasury Department are forcing banking institutions to sign "consent decrees." The Administration recognizes that its social goals would not be popular; therefore, banks are being forced to relocate branches based on race-specific quotas and to agree to offer mortgages at below-market rates to minorities.

- **ETIs violate the legal standards for pension fund investments and would harm millions of Americans by lowering their pension benefits.**

1. Section 404 of the Employee Retirement Income Security Act (ERISA) is unambiguous: A pension fund manager is required to "discharge his duties with respect to a plan **solely** in the interest of the participants and beneficiaries and for the **exclusive purpose** of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."
2. The requirement that a trustee act **solely** in the interests of the beneficiaries and **exclusively** for their benefit derives from the fundamental Anglo-American legal principle that a trustee must have **undivided loyalty** to the beneficiary of the trust.
3. ETIs violate the fiduciary duty of undivided loyalty because ETI investments are made with the intent to benefit non-beneficiaries of the pension trust.
4. Secretary of Labor Robert Reich attempted to lower the ERISA duty of undivided loyalty by approving ETIs in an official Labor Department Interpretive Bulletin, which defines ETIs as investments "selected for their economic benefits apart from their investment return to the employee benefit plan." (IB 94-1)
5. The Labor Department has actively encouraged the use of ETIs among the pension community: the Assistant Secretary of the Pension and Welfare Benefits Administration (PWBA) has frequently travelled the country to persuade pension advisors to start investing in ETIs. Unfortunately, pension managers who accept the Administration's argument and actually invest in ETIs risk being prosecuted by the enforcement division of the Labor Department in the not-too-distant future.

- **By lowering the standards by which pension managers must abide, Secretary Reich is jeopardizing the investment returns on $3.5 trillion dollars in private pension**

funds. Several state pensions --which are not subject to the fiduciary duties in ERISA-- have tried ETIs and have lost millions of dollars.

1. The Kansas Public Employees' Retirement System (KPERS) invested in the Kansas-based Home Savings Association. After federal regulators seized the thrift, KPERS lost $65 million. KPERS invested $14 million in Tallgrass Technologies, Inc.; that investment is now virtually worthless. KPERS invested $7.8 million in Christopher Steel; it is now an abandoned steel plant. KPERS has already lost many millions of dollars on ETIs, and the total could reach from $138 to $236 million.
2. The State of Connecticut Trust Fund paid $25 million for a 47 percent stake in Colt manufacturing, a locally-based company. Just three years later, hopes for profits evaporated. On March 19, 1993, Colt filed for bankruptcy; it is unlikely the pension beneficiaries will recover any of their money.
3. The Missouri State Employees' Retirement Fund was forced to invest $5 million in ETI venture capital projects. The program, terminated three years after its inception, realized markedly poor investment returns and resulted in two lawsuits.
4. President Clinton was a proponent of ETIs when he was Governor of Arkansas. When the Kappa Kappa Gamma Sorority needed a loan for a new building, Governor Clinton prevailed on a local pension fund, the Arkansas Teachers Retirement System (ATRS), to finance the sorority's mortgage loan. When questioned about this, the ATRS pension fund manager replied, "I know the daddies of those girls, and there is no way they would have allowed that loan to go bad." (Thomas Donlan, ***Don't Count on It***, 1994).

- **The poor track record of ETIs at the state and local level strongly suggests that the Administration's ETI program would jeopardize the pension benefits of 36 million working Americans to finance social investments.**

1. The Administration's ETI initiative is an attempt to partially redirect the baby boomers' future pension funds to risky social investments. But what will happen ten, fifteen, or twenty years from now when there is not enough money in the pension funds to pay pension benefits?
2. Because ETIs deviate from the single-purpose investment standard mandated by ERISA for the sake of a social agenda, the Administration's pension plan betrays the trust that individual contributors have placed in the current ERISA system. Regrettably, the millions who have made contributions for ten, twenty, or thirty years with the legitimate expectation of a secure future now face worry about the long-promised return on their hard-earned investments.
3. Once an investment manager ceases to focus exclusively on maximizing the return for beneficiaries, it is very difficult to avoid social or even political considerations. Here is one of many examples: the pension managers of Pennsylvania's public school employees' and state employees' retirement funds were pressured by state officials to invest in a $70 million plant for Volkswagen; the investment lost more than 57 percent of its value in a 14-year period.

4. Who decides what is a qualified ETI? Would not that determination be subject to legal challenge once it proves an inopportune investment? The Department of Labor has not issued any guidelines for judging whether a particular investment merits status as an ETI. Without any standards, the process imprudently risks waste and abuse of workers' money for the benefit of special interests having their own agendas. In the end, retirees, especially those of the baby-boom generation, will pay for President Clinton's ETI program.

- **H.R. 1594, the Pension Protection Act of 1995 (PPA), would protect the 36 million private pension participants who are relying on their pensions for a secure retirement.**

1. The main purpose of H.R. 1594 is to restore the undivided duty of loyalty originally written into ERISA, which required pension funds to be invested for the sole purpose of increasing the economic benefit of the pension's participants and beneficiaries.
2. The PPA would nullify Secretary Reich's Interpretive Bulletin which encourages ETIs and would ensure that pension managers do not select investments for the purpose of achieving collateral or external benefits for non-beneficiaries.
3. The PPA would abolish the Clearinghouse recently established by Labor Secretary Reich which would have highlighted the list of investments that the Clinton Administration might deem socially beneficial.
4. The PPA would force the Labor Department to cease acting as a promoter of ETIs and to resume its normal function as the guardian and enforcer of ERISA's fiduciary standards.
5. The PPA would deny funding to any governmental agency that wanted to create a list or database to promote ETIs.