

**Building on Past Success:
Labor-Friendly Investment Vehicles
and the Power of Private Equity**

by

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I. Introduction¹

This paper profiles the leading “union-friendly” alternative investment vehicles, which are now an option in nearly every asset allocation category. Nearly five years ago the Department of Labor formally reiterated its longstanding position that pension fiduciaries may consider “collateral benefits” in choosing between investments, so long as the expected financial return is no worse than competing investment options with comparable degrees of risk.² An informal survey of Taft-Hartley investment managers for this paper indicates that labor-sensitive alternative investing has more than tripled over this same five-year period with respect to both assets under management and the number of such funds in operation. The sixteen investment vehicles described in Section III below report total assets of \$18 billion, nearly all of which has been invested by multi-employer pension plans jointly trusted by affiliates of the AFL-CIO.³

Real estate debt and equity funds that finance union-built construction continue to be the largest and most focused examples of alternative investments targeted to generate extra benefits for plan participants. A recent but potentially more powerful trend involves *direct* private equity investing in smaller, typically non-public companies. Private equity investing offers a surprising degree of both financial and social leverage. Large corporate and public pension funds have long realized the *financial* potential of private equity and now allocate an average of almost 5% of total assets to private placements. In contrast, few union-sponsored pension funds make private equity allocations at all. The track record of ULLICO’s “Separate Account P,” described below, provides strong evidence that investing sorely needed expansion capital in entrepreneurial

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² DOL Interpretive Bulletin 94-1 on Economically Targeted Investments, 59 Fed. Reg. 32,606 (June 23, 1994), *codified in* 29 C.F.R. Sec. 2509.94-1. No significant opinion letter, official speech or enforcement action since 1994 has amended IB 94-1. *See also* DOL Interpretive Bulletin 94-2, 59 Fed. Reg. 38,860 (July 29, 1994), which encouraged shareholder activism by pension funds, formally reiterating DOL’s longstanding view that proxy voting is a fiduciary act of plan asset management.

³ Half of this total (\$9 billion) is in a number of stock index funds enhanced by active management of proxy voting rights; the other \$9 billion is spread among a wide variety of investments in private equity, mortgage-backed securities, real estate equity, project finance and other direct lending to companies and real estate projects.

young companies, or in growing middle-market companies, can yield both premium financial returns and “social” leverage. Unlike investments in public equity markets, private equity investors can demand special covenants requiring progressive corporate policies, including union neutrality and card check recognition, union-built construction, environmental protection and other corollary benefits.

II. A Brief History of Union-Led, Non-Traditional Pension Investing

The ability of workers to control, or even to influence, the investment of their deferred wages in pension funds — which are now by far the nation’s largest source of capital — is an old but recurring debate. Unions played a leading role in the creation and expansion of private pension trusts, particularly the traditional defined-benefit plans that are funded almost entirely by employer contributions.⁴ Yet because control over how pension assets would be invested was never made a bargaining priority, today at least 90 percent of private sector pension fund assets are controlled exclusively by management.

According to Federal Reserve data, of the more than \$6.7 trillion in qualified pension assets, private sector plans hold more than \$4 trillion in total assets, of which an estimated 10 percent — between \$350 and \$400 billion — are in multi-employer plans jointly trusted by participating unions and contributing employers.⁵ Although union-influenced pension funds are shrinking as a share of total pension assets, multi-employer funds are targeting a steadily increasing share of their assets into union-friendly investment vehicles that generate extra benefits for plan participants and local economies where union members live and work.

⁴ See Teresa Ghilarducci, *Labor’s Capital: the Economics and Politics of Private Pensions* (Cambridge, MA: MIT Press, 1992), at 25-51, for an excellent history and analysis of labor’s role in shaping private pensions and other social insurance programs.

⁵ Board of Governors of the Federal Reserve System, *Flow of Funds Accounts*, March 1999 quarterly Z.1 release (for the period ending December 31, 1998). Federal Reserve data show that private defined benefit and defined contribution plans (including 401(k)s) had \$4.3 trillion in total financial assets, with \$2.2 trillion invested in corporate equities and another \$600 million in mutual funds. State and local public employee retirement funds had \$2.3 trillion in total financial assets, \$1.6 trillion of which was invested in corporate equities. Since the Federal Reserve does not separately track private multi-employer (Taft-Hartley) plans, the 10 percent figure represents an estimate based on the literature and interviews with investment managers. See Terry Williams, “Big Union Funds Still Avoiding Private Equity,” *Pensions & Investments*, May 4, 1998, at 20.

In 1959 Paul Harbrecht, in a book published by the Twentieth Century Fund (now The Century Foundation), debunked the notion that pension funds, as they were evolving, would necessarily create a “people’s capitalism,” since workers “enjoy none of the prerogatives of management and direction that usually pertain to ownership or proprietorship.”⁶ He recognized that only if the major unions of the newly merged AFL-CIO took a long-term perspective, and made joint trusteeship a priority, could capital itself become a major source of power for organized labor. Ironically, 15 years later Peter Drucker, a nationally-known management consultant and pundit, published *The Unseen Revolution: How Pension Fund Socialism Came to America*. His provocative thesis was that workers would increasingly own the means of production through their pension funds — but that contrary to socialist rhetoric, this would undermine unions and strengthen the free market as workers gained a direct self-interest in the profitability of corporate America.

However, Drucker neglected to emphasize the distinction between ownership and control. That distinction — and the difference it made to both organized labor and the communities in what was then becoming known as the “rustbelt” — became the topic of an influential rejoinder by activists Randy Barber and Jeremy Rifkin. In *The North Will Rise Again*,⁷ they argued that the separation of pension fund ownership from control was actively undermining unions and the prosperity of many states and communities, particularly in the northeast and midwest. Union members’ own savings were being invested in companies that earned higher profits by employing aggressively anti-union strategies, including relocating plants and jobs from heavily unionized and higher-wage cities in the north to non-union and low-wage locations in the south and, increasingly, outside the U.S. Barber and Rifkin urged both union and public pension trustees to affirmatively redirect investment in a bid to reverse deindustrialization and relocation.

Of course, by the time their book appeared in 1978, much of the investment strategy recommended by Barber and Rifkin was arguably prohibited by ERISA, which went into effect in 1975. As the next section explains, ERISA made the sort of profit-driven investment strategy

⁶ Paul Harbrecht, *Pension Funds and Economic Power* (New York: Twentieth Century Fund, 1959), at 266.

⁷ Randy Barber and Jeremy Rifkin, *The North Will Rise Again: Pensions, Politics and Power in the 1980s* (Boston, MA: Beacon Press, 1978).

they decried a virtual legal requirement. Pension fiduciaries can target investments, but only to the extent that the expected financial returns are comparable to alternative investments with the same risk characteristics.⁸ Although creative and coordinated public-private partnerships could have been structured (using public subsidies, guarantees and other credit enhancements) to facilitate pension investment in declining industries and inner cities, even today very few programs have been developed to protect trustees inclined to leave the safety of the herd that is grazing on traditional publicly-traded securities.

This legal reality left the labor movement with only two basic ways to leverage its limited pension power (which was, and still is, restricted to multi-employer plans and a handful of large state and local government plans with union members or sympathetic public officials on the board of trustees). One strategy has been to encourage investment through union-friendly investment managers dedicated to generating “collateral benefits” for union members or communities on top of a competitive market rate of return.⁹ The second strategy has been to leverage the proxy voting power of union-influenced pension funds in support of both financial and long-term union policy objectives.

Beginning in the mid-1980s and since, the latter strategy — shareholder activism — has been more visible, primarily because it has been used during a number of high-profile “corporate campaigns” organized in reaction to strikes, lock-outs, union-busting and other labor disputes.

⁸ One example of pension investment in urban revitalization rejected by DOL was a New York City affordable housing partnership championed by Jack Kemp, then President Reagan’s Secretary of Housing and Urban Development. In a November 1990 letter to then-Secretary of Labor Elizabeth Dole, Kemp requested an ERISA exemption. “With an estimated \$2 trillion in pension funds, access even to a relatively small portion of this amount would result in a dramatic increase in the affordability of housing for families,” Kemp wrote. However, because the bonds would have paid 2 percent less than conventional mortgage-backed securities, Dole firmly rejected Kemp’s suggestion that pension funds could participate without violating ERISA. Calabrese, “Would Economically Targeted Investments Trigger a Pension Crisis? No,” *Insight*, Sept. 16, 1996, at 25. Kemp’s successor at HUD, Henry Cisneros, implemented a community investment partnership with the AFL-CIO Housing Investment Trust and other pension investors in 1994, but that program guaranteed a market rate of return with virtually no risk of default. See *Hearing on Pension Investments and Economic Growth Before the Joint Economic Committee*, 103d Congress, 2d Session (June 22, 1994), testimony of Steven Coyle and HUD Secretary Henry Cisneros.

⁹ This strategy fits squarely within the Department of Labor’s explicit and longstanding position that ERISA permits “economically targeted investments” (ETIs), which is defined as an investment selected for the economic benefits it creates *in addition to* the investment return on plan assets. See DOL Interpretive Bulletin 94-1, *supra* note 2.

As part of stepped-up efforts to wage comprehensive campaigns against anti-union companies, several AFL-CIO departments and a number of national unions set up special coordinated campaign teams with expertise in leveraging pension power through proxy voting strategies. The most common and effective of those tactics involved sponsoring pro-shareholder corporate governance reform proposals opposed by management and organizing the support of other large institutional investors.¹⁰ To assist this effort, both the AFL-CIO and the United Brotherhood of Carpenters began systematically collecting data on the stock holdings of union-influenced Taft-Hartley and public sector pension funds.

In February, 1991, the AFL-CIO Executive Council adopted *Model Guidelines for Delegated Proxy Voting Responsibility*, which it stated “were drafted specifically for the occasion when proxy voting authority *is not* retained by the plan trustee(s) but is, instead, delegated to another voting fiduciary (whether to an investment manager, custodial bank or other registered investment adviser).”¹¹ This aimed to remedy the tendency of traditional money managers to be overly deferential to management on contested proxy issues and to simply vote union member assets however they voted their other clients’ proxies. Union shareholder activism has also benefitted from the steady and accelerating consolidation of delegated proxy voting authority in the hands of union-friendly consultants and index fund managers. This is one reason that although “enhanced” stock index funds with active corporate governance policies do not fit the usual conception of an “ETI,” they are profiled in this paper as important union-friendly alternative investment vehicles.

While multi-employer plans have been at the forefront of the shareholder rights movement, they have considerably lagged the large public pension funds with respect to making non-traditional investments.¹² In 1991 the AFL-CIO Executive Council adopted a set of

¹⁰ See Calabrese, “A Union Perspective on Pension Fund Shareholder Activism,” *The Corporate Governance Advisor*, Jan./Feb., 1994. See also Richard C. Ferlauto, “Labor’s Growing Shareholder Activism Agenda,” *Pensions & Investments*, March 23, 1998, at 12.

¹¹ AFL-CIO, *Investing in Our Future: An AFL-CIO Guide to Pension Investment and Proxy Voting* (1991), at 8. (Disclosure: As an AFL-CIO staffer, the author was a principal drafter of the AFL-CIO investment principles and proxy voting guidelines adopted in 1991.)

¹² The most recent published survey of “ETIs” by public pension funds, by the Institute for Fiduciary Education (IFE) in 1993, reported that 50 large public plans responding to the survey had a total of \$20 billion in self-described ETIs. IFE reported that two-thirds of this overall allocation was targeted at in-state residential housing

“pension investment principles” intended to encourage union trustees to “pursue prudent investments that reflect the long-term interests of plan participants and beneficiaries.”¹³ The principles called for a “balancing of interests” that takes into account not just the financial rate of return, but also the multiple “long-term interests” of plan participants and beneficiaries. These non-portfolio interests include “continuous employment of plan participants,” the “viability of participants’ employer or employers,” “improvement in wages and benefits” and “promotion of local economic development.” As one means to this end, the AFL-CIO Executive Council urged union trustees to “use targeted or exclusionary investment criteria as a way to advance certain economic, regional or social objectives without compromising the prudence of the investment.”¹⁴

It would be difficult to point to any immediate surge in alternative or targeted investing among multi-employer plan trustees in the wake of either the AFL-CIO’s 1993 declaration or the Department of Labor’s 1994 clarification that ETIs are permissible under ERISA. Nevertheless, both the number and variety of union-friendly investment vehicles, as well as the share of assets allocated to targeted investments by multi-employer plans, have expanded at an accelerating pace since 1993. Just six years ago more than 80 percent of all pooled alternative investments by union pension funds were dedicated to financing union-built construction. There were no significant vehicles targeting private equity placements, direct business lending or international investment.¹⁵ Thus, both the expansion of union-built construction fund options and the creation of successful new funds in areas including private equity placements, described in section III below, represent a significant development with respect to using pension assets to promote workers’ overall interests.

(with 84% in real estate investments overall). Nearly \$1 billion was targeted at in-state venture capital and private placement debt and equity with the goal of promoting in-state business development and job creation. See Institute for Fiduciary Education, *Economically Targeted Investments: A Reference for Public Pension Funds* (June 1993), at 13-15. By comparison, an informal survey by the AFL-CIO that same year identified between \$2 and \$3 billion in multi-employer plan “ETIs,” \$1.8 billion of which was invested in the three largest union-built construction funds. See AFL-CIO, Department of Employee Benefits, *Pensions and Changing Capital Markets* (Feb. 1993).

¹³ *Supra* note 11, at 3-4. The *AFL-CIO Policy on Pension Fund Investments* was adopted in May, 1991.

¹⁴ *Id.* at 5-6.

¹⁵ An exception is Poland Partners Fund LP, which began operating in 1993. That fund, organized by Landon Butler & Company, provides start-up and expansion capital to companies in Poland, particularly firms projected to expand export markets for unionized U.S. companies. Although this paper does not profile any international fund, the AFL-CIO Corporate Affairs Department recently identified ten international funds that describe

ERISA Clearly Permits Fiduciaries to Generate Extra Benefits

For more than two decades the Department of Labor (DOL) has consistently taken the position that a fiduciary may choose a particular investment because it generates non-portfolio benefits for plan participants, for the industry, or even for the community or society at large, so long as investment income is not sacrificed.¹⁶ In a brief interpretive bulletin in 1994,¹⁷ DOL summarized previous advisory opinions and letters related to economically targeted investing. An ETI, as defined by Interpretive Bulletin 94-1, is an investment selected for the economic benefits it creates *in addition to* the investment return on plan assets. In IB 94-1, DOL specifically addressed what it termed the “misperception” that “exists within the investment community that investment in ETIs are incompatible with ERISA’s fiduciary obligations.”¹⁸

DOL’s IB 94-1 states simply that “the fiduciary standards applicable to ETIs . . . are no different than the standards applicable to plan investments generally.”¹⁹ Any investment selected by an ERISA fiduciary must have “an expected rate of return that is commensurate to rates of return of alternative investments with similar risk characteristics that are available to the plan,” and must be “otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan.”²⁰ If an investment would be prudent irrespective of its “collateral benefits,” it can be given preference so long as it does not cause the

themselves as union-friendly.

¹⁶ DOL’s position dates back to at least 1980, when the Department’s first ERISA Administrator, Ian Lanoff, stated that while ERISA “does not exclude the provision of incidental benefits to others, the protection of retirement income is, and should continue to be, the overriding social objective governing the investment of plan assets.” Ian Lanoff, *The Social Investment of Private Pension Plan Assets: May it Be Done Lawfully Under ERISA?*, 31 Labor Law Journal 387, 389 (1980).

¹⁷ DOL Interpretive Bulletin 94-1, *supra* note 2. For a more detailed discussion of ERISA’s requirements, including the important aspects of “procedural prudence” involved in selecting and monitoring alternative investments, see the paper in this collection by Jayne Elizabeth Zanglein, “Overcoming Institutional Barriers on the ETI Superhighway” (April 1999).

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ *Ibid.* This refers to the “whole portfolio” approach, under which the risk and return of an investment are properly analyzed in the context of overall asset allocation and diversification. For example, an alternative investment (e.g., project finance) may show greater variability of return than a traditional investment (e.g., corporate bonds), yet may be preferable because it enhances diversification and lowers the risk profile of the portfolio as a whole.

plan to forgo comparable investment opportunities with a higher expected return in relation to risk.²¹

One issue skirted by DOL's Interpretive Bulletin 94-1 — and the subject of continuing debate — is what special consideration, if any, fiduciaries should give to an investment opportunity expected to confer *extra* benefits directly on the plan's own participants or contributors, in addition to a market-rate of return. Certain investments, such as geographically-targeted investments in union-built construction, can directly enhance both the economic welfare of plan participants and the solvency of the trust itself. Large public pension funds in states like California, Wisconsin and Pennsylvania — which for many years have committed a far larger share of assets to ETIs than most Taft-Hartley funds — employ a similar rationale for their “in-state” investment programs. Many state funds, with and without statutory authority, geographically target investments in venture capital, small business loans and affordable housing for the purpose of improving the tax base that ultimately supports both the employment and the pension security of their public employee participants and beneficiaries.

Along these lines, Randy Barber and Teresa Ghilarducci have called for a “whole participant approach” to the fiduciary standard of loyalty, which “recognizes that pension funds, and participants by extension, rely on employment growth, as well as investment returns” for financial security.²² As an example, they cite the common situation of multi-employer funds that struggle under a high ratio of beneficiaries to active participants, making such plans more likely to default on future benefit obligations. Investments that increase work hours and contributions paid on current employees doesn't benefit only active participants, but non-active beneficiaries as

²¹ Some conservative opponents of ETIs claim that DOL has misinterpreted ERISA, arguing that the exclusive benefit rule prohibits the consideration of any goal other than maximizing the financial return on plan assets. The leading proponent of this view is Rep. James Saxton (R-NJ), who introduced legislation in 1995 (H.R. 1594) to amend ERISA to outlaw ETIs, which he called “PTIs” — politically targeted investments. His bill passed the House on a party-line vote, but was not taken up in the Senate during that Congress or since. However, Congress did add a rider to DOL's annual appropriation for fiscal year 1996 that barred any expenditure for the promotion of ETIs, which effectively killed the ERISA Clearinghouse announced the year before. See Alvin D. Lurie, “ETIs: a Scheme for the Rescue of city and Country with Pension Funds,” 5 *Cornell Journal of Law and Public Policy* 315 (Spring 1996).

²² Teresa Ghilarducci, “U.S. Pension investment Policy and Perfect Capital Market Theory,” *Challenge* 37 (1994); see also Barber and Ghilarducci, “Pension Funds, Capital Markets and the Economic Future,” in Gary A. Dymnski, Gerald Epstein and Robert Pollins, eds., *Transforming the U.S. Financial System: Equity and Efficiency in the 21st Century* (Armonk, NY: M.E. Sharpe, 1993).

well by strengthening the trust and its sponsors. In a private defined benefit plan context — where beneficiaries are typically receiving relatively fixed monthly benefit amount insured by the federal Pension Benefit Guarantee Corporation — this approach would seek to optimize the multiple and very-long term interests of both current retirees and active workers contributing to the plan, many of whom may be 30 or more years away from drawing benefits.

Although there is no legal precedent for sacrificing investment return to generate non-portfolio benefits for any particular sub-group of plan participants or beneficiaries, courts have recognized that “the legitimate end of preventing the exhaustion of the assets,” in a manner that is “in the interest of all beneficiaries,” can justify making an investment that would otherwise be considered inappropriate or inferior compared to available alternatives.²³ A limited version of this “whole participant” concept garnered some support within the Secretary of Labor’s ERISA Advisory Council which, in a 1992 policy review, favorably discussed the possibility that collateral benefits accruing directly to plan participants could be quantified and factored into the fiduciary choice among competing investments. The DOL advisory group concluded that by investing in projects that are of local or occupational interest to participants, pension funds can create a “primary benefit from competitive financial returns and a collateral benefit from the creation of jobs, wealth, and other local economic ripple effects.”²⁴ The group also recommended a “safe harbor” test that would presume a prevailing market rate of return when a fiduciary co-invests with other investors not seeking a collateral objective. In 1994 DOL adopted the ERISA

²³ *Withers v. Teachers’ Retirement System*, 477 F.Supp. 1248, 1256 (S.D.N.Y. 1978), *affirmed* 595 F.2d 1210 (2d Cir. 1979). In that case the trustees of the municipal Teachers’ Retirement System (TRS) in New York successfully defended against a suit brought after the fund purchased \$860 million in very risky “Big Mac” bonds for the purpose of helping New York City avoid bankruptcy, which the trustees believed would have led in turn to the insolvency of the pension trust.

²⁴ Report of the Work Group on Pension Investments, Advisory Council on Employee Welfare and Pension Benefit Plans, U.S. Department of Labor, “Economically Targeted Investment: An ERISA Policy Review” (Nov. 1992). Legal commentators are split on whether DOL would be correct to interpret the provision of “benefits” under ERISA more broadly. See Ronald B. Ravikoff and Myron P. Curzan, “Social Responsibility in Investment Policy and the Prudent Man Rule,” *California Law Review* 68:518, at 532-533, who argue that ERISA’s exclusive benefit rule can be interpreted broadly to include a range of “positive” benefits, including “job security and improved working conditions” for plan participants. Other commentators flatly reject construing the term “benefits” to include anything beyond monetary plan assets available for distribution among all fund beneficiaries. See John H. Langbein and Richard Posner, “Social Investing and the Law of Trusts,” *Michigan Law Review* 79, no. 1 (November 1980), at 103.

Advisory Council’s additional recommendation that an ETI Clearinghouse be created to collect and disseminate best practices information on ETIs.²⁵

That same year a conservative counterattack began in Congress against the Clinton administration’s attempts to leverage public spending with pension capital — which resulted in the defunding of the ETI Clearinghouse by the new GOP Congressional majority in 1995. The tenacity of the conservative attack on ETIs as a “raid” that threatened retirees put the administration on the defensive and abruptly ended any additional efforts to facilitate ETIs.

Extra Benefits Generated by Union-Built Construction

While prevailing interpretations of ERISA do not permit fiduciaries to sacrifice current financial return to generate broader economic benefits for plan participants, the extra benefits delivered by most union-oriented alternative investments provide a sharp contrast to the false caricature of ETIs as concessionary “social investing” that undermines pension security. The most clear-cut examples of alternative investing vehicles that provide extra benefits to plan participants are the leading union-built construction funds. By geographically targeting investments in new construction — and often by steering business to employers that contribute to multi-employer plans — the real estate debt and equity funds profiled below have proven they can generate one or more of the following enhanced benefits for plan participants.

First, to the extent that the investment manager geographically targets capital back into investors’ jurisdictions on a reciprocal basis, union-built real estate trusts generate millions of additional hours of work for active plan participants. This not only provides an extra monetary benefit to active participants, but also benefits all plan beneficiaries by increasing plan contributions, which are tied by formula to hours worked. This is particularly important for multi-employer plans, which as a whole have more retired than active participants, which makes it more difficult to remain fully-funded on an actuarial basis.

²⁵ Advisory Council on Employee Welfare and Pension Benefit Plans, U.S. Department of Labor, “A Clearinghouse for Economically Targeted Investments” (November, 1993).

Second, targeted union-built funds similarly strengthen the market position of employers contributing to the plan, which participants rely on to fund future obligations. The Carpenters' *ProLoan* program is particularly strong in this regard because although it is a commingled fund, multi-employer plan investments are recycled back into that jurisdiction on a proportional basis.

Third, enlarging the union-built share of the local market puts upward pressure on plan participant wage levels more generally. This not only provides an extra benefit to active participants. It also translates into higher contribution levels and stability for the pension fund as an on-going entity. As union share increases, the pension fund and its participants become more secure.

Fourth, several of the vehicles described below also help to diversify the types of properties built union in a particular jurisdiction, which benefits plan participants and beneficiaries over the long term. Because central-city commercial construction is far more cyclical than residential, and tends to dry up at the first sign of an economic downturn, multi-employer plans in areas where union work is concentrated in large commercial projects tend to experience greater volatility with respect to plan contributions.²⁶ Plan income from contributions becomes more stable to the extent that the union share of local construction is diversified among residential and commercial construction (and, within the latter, among large and small projects). As described below, the St. Louis Council of Carpenters have successfully pursued this strategy, first targeting the single-family residential market with the **Builders Fixed Income Mutual Fund** and its *ProLoan* organizing program; and more recently targeting smaller and suburban commercial projects with the **Commercial Mortgage/Plus Fund**.

As union-built real estate funds reach a critical mass they also strengthen the labor movement and building trades plan sponsors in particular. These funds help create new and often lasting relationships between big developers and union contractors.²⁷ When these funds build outside the old central cities — financing the construction of residential housing, strip malls and industrial sites in the suburbs, or even in southern and western cities — they are typically in

²⁶ Interview with Scott Hartzell, Managing Director, ProLoan Builders Fixed Income Fund, Feb. 19, 1999.

²⁷ Interview with Landon Butler, Policy Board member and marketing director, Multi-Employer Property Trust (MEPT), February 21, 1999.

“battleground situations,” as MEPT’s Landon Butler calls it, where developers or contractors have rarely or never used union labor. As the union-built funds grow in size, expertise and reputation, major developers and contractors across the country find themselves motivated to have a far more receptive attitude toward the reality that the higher productivity, quality and reliability of union construction workers make their higher wages and benefits worth paying.

The Promise of Private Equity

While union-built construction funds remain the largest and most developed segment of the market for non-traditional investments, private placement debt and equity — already well-established among public and corporate pension plans — is beginning to attract attention among multi-employer plans. ULLICO’s stunning success with direct equity investments in non-public firms over the past three years, described below, should provide the impetus for a number of new funds that combine private equity placements with demands that those companies agree to maintain positive labor relations. ULLICO’s Separate Account P clearly shows that *direct investing* in entrepreneurial young companies, and in middle-market companies needing expansion capital, can yield both premium financial returns and “social” leverage — that is, the ability to demand special covenants requiring union neutrality and card check recognition, union-built construction, environmental responsibility, and other corollary benefits.

Private placements are a critical source of capital for start-up firms, private middle-market firms (between \$5 and \$100 million in sales), public firms seeking buy-out financing and firms in financial distress. Despite all the attention paid to LBOs and venture capital, the broader private equity market receives relatively little attention, in large part because the information about these private transactions is sketchy at best. Unlike publicly-traded stocks and bonds, a private equity security is exempt from registration with the Securities and Exchange Commission because it is issued in negotiated transactions “not involving any public offering.”

Until the 1980s, this market was small and occupied mainly by wealthy families and financial institutions, such as insurance companies or merchant banks, making direct investments in issuing firms. Since the mid-1980s, however, private equity has been by far the fastest growing

source of corporate finance, in recent years raising more capital for companies than initial public offerings or public high-yield corporate bonds.²⁸ From 1980 to 1994, total private equity capital under management grew from \$5 billion to more than \$100 billion. While venture capital increased tenfold, from \$3 to \$30 billion from 1980 to 1994, non-venture private equity placements grew 35-fold, from less than \$2 billion to more than \$70 billion in total outstandings in 1994.²⁹

Over the most recent five years period, private equity markets have grown at an even faster pace, with public and corporate pension funds becoming the nation's largest holders of non-public equity. In 1998 a record \$85.3 billion in new commitments were made to private equity partnerships, a 53% increase over 1997. More than three-fourths of new private equity commitments in 1998 went to buyouts (\$47.4 billion) and venture capital (\$17.2 billion), pushing total funds raised by private equity limited partnerships (LPs) up 52% over 1997.³⁰

Public and corporate pension funds supplied 43% of this private equity capital by 1994 and almost certainly provide a majority now. A survey by the *Private Equity Analyst*, the leading newsletter tracking private equity, showed that by year-end 1991 the 56 largest public pension funds already had allocated an average 4.3% of total assets to private equity.³¹ The nine largest public funds each had between \$800 million and \$2 billion in private equity last year. Corporate and public pension funds boosted their target allocations to private equity by 1997 to 7.0% and 4.7%, respectively, according to data compiled by Goldman Sachs.³²

²⁸ See George W. Fenn, Nellie Liang and Stephen Prowse, *The Economics of the Private Equity Market*, Staff Studies 168, Board of Governors of the Federal Reserve System (Washington, DC: Dec. 1995), chapter one. This study by staff at the Federal Reserve System, provides an excellent overview of the economic foundations of the private equity market, including the roles of the key players in those markets, particularly intermediaries (especially limited partnerships), institutional investors, agents and advisers. See also Mark Carey, Stephen Prowse, John Rea and Gregory Udell, *The Economics of the Private Placement Market*, Staff Studies 166, Board of Governors of the Federal Reserve System (Washington, DC: 1993).

²⁹ *Id.* References here are to what the Federal Reserve study defines as the *organized private equity market*, which does not include so-called "angel capital" (investments in small, closely-held companies by wealthy individuals), or the "informal" private equity market, which are pre-packaged unregistered securities sold by agents to institutional investors and accredited individuals who do not as a result become major holders or active owners the way limited partnerships (LPs) and other direct investors typically do.

³⁰ "Funding Sets Fifth Annual Record, Surging 53% to Exceed \$85 Billion," *The Private Equity Analyst*, January, 1999, at 1, 46.

³¹ See "Public Funds Earmark \$9.3 Billion for Investment in Private Equity," *The Private Equity Analyst*, February 1992.

³² Hamilton Lane-Carpenters' Partnership Fund, L.P., "Presentation Book," Hamilton Lane Advisors (1999), at 8.

Because of the extreme information asymmetries between firms and potential investors, pension funds typically participate in the private equity market as limited partners in a partnership (LP) organized by a general partner — generally a professional management team.³³ As of 1994, LPs managed more than 80 percent of all private equity investments.³⁴ For added diversification or expertise in selecting LPs, some pension funds invest in a “fund of funds,” such as the Hamilton Lane/Carpenters Union Partnership Fund described below, which invests in a variety of other LPs. Alternatively, pension funds can invest in a commingled fund, such as ULLICO’s Separate Account P, which assembles a portfolio of direct investments. In either instance, specialized private equity managers typically take large ownership stakes and play an active role in monitoring and advising portfolio companies. These funds often exercise as much control as company insiders, particularly in a venture capital or distressed company context. While most pension funds invest through intermediaries, mainly LPs, some of the largest corporate pension funds “have become quite active in direct investment and co-investment,” according to the Federal Reserve study.³⁵

Private placement debt markets are another area where multi-employer pension plans are relatively inactive, but where the right intermediary could achieve a similar combination of premium returns and collateral benefits. Privately-held mid-sized companies (between \$5 and \$100 million in annual sales) find it very difficult to obtain capital to grow and expand, particularly if they are in a relatively slow-growing or “low-tech” industry. Over the past two decades this capital gap between large public companies and smaller private companies has grown in part because the traditional sources of private placement lending — commercial banks and insurance companies — are shrinking as a share of U.S. private capital markets.

For example, in 1980 U.S. commercial banks held \$1.5 trillion in financial assets — more than twice the \$700 billion in total private and public pension assets. By 1997, financial assets

³³ Partnerships are the dominant format for private equity investing because of their ability to accommodate both pension and non-pension investors, favorable tax treatment, limited liability and well-established legal precedent and familiarity. In LPs, the general partner is almost always itself organized as a partnership or corporation. Two alternative vehicles are the commingled trust (ULLICO’s model) and the limited liability company (LLC), which is a new but increasingly common structure described as a hybrid between a corporation and a partnership.

References to LPs in this paper include LLCs, since they are similar from a fiduciary perspective.

³⁴ *The Economics of the Private Equity Market*, *supra* note 28, chapter 5.

held by pension funds exceeded total banking assets by \$500 billion. Similarly, in 1980 insurance company assets were almost as large as total U.S. pension assets, but are now only half as large.³⁶ Banks and insurance companies are particularly important as private placement lenders because they have the institutional capacity to do the sort of in-depth due diligence required to prudently invest in non-public companies, as well as the long-term liability structure it takes to invest in illiquid private offerings.

By their nature, pension funds are also ideally suited to capture the premium returns that flow, on average over time, to less liquid private placement debt and equity. Mutual funds and most individual investors put a premium on liquidity — the ability to turn assets quickly into cash. But pension funds aspire to eternal life; they have large reserves and their liquidity needs are predictable and frequently far in the future. As a result, the typical pension fund should be no more constrained to secondary public markets for stocks and bonds than the typical life insurance company. With access to appropriate intermediaries, even small pension funds can achieve the diversification and professional due diligence that permit insurance companies or hedge funds to make the sort of private placement debt and equity investments that pay a premium.

Since companies requiring private equity and debt infusions expect to give up a certain degree of autonomy, conditions related to the firm's future labor relations are negotiable if the fund manager makes it a priority.³⁷ This is very different than the purchase of public stock on a secondary market, such as the New York Stock Exchange. Publicly-traded securities are essentially commodities and the transaction is impersonal. In contrast, non-public company management teams and private investors commonly negotiate a variety of covenants with respect to a large investor's participation, which can include corporate policies such as labor union neutrality, card check recognition, union-only construction, preferences for unionized suppliers and other collateral objectives that don't substantially diminish expected returns. Still, despite the

³⁵ *Ibid.*

³⁶ U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States 1998*, Table 794, at 512.

³⁷ Interview with Michael Steed, Senior Vice President, Union Labor Life Insurance Company (ULLICO), March 5, 1999.

potential to realize both a financial return premium *and* the leverage to generate progressive corollary benefits, multi-employer pension funds have generally not joined corporate and public plans in diversifying into private equity placements.³⁸

III. Profiles of Union-Oriented Alternative Investment Vehicles

The sixteen union-oriented investment programs profiled below represent virtually every traditional asset allocation category.³⁹ This is important because it allows a pension fund to invest in a variety of these funds, while maintaining a prudently diversified asset allocation. The funds below reported total assets of \$18 billion in March 1999, nearly all of which has been invested by multi-employer pension plans jointly trusted by affiliates of the AFL-CIO.

ULLICO's Separate Account P: Direct Private Equity Placements

When Sam Gompers persuaded the AFL to establish a union-owned life insurance company back in the 1920s, he probably did not foresee its future. The fund would eventually leverage private capital to unionize workers more cost-effectively than most traditional organizing campaigns. Yet that's precisely what the Union Labor Life Insurance Company (ULLICO) and its Separate Account P are doing. "P is the only private equity fund dedicated to creating and preserving union jobs," boasts Michael Steed, ULLICO senior vice president for investments.⁴⁰

Large corporate and public pension funds have long realized the *financial* potential of private equity and now allocate an average of almost 5% of total assets to private placements. In contrast, few union-sponsored pension funds make private equity allocations at all. This gap may close now that ULLICO's "Separate Account P" has demonstrated that investing sorely needed expansion capital in entrepreneurial young companies can yield both premium financial

³⁸ See Terry Williams, "Big Union funds Still Avoiding Private Equity," *Pension & Investments*, May 4, 1998, at 20.

³⁹ While this paper does not profile any international fund, the AFL-CIO Corporate Affairs Department recently identified ten international funds that describe themselves as union-friendly.

⁴⁰ Interview with Steed, *supra* note 37.

returns and “social” leverage, such as the ability to demand special covenants requiring union neutrality and card check recognition, union-built construction and other corollary benefits. ULLICO’s Steed estimates “that for every \$7 billion of equity in private equity deals, a fund can influence \$100 billion in corporate activity. Private equity should be a regular, substantial and on-going part of the equity allocation for Taft-Hartley pension funds,” he asserts.⁴¹

ULLICO’s track record appears to confirm this potential. It’s fair to say that creating union jobs has seldom been so profitable. Separate Account P’s annual return during its first three years has averaged 39%, while ULLICO’s in-house portfolio that preceded “P” sports an internal rate of return in excess of 100% *per year* since January, 1992. Steed argues that ULLICO is proving that direct private equity investing offers a surprising combination of premium financial returns *and* the bargaining power to pursue extra, non-portfolio benefits.

In 1992 ULLICO began direct investing, using insurance reserves, by co-investing with the Carlyle Group (a politically-connected merchant banking firm) to purchase the aircraft division spun off by bankrupt defense contractor LTV. As the investment bankers rushed to complete the deal, ULLICO insisted that the buy-out group ratify the existing collective bargaining agreement with the UAW and agree to shore up the under funded rank-and-file pension plan. Although ousting unions and plundering pension assets are two of the classic tactics used in leveraged buy-out transactions, ULLICO’s co-investors reluctantly agreed. After two years ULLICO exited with a 75% internal rate of return.⁴²

Leveraging Ownership Into Responsible Employment Policies

After a period of apprenticeship as a co-investor on several deals, ULLICO added solo direct investing to its arsenal and, in December 1995, opened a group annuity account (“P” for Private Capital) aimed at multi-employer plan clients. The following are examples of the 57 private equity deals ULLICO has done since 1992, the majority of which involved both financial *and* corollary benefits for investors or for organized labor more generally:⁴³

⁴¹ *Ibid.*

⁴² *Ibid.*

⁴³ Except as noted, data are from ULLICO, “Separate Account P: The Union Labor Life Insurance Company Private

- **Super Shuttle:** The bright blue vans that are rapidly taking fares from taxis at major airports across the country are part of a classic franchised service business that unions find tough to organize. Airport authorities welcome shared-ride services because they relieve congestion and, in Super Shuttle's case, are fueled by clean-burning natural gas. In return for \$3 million in expansion capital, ULLICO achieved two concessions that private investors would not have bothered about: First, the vans must be manufactured domestically by U.A.W. members, creating 500 jobs to date; and second, neutrality and card-check recognition should a union organize the drivers or other personnel. As a result, the Teamsters (West coast) and SEIU (East coast) are quickly bringing the drivers in this fast-growing and profitable company under contract.
- **Residential Services Inc.:** RSI had a business plan calling for the construction of 75 new assisted living centers at an average \$7 million per location. While other institutions provide mortgage financing on a building-by-building basis, ULLICO made a private equity investment of \$5 million, infusing badly needed operating capital and becoming a part owner in the process. As a term and condition of this investment, RSI agreed that all 75 centers be built with union labor and that all the workers at the centers would be covered by neutrality and card check recognition agreements. ULLICO projects that it will sell its 18% ownership stake within 5 years for an estimated annual return of 20%.
- **Global Crossing:** The primary reason that ULLICO's in-house portfolio is up an average 100% annually since 1992 (compared to a 39% annualized return for Account P), is one venture capital investment that would make even veteran Silicon Valley investors envious.⁴⁴ Global Crossing Ltd. is building a global network of undersea fiber-optic cables with a new technology that can accommodate exploding Internet transmissions by carrying hundreds of times as much data as older cables. Two years ago ULLICO invested \$7.6 million in the start-up. The company went public last August, after its largest cable across the Atlantic Ocean went into service, leaving ULLICO's 8% ownership stake with a market value in excess of \$1.6 billion — more than 200 times its cost.⁴⁵ In return, the entrepreneurs agreed to use a U.S.-based union company to lay the cable, to purchase most components from union manufacturers, and to employ union seafarers and maritime

Capital Fund, *Confidential Update*, June 30, 1998; and from the author's interview with Michael Steed, *supra* note 37.

⁴⁴ Separate Account P does not invest in start-ups, which are considered more risky, but only in more established private companies with proven business models and profitability, according to Steed and Kennedy.

⁴⁵ Steven Lipin, "Investors Find Gold Mine in Global Crossing Stock," *The Wall Street Journal*, March 19, 1999, p. C1. The company's value and employment may soon be substantially greater. In March Global Crossing announced an agreement to use its stock as currency to acquire Frontier Corp., the nation's fifth largest long-distance telecom carrier. If completed, Global Crossing will be a major player in Internet commerce, with a market value of \$30 billion and 8,500 employees. Mike Mills, "Two Telecom Powers to Merge: Global Crossing Buys Frontier Corp.," *The Washington Post*, March 18, 1999, p. E1. In April, 1999, ULLICO also achieved a huge gain on its investment in Value America, an Internet shopping service, when that two-year old company completed its initial public offering. Jerry Knight, "Value America Stock Soars in Initial Offering," *The Washington Post*, April 9, 1999, p. E3.

officers on the construction rigs.⁴⁶ Steed estimates that the cable construction alone has employed 1,500 IBEW and CWA members — with more to come as ULLICO maintains its stake in this rapidly growing company.

- ***Omni Facility Resources, Inc.:*** One of the most profitable business strategies in the 1990s is the “roll-up,” whereby holding companies consolidate fragmented industries (e.g., office supply stores, funeral homes) by buying up smaller and less efficient businesses. As both an investment and as an organizing tool, there may be few opportunities as promising as a company that rolls-up dozens or hundreds of small shops into one large and more profitable network. Omni rolls up small facilities maintenance firms, which do janitorial and landscaping work on a contract basis. As a term and condition of ULLICO’s \$7.5 million investment, Omni agreed that all of its current and acquired workforce would be covered by neutrality and card check agreements. Steed said this should facilitate efforts by SEIU to organize thousands of maintenance workers as subsidiaries are acquired.
- ***Newport News Ship Building:*** Separate Account P’s first deal invested in the construction of five environmentally-safe double-hulled oil tankers at a total cost of \$280 million. ULLICO’s \$10 million equity stake gave it enough leverage to achieve an agreement that the ships would be constructed in the U.S. at one of the nation’s few remaining union shipyards, providing work for 12,000 steel workers over a 28-month period. In addition, the firms that would operate the ships agreed to a union pre-hire agreement (allowed under the Jones Act that governs maritime trade), which guarantees jobs for 150 members of the Seafarers International Union. ULLICO exited the investment last year, recovering 100% of invested capital plus an internal rate of return of 20.4%.

“That is the abject power of private equity,” explained Steed, referring to the RSI deal as a particularly potent model. He said that as a part-owner, “through covenants, private equity investment can control the structure of 100 deals rather than investing project by project.” Steed noted that while it took ULLICO’s “J for Jobs” 30 staff last year to generate \$740 million in commitments for union-built construction, one staffer took just two months to leverage P’s \$5 million equity investment in RSI into \$450 million in construction — plus recognition agreements for more than 1,000 health care workers to be hired at those facilities. Ironically, Steed’s biggest

⁴⁶ Interview with Jim Kennedy, Vice President, ULLICO, January 25, 1999.

disappointment is that among the companies where ULLICO, as an investor, has negotiated neutrality and card check recognition, unions have only bothered to target three for organizing.⁴⁷

ULLICO's Separate Account P appears particularly well-suited for qualified pension plans subject to ERISA. First, while LPs are typically illiquid during their typical 10-year lifespan, "P" operates as an open-ended group annuity contract, which has two advantages. It allows investors to exit at any point at a unit price that is revalued monthly; and it allows the fund to operate indefinitely, freeing it from the early-cycle fundraising and late-cycle forced liquidations that burden fixed-term LPs. Second, as an open-end fund, "P" can be "opportunistic" and make a wide variety of investments, including direct placements and investments in LPS, as well as in post-venture public stock offerings.

Third, as an insurance company pooled separate account, ULLICO's "P" enjoys a class exemption from most ERISA prohibited transaction constraints, similar to the exemption that applies to other qualified private asset managers (QPAMs).⁴⁸ Since fiduciary duty can be completely delegated to a qualified asset manager, the trustees need only perform due diligence in the initial hiring and monitoring of the manager; liability for specific investments made by the trust lies with the manager. Investors are sheltered from unrelated business income taxation (UBTI); the trust is responsible for filing and paying taxes on any UBTI.

Finally, direct investing puts union-oriented professionals at the table with leverage as the deal is structured. In contrast, when a pension fund invests in a conventional limited partnership, or in a fund of such investments (a "fund of funds"), discretion is delegated to the general partner and it is difficult for the pension fund to influence the terms of individual deals. The exception might be a vehicle like the Carpenters' new "fund of funds," describe below, where the manager is acutely aware that the investors are all union-affiliated and share a concern for extra-portfolio outcomes.

⁴⁷ Interview with Steed, *supra* note 37.

⁴⁸ Prohibited Transaction Class Exemption 90-1 (insurance company pooled separate accounts), 55 Fed. Reg. 2891 (Jan. 29, 1990). When pension trustees delegate investment authority to a "qualified private asset manager" (QPAM), as defined by ERISA, the underlying investments within a commingled fund are exempt from many rules prohibiting transactions with potential conflicts of interest, such as transactions that benefit "parties in interest," including participating employers, services providers and fiduciaries.

Carpenters' Limited Partnership 'Fund of Funds'

While ULLICO's pooled account makes *direct* private equity investments, more than 80% of the record \$85 billion invested in the private equity market last year flowed through specialized intermediaries, nearly all of which are organized as limited partnerships, or LPs.⁴⁹ As explained above, limited partnerships typically have a 10-year life and specialize by type of transaction (viz., buy-outs, venture capital, distressed companies) and often by industry and geographic region as well.

A "fund of funds" is a professionally-managed pool of investments in other LPS, as a limited partner. In 1998 commitments to funds of funds soared 138%, to \$9.6 billion, as 30 new funds were formed.⁵⁰ Working with Hamilton Lane Advisors of Philadelphia, which specializes in alternative investing, the United Brotherhood of Carpenters' Strategic Investment Council has fashioned its own fund of funds — the **Hamilton Lane/Carpenters' Partnership Fund, L.P.** The fund's initial closing was March 9, with approximately \$225 million in commitments from various UBC-sponsored Taft-Hartley plans.⁵¹

The most obvious advantage of a fund of funds format is diversification across a number of different LPS, investment types, industries and regions. While some large pension plans achieve a similar diversification by assembling their own portfolio of LP investments, considerable in-house expertise (or a specialized advisor, such as Hamilton Lane) is needed to identify, evaluate, negotiate and monitor LP investments on a continuous basis. This may be impractical or uneconomical, particularly for a small pension fund.

In contrast, the manager of a fund of funds brings experience and economies of scale to these functions, while achieving a greater degree of diversification. A fund of funds can put more assets to work more quickly, since due diligence focuses on identifying proven "deal teams" rather than on the more arduous task of identifying, evaluating and negotiating investments in

⁴⁹ *The Economics of the Private Equity Market*, *supra* note 28, chapter 1. The Federal Reserve Staff Study estimated that of the \$100.4 billion in private equity holdings at the end of 1994, \$82 billion was invested through LPs and less than \$19 billion was invested directly.

⁵⁰ *The Private Equity Analyst*, *supra* note 30, at 60.

⁵¹ Funds are often raised in several stages, referred to as "closings." The Carpenter fund has a goal of raising \$500 million, according to the union's general counsel, John De Carlo.

individual companies. Also, just as “deal flow” (access to non-public information about high-quality investment opportunities) is crucial to the success of individual LPs, an advisor such as Hamilton Lane has the extensive contacts and credibility to access exclusive partnership opportunities.⁵²

A second advantage of the Carpenter LP model, compared to direct private placements, is that by delegating fiduciary control to a qualified plan asset manager (QPAM), the fund is less constrained and the pension trustees are more insulated under ERISA.⁵³ Trustees completely delegate their fiduciary duty to the fund manager with respect to the selection and monitoring of specific LP investments.⁵⁴ Of course, trustees must still perform due diligence in selecting the fund of funds manager and in monitoring the fund’s performance from period to period.

Unlike most LPs and funds of funds, by joining together Carpenter-sponsored pension funds had the leverage not only to select a union-friendly investment manager, but also to negotiate favorable terms that give the fund a risk-and-return advantage compared to comparable vehicles. First, the Carpenter group negotiated a favorable fee structure that aligns incentives in favor of the pension investors. Hamilton Lane will receive a relatively low annual management fee of 0.5% of invested assets (reduced to 0.4% after 5 years), plus 8% of net profits only after the limited partners receive a 10% annual return⁵⁵. At the same time, Hamilton Lane will be at risk with a 1% equity investment.⁵⁶

⁵² Interview with Luther Jones, Managing Director, Hamilton Lane Advisors, Feb. 10, 1999.

⁵³ The advantages are similar to those described above with respect to ULLICO’s commingled account. (See *supra*, note 48). Perhaps most critically, from a trustees’s perspective, investing through a qualified asset manager is a protected delegation under ERISA because the commingled fund’s underlying assets are not considered to be plan assets. This allows the partnerships to invest without regard to most ERISA restrictions. A Taft-Hartley plan investing directly in LPS can achieve this result — without the extra layer of management involved in a fund of funds — but only if each individual partnership qualifies as a venture capital operating company, or if employee benefit plans represent less than 25% of the equity in the partnership. (See 29 C.F.R. section 2510.3-101(a)(2)(ii)). In 1980 the Department of Labor granted private equity partnerships a “safe harbor” exemption from plan asset restrictions if they qualify as *venture capital operating companies* (VCOCs). To qualify, partnerships must not have more than 100 investors and must actually exercise contractual management rights over one or more of the operating companies or LPS in which it invests. See, e.g., William M. Mercer, Inc., “Key Terms and Conditions for Private Equity Investing,” a study commissioned by eight large public pension funds (1996), at www.calpers.ca.gov/invest/keyterms/keyterms.htm.

⁵⁴ Interview with John DeCarlo, General Counsel, United Brotherhood of Carpenters, Feb. 25, 1999.

⁵⁵ Hamilton Lane-Carpenters’ Partnership Fund “Presentation,” *supra* note 32, at 28.

⁵⁶ Interview with DeCarlo, *supra* note 54.

Second, the Advisory Committee selected by the limited partners, all of which are Carpenter pension funds, can remove the manager (Hamilton Lane) by majority vote. Third, the investors negotiated a special covenant that allows the pension fund investors to “opt-out” of any fund investment they object to on policy or other grounds.⁵⁷ In general, the ability of limited partners to negotiate special covenants that restrict the discretion of the general partner is quite common,⁵⁸ although its use by the Carpenters to influence the collateral impact of the fund’s investments is unusual and potentially powerful.⁵⁹

Corollary Benefits More Difficult to Achieve

Although the fund of funds approach is perhaps the easiest way to persuade risk-averse trustees to join corporate and public pension funds on the new frontier of private equity investing, it also presents severe limitation compared to the ULLICO direct investing model. First, the two layers of partnerships together could consume as much as 30% of gross returns in fees and expenses.

Second, the pension trustees’ influence over the pursuit of collateral benefits is more indirect and diluted in a fund of funds. For example, an intermediary like ULLICO can negotiate *directly* with companies it invests in for concessions that confer collateral benefits (such as neutrality or card check recognition). In contrast, the manager of a fund of funds is taking at most a 10% stake as a limited partner in funds where *other managers* have investment discretion. Unless those other partnerships have substantial and coordinated Taft-Hartley participation, it will be extremely difficult to achieve the kind of collateral benefits that could be achieved using a direct investment approach. At a bare minimum, union-oriented investors in a fund of funds should ensure that the fund manager will, before investing, insist on covenants that allow the fund to opt out of any anti-union investments made by the LPs in which it invests.⁶⁰

⁵⁷ *Ibid.*

⁵⁸ See *The Economics of the Private Equity Market*, *supra* note 28.

⁵⁹ Interview with DeCarlo, *supra* note 54.

⁶⁰ Interview with Steed, *supra* note 37.

CIGNA America Fund: Private Placement Bonds

Insurance companies have historically financed a disproportionate share of the private placement debt market. Companies that either cannot, or prefer not to, float a public bond issue will instead borrow directly from life insurance companies and other institutional investors. CIGNA currently manages \$15 billion in private placement debt, of which \$250 million resides in a separately-managed account for Taft-Hartley plan investors. That account targets loans to “U.S.-based operations to maintain and create jobs and provide capital to union employers.”⁶¹ Since 1994 the Fund has made loans to more than 50 companies with at least a 25% unionization rate, or which were borrowing to finance a union-built construction project. IBEW-sponsored funds were the initial investors and account for roughly half the Fund’s assets.

The **CIGNA America Fund** seeks a balance between the higher yields generated by private placement bonds and the liquidity offered by publicly-traded corporate and Treasury issues. At year-end 1998, the Fund had approximately two-thirds of its assets in private placement bonds and one-third in U.S. Treasuries, public corporates and cash equivalents. According to the Fund, its annualized total return since inception is 9.4%, compared with a 8.9% average return on the benchmark Lehman Government/Corporate Bond Index.⁶² The fund has achieved an average 50 basis point (0.5%) spread over high-quality corporate bonds, while limiting risk by shunning issues below investment grade (i.e., junk bonds).

Although the targeting of expansion capital to unionized employers represents a collateral benefit, it is unclear whether CIGNA would have done anything different in the absence of this fund. Since the Fund represents less than 2% of CIGNA’s private placement debt portfolio, more than one union official voiced the suspicion that the Fund may simply be a subset of loans the insurance giant would have made with or without a Taft-Hartley marketing vehicle. CIGNA, however, insists that the Fund’s existence prompts the insurer’s team of analysts to more aggressively seek out unionized employers needing capital.⁶³

⁶¹ CIGNA America Fund *Review*, January, 1999.

⁶² *Ibid.*

⁶³ Interview with John M. Depenbrock, Senior Vice President-Multi-Employer Market, CIGNA Retirement & Investment Services, Feb. 23, 1999.

Roofers Loan Fund: Linked-Deposit Certificates of Deposit

Linked-deposit loan programs are a very low-risk but seldom used approach to alternative investing. Pension funds typically have a portion of their fixed-income allocation invested in very short-term bonds or “cash reserves,” including money market and bank certificates of deposit. Bank CDs pay relatively low interest, but are super-safe because the Federal Deposit Insurance Corp. (FDIC) guarantees CDs against default up to \$100,000 per plan participant. More than a decade ago two Boston-based building trades locals formed the Bricklayers and Laborers Non-Profit Housing Co. (B&L) to pioneer the concept of “development deposits.” The two multi-employer funds initially invested \$6.5 million in bank CDs at the U.S. Trust of Boston, while a local public pension fund deposited \$20 million. In return the bank agreed to make reduced-rate loans to finance low-income housing projects built with union labor.⁶⁴

A new variation on this theme is the “targeted CD” program by a California multi-employer fund sponsored by the Roofers union.⁶⁵ In exchange for the pension fund’s \$2 million deposit in a CD, the bank finances low-interest loans to consumers for the purpose of replacing or repairing their roof, provided they hire an approved union contractor.

Like the Carpenters’ *ProLoan* mortgage program described just below, the Roofers’ program benefits all parties. The pension fund gets a risk-free return at market rates. Consumers get a more affordable loan. The bank shoulders the risk of making home improvement loans and earns a spread between what it pays the fund and what it charges consumers. And both plan participants and signatory contractors realize extra wages, profits and plan contributions as the fund’s deposits flow back into the community to pay for the repair or replace roof using union

⁶⁴ “Pension-Backed Housing Expands,” *Labor & Investments* (vol. 7, no. 8), October 1987. For a description of several other targeted CD programs by church groups in Brooklyn, and by public pension funds in Colorado and Pennsylvania, see Jayne Elizabeth Zanglein, *High Performance Investing: Harnessing the Power of pension Funds to Promote Economic Growth and Workplace Integrity*, 11 THE LABOR LAWYER 59, 72-74 (1995).

⁶⁵ Kirsten Snow Spalding and Elizabeth C. Rudd, *Culture Clash: Labor’s Economic Agenda and Taft-hartley Trustees’ Interpretation of ERISA*, Berkeley Center for Labor Research and Education, Institute of Industrial Relations (Oct. 1998), at 45. The specific multi-employer pension fund involved is not identified in the Berkeley case study.

contractors. The Roofer fund's primary investment manager — McMorgan & Company — has delegated fiduciary responsibility to structure and monitor the program.⁶⁶

ProLoan: Builders Fixed Income Mutual Fund

One of the most innovative and low-risk alternative investment programs is the **Builders Fixed Income Fund** and its *ProLoan* residential lending and organizing program. The Builders Fund is a publicly-traded mutual fund (ticker: PRLNX) that invests at least 65% of its assets in investment-grade bonds, including at least 30% in mortgage-backed securities issued and guaranteed by Ginnie Mae, Fannie Mae and Freddie Mac.⁶⁷ The Fund's *ProLoan* program coordinates with participating home builders and lenders to ensure that the mortgages pooled by the Fund finance only new home construction and complete renovations built with 100% union labor.⁶⁸

From a fiduciary perspective, the Builders Fund is an alternative to a conventional core fixed-income allocation, since it is managed to mirror the risk and return characteristics of the Lehman Aggregate Bond Index. While the Fund puts 33% of its assets into mortgage-backed securities that finance new home construction, two-thirds of its assets are in U.S. corporate, Treasury and other conventional bonds with an average credit quality of AA1. Since its inception in October, 1997, the Fund has almost precisely tracked the 7% return of the Lehman Mortgage-Backed Securities Index.⁶⁹

⁶⁶ *Ibid.* The Roofers' linked-deposit loan program is just one of a number of mechanisms by which McMorgan & Company, a union-oriented professional money manager, coaxes and coordinates building trades multi-employer plans in California to boost their investment in local union-built construction. For a case study describing the Roofers' fund and the critical role that McMorgan & Co. plays in shaping a pro-union investment strategy, see *id.* at 46-48.

⁶⁷ HUD's Federal Housing Administration guarantees mortgages on qualified low-income housing. The Government National Mortgage Association (GNMA) packages these mortgages into securities (bonds) with a guaranteed fixed-income stream and sells them to investors. The Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) are federally-created entities, now privately operated, that likewise purchase, securitize and insure repayment on pools of qualifying mortgages purchased from private lenders nationwide. By pooling the mortgages and arranging to repurchase them as securities issued by these guarantee agencies — rather than holding individual mortgages — ProLoan (like the AFL-CIO Housing Investment Trust) virtually eliminates the risk of default.

⁶⁸ Builders Fixed Income Fund, *Prospectus*, January 29, 1999, at 3.

⁶⁹ *Id.* At 5.

The Builders Fund currently has \$150 million in assets, all from Carpenter-sponsored pension funds, which will generate between 500 and 600 union-built housing starts annually in St. Louis, Detroit, Chicago and southern Illinois. The Fund's goal is \$1 billion in assets within two years, which would finance more than 2,000 new homes and more than two million man hours within the jurisdictions of the pension funds investing in the program.⁷⁰ To expand its impact, the Fund hopes to extend the program to additional jurisdictions and, once a track record is established, to seek investments from other building trades and public plans in those areas.⁷¹

Extra Benefits: The ProLoan Organizing Program

The Builders Fund grew out of a similar program initiated by the St. Louis Council of Carpenters multi-employer pension fund more than a decade ago. The St. Louis Carpenters fund at one point had virtually its entire fixed-income allocation in the Fund, but has cut back to 50% of its bond allocation — a level the Fund recommends to other Carpenter plans.⁷²

Both the Builders Fund, in its marketing materials, and the union are extremely direct about their efforts to generate extra benefits for plan participants and contributing employers on top of a market-rate core fixed income return. “It’s a residential organizing tool,” explains Scott Hartzell, the Fund’s managing director. He noted that the St. Louis Carpenters have been able to double the union-built share of the new home construction market, pushing it up to 80% since the program began, compared to a 5% average nationwide. Once the *ProLoan* program becomes a critical mass in the local market for new home lending, he said, developers and builders suddenly become very interested in participating — the price of which is union pre-hire agreements.

ProLoan forms an on-going partnership with selected mortgage lenders, developers and contractors within a geographic area where Carpenter funds have made a minimum \$50 million commitment. The Fund guarantees participating lenders (typically banks) that it will buy conforming mortgages on a when-issued basis. Consumers are attracted by the unusual six-month rate lock and “float down” feature, which protects the new home buyer against rising interest

⁷⁰ Builders Fixed Income Fund, *ProLoan Program*, marketing presentation (1998).

⁷¹ Interview with Scott Hartzell, Managing Director, ProLoan/Builders Fixed Income Fund, Feb. 19, 1999.

⁷² *Ibid.*

rates even as it promises savings if rates fall during construction.⁷³ Since prospective home buyers are approved only if their builder is union-approved, non-union contractors see that the special mortgage program is giving union contractors a competitive advantage. The local Carpenter Councils actively helps participating developers and builders win business by making *ProLoan* marketing material, and even union reps, available at model home sites to tout both the financial advantages and the quality craftsmanship associated with building union.⁷⁴

AFL-CIO Housing Investment Trust: Mortgage-Backed Securities

Founded in 1964, the AFL-CIO Housing Investment Trust (HIT) is the grand daddy of labor-sponsored investment vehicles. With total assets of \$2 billion, HIT is also the largest, most visible and least risky of the alternative investment vehicles that generate extra benefits for pension beneficiaries and their local communities. The Trust invests primarily in mortgage-backed securities that are issued and guaranteed by the federal government or by government-sponsored entities, such as Ginnie Mae, Fannie Mae and Freddie Mac.⁷⁵ More than 400 pension funds own unit shares. Funds typically place HIT within the fixed-income portion of their portfolio, alongside Treasury bonds or other mortgage-backed securities, since investments in HIT are fully liquid and have virtually no credit risk because most of the highly diversified portfolio is backed by government guarantees.

Although the assets ultimately owned by HIT are similar, with respect to risk and return, to the mortgage-backed securities routinely held by corporate pension funds, or for that matter, by individuals in GNMA fixed-income mutual funds, HIT plays a very different role. While other institutions typically purchase pre-existing securities that trade on public secondary markets, HIT functions like a developer in structuring deals that originate mortgages, which it

⁷³ *Ibid.* While other lenders charge a steep fee for this feature, the Fund's long time horizon, high volume and low overhead allows it to economically hedge the risk with "out of the money" puts, according to Hartzell. *Supra* note 71.

⁷⁴ *Ibid.*

⁷⁵ See the discussion at *supra* note 67. FHA loans account for nearly half of HIT's portfolio, with Fannie Mae, Ginnie Mae and Freddie Mac securities accounting for the rest. Gregory Sandler, "HIT Puts the Union Label on America's Housing," *Multifamily Executive*, May 1997, at 56.

then arranges to securitize through special partnerships with guarantee agencies such as Fannie Mae.⁷⁶

A Double-Dose of Corollary Benefits

HIT specializes in building low-income and affordable housing that is also built with 100% union labor. By playing the role of developer in the highly-technical area of government-subsidized housing, HIT's deal team is able to generate both types of corollary benefits while significantly out-performing industry benchmarks.⁷⁷ The complexity, unpredictability and labor-intensity of packaging deals using state and federal subsidies and loan guarantees creates a niche that HIT has been able to exploit to produce both market-beating low-risk yields *and* double-edged social benefits.

“There is a whole catechism you need to know in order to access public finance,” explains Steve Coyle, HIT's CEO. HIT's expertise in structuring projects that leverage public financing are particularly important because it often invests in relatively high-risk inner-city and poor rural areas.⁷⁸

In 1994 Coyle, a former HUD official, engineered HUD's National Partnership for Community Investment, which used federal Section 8 rental subsidies to leverage pension and private investment. HIT made about \$60 million in loans under the program, leveraging \$240 million in total construction of affordable housing.⁷⁹ HIT's new “Urban Investment 2000” program — a partnership with HUD, Fannie Mae, foundations, cities and state housing agencies — will target \$1 billion in HIT and BIT investment over the next five years to promote home

⁷⁶ Interview with Walter Kamiat, HIT/BIT General Counsel, Jan. 26, 1999. For example, HIT and Fannie Mae have an on-going joint initiative to finance up to \$400 million in multi-family affordable housing built with 100% union labor over a five-year period. See AFL-CIO Housing Investment Trust, *HIT-Fannie Mae Joint Initiative: Financing Multi-Family Affordable Housing* (HIT: 1998).

⁷⁷ According to HIT financial statements, the trust has outperformed both the Salomon Mortgage Index and the Lehman Aggregate Bond Index over the past 1, 3, 5 and 10 year periods by a significant margin. HIT's total gross rate of return for the year ending last June 30 was 11%, exceeding the Salomon Mortgage Index (8.9%) by 2%. Over the trailing 5-year and 10-year periods, the trust eclipsed both industry indices by more than 1% annually on average. (AFL-CIO HIT, *Semi-Annual Report, June 30, 1998*). HIT's total expenses have fallen to 39 basis points (0.39%) due to economies of scale, its non-profit charter and the fact that its professional staff are compensated at below-market rates because of their commitment to the Trust's goals, according to HIT Vice President Mike Arnold.

⁷⁸ Sandler, *supra* note 75, at 57.

ownership, low-cost rental housing production, economic development and neighborhood stabilization in 14 or more targeted cities. In addition to generating extra wages and pension contributions for union plan participants, the Trust's identification with the AFL-CIO also boosts Labor's image and relationships with community leaders.⁸⁰

Like the other union-built real estate funds profiled here, HIT attempts to target much of its investment back into the jurisdictions of its multi-employer and public pension plan investors. The trust's \$400 million in new commitments last year will generate at least 5 million work hours for union members, assuming its job generation rates are similar to ULLICO's. In February, 1999, HIT's board of directors adopted an expanded union-only policy directing the staff to demand that the owner-operators of nursing homes, hotels and other facilities financed by HIT or BIT agree to neutrality and card-check recognition with respect to future employees.⁸¹

Boilermakers' Co-Generation and Infrastructure Fund: Project Finance

One of the most sophisticated and successful alternative investment programs initiated by a Taft-Hartley pension plan is the **Boilermakers' Co-Generation and Infrastructure Fund**. Managed by the Trust Company of the West (TCW), the Fund uses a project finance model to co-invest in the construction of power generation plants that are then leased or sold to independent power producers, industrial companies or the government. Over its nearly 12-year history, the Boilermakers' Fund has invested \$450 million in 30 projects, achieving a 15% annual rate of return over the life of the Fund, while generating an estimated 1.4 million hours of work for plan participants.⁸²

Although the Fund's 15% average internal rate of return over the last 12 years would be market-rate for an *equity* fund, the Boilermakers' Fund takes less risk because it provides just the senior or subordinated debt slice of each project financing. One reason the Fund can take less risk — and ensure that the project employs union boilermakers — is that it usually takes the lead in

⁷⁹ *Ibid.*

⁸⁰ Interview with Mike Arnold, Vice President and director investor relations, HIT, Feb. 11, 1999.

⁸¹ *Ibid.*

⁸² Interview with Dave Hanson, Chief Investment Officer, Boilermakers & Blacksmiths National Pension Trust,

structuring the deal thanks to its track record and the expertise of the management team. TCW typically syndicates the deal, investing alongside major banks, insurance companies and other private investors.⁸³ By co-investing the Fund adds diversification, reduces risk and demonstrates that the private market regards the projects as good investments regardless of the covenants requiring union labor.

The \$5.6 billion Boilermakers & Blacksmiths National Pension Trust is the sole investor in the Fund. Its current investment is \$200 million, or 4% of assets, with latitude to go up to 8%.⁸⁴ TCW maintains that as the fund's reputation has grown, so has its ability to put more money to work. Although the Fund could be opened to other pension investors, the trustees have hesitated to do so because of potential conflicts over work rules or jurisdiction if the investments were commingled with other building trades.⁸⁵ Another option under consideration is a clone fund that could be managed by TCW with an emphasis on jobs for other trades. From a labor movement perspective, this would take greater advantage of the "deal flow" and expertise that the Boilermakers have built up at TCW.

Corollary benefits generated by project finance can be tightly targeted to plan participants. Because the Boilermakers pension trust is a *national* fund, the Fund can target projects that generate hours for members and still achieve geographic diversification. The estimated 1.4 million man hours generated to date represents a substantial extra benefit because the trust's benefit formula is based strictly on hours worked. Thus, extra hours represent not just extra wages, but also extra current income to the trust and higher retiree benefits for participants in the future.

Longview Ultra I Construction Loan Investment Fund

Amalgamated Bank of New York, the union-owned bank controlled by UNITE, is currently recruiting investors for its own distinctive entry: the **Longview Ultra I Construction**

Feb. 26, 1999.

⁸³ Interview with Brian Daly, Trust Company of the West, Feb. 10, 1999. Daly manages the Fund at TCW in New York City.

⁸⁴ Interview with Hanson, *supra* note 83.

Loan Fund. The fund will invest primarily in construction loans for new office buildings, shopping centers, hotels, industrial/warehouse and multifamily residential properties. Unlike the permanent, post-construction mortgages held by ULLICO's Account "J for Jobs," or the Carpenters' Mortgage-Plus Fund (described below), the Longview Ultra Fund will provide relatively short-term loans of one to two years that finance the acquisition, development and construction of new properties built with union labor.⁸⁶

In terms of collateral benefits, this model has two advantages over permanent mortgage funds. First, the Longview Ultra Fund's loans turn over far more frequently, allowing the same pension assets to finance far more new construction over a five- or 10-year period. Second, since acquisition and construction financing carries higher risks and requires greater expertise by the lender, it is valued more highly by developers and contractors. By getting in literally at the "ground floor" by supplying scarce up-front financing, Amalgamated Bank expects to achieve both market-rate returns and the leverage to insist on collateral benefit concessions.

UFCW's Shopping Center Mortgage Loan Program

Despite \$20 billion in jointly-trusted pension assets, the United Food and Commercial Workers (UFCW) has found it difficult to target corollary investment benefits to a membership that works primarily in the retail service sector. One innovative effort by UFCW locals in Southern California allocates \$100 million to finance construction loans and first mortgage financings for developers (or unionized employers) who agree to include a unionized supermarket as the anchor tenant in new shopping centers or strip malls. To date approximately \$65 million has been loaned out by AMRESO Advisers, a respected real estate investment management firm that has been delegated fiduciary duty to manage the allocation.⁸⁷

According to an agreement reached during collective bargaining with the Food Employers Council, the purpose of the real estate allocation is to achieve a positive yield spread over

⁸⁵ Interview with Daly, *supra* note 84.

⁸⁶ Amalgamated Bank, Longview Ultra I Construction Fund, *Disclosure Statement* (1999) and interview with Ron Luraschi, Senior Vice President, Pension Trust Dept., Amalgamated Bank of New York, Feb. 18, 1999.

⁸⁷ Interview with Dave Barry, Chairman, Retail Food Industry Joint Labor-Management Committee, UFCW, March

comparable fixed-rate debt instruments, while facilitating new shopping centers that include participating employers as tenants. The union maintains that in addition to securing a prime location for new stores that would create jobs and pension contributions for union plan participants, the program simultaneously helps to deny those locations to non-union chains that would undercut union wage and benefit levels.⁸⁸

AFL-CIO Building Investment Trust: Real Estate Debt and Equity

HIT's sibling, the AFL-CIO Building Investment Trust (BIT) is a pooled unit trust that invests in institutional quality commercial properties built with union labor. The fund is structured with an unusual degree of flexibility to make both debt and equity investments. Although roughly 80% of BIT's new commitments are equity investments, which involve the ownership of real property, its \$800 million portfolio also includes construction loans and permanent mortgage financings. Since its inauguration in 1988, BIT's combination of debt and equity has worked to minimize volatility, while generating steady market-rate returns between 9 and 10% annually. Returns have remained remarkably stable at that level despite the substantial decline in inflation and in interest rates over the past five years.⁸⁹ And because BIT operates on a non-profit basis, its management and administrative fees are among the lowest in the industry.

BIT's flexibility to make construction loans has proven a boon to its ability to generate, and to geographically target, the corollary benefits that flow from union-built construction. BIT's dual role as a lender and equity investor allows it to identify more deal opportunities. Developers seek out BIT because they can realize significant transaction savings by arranging both construction and permanent financing through a large and very experienced investor like HIT/BIT.⁹⁰ By increasing deal flow, BIT is better able to both diversify by property type (viz., office, industrial, retail) and to target high-quality projects within the jurisdictions of participating pension funds. HIT/BIT staff attribute the Trusts' increasing penetration into

9, 1999.

⁸⁸ *Ibid.*

⁸⁹ AFL-CIO BIT, *Semi-Annual Report*, June 30, 1998.

⁹⁰ Interview with Mike Arnold, *supra* note 80.

historically non-union cities such as Dallas, Jacksonville and Atlanta — working with previously non-union contractors — to BIT’s ability (unlike a mortgage fund) to become a valued partner in a project from the outset by providing construction financing.⁹¹

Multi-Employer Property Trust: Real Estate Equity

The Multi-Employer Property Trust (MEPT) is one of the largest and top-performing open-end real estate equity funds in the nation. MEPT acquires, owns and holds income-producing commercial properties including office buildings, warehouses, shopping centers and multi-family housing. All of its projects represent 100% union-built new construction “that create economic activity and jobs in areas where beneficiaries of participating pension plans live and work.”⁹²

The trust ended 1998 with 135 participating pension plans and \$1.75 billion in net assets. Its investment performance has consistently exceeded industry benchmarks over the past four years. In 1998, MEPT returned 13% (net of all fees), topping its 10.7% return in 1997.⁹³ MEPT has also out-performed all but one of the other 20 largest open-end commingled real estate equity funds over the past 10 year period, despite having the lowest risk-rating.⁹⁴ Riggs Bank of Washington retains fiduciary responsibility for the trust’s management, which is directed by Kennedy Associates, a real estate and securities advisory firm based in Seattle.

MEPT puts a premium on targeting extra benefits to pension plan participants and their communities. Last year it commissioned an independent study, by the respected Minnesota IMPLAN Group (MIG), to measure the non-portfolio impact of 110 of its projects in 26 metropolitan areas nationwide.⁹⁵ The study used Commerce Department input-output data to estimate the direct and indirect effects of incremental construction activity. It concluded that

⁹¹ *Ibid.*

⁹² Multi-Employer Property Trust, *1997 Year-End Report* (Dec. 31, 1997), at 8.

⁹³ MEPT, *Trust Report*, Jan. 1999.

⁹⁴ MEPT, *1997 Year-End Report*, *supra* note 92, at 12.

⁹⁵ Minnesota IMPLAN Group, *The Impact of Multi-Employer Property Trust Investments Across the United States*, Prepared for MEPT (July 8, 1998).

from MEPT's inception in 1982 through the first quarter of 1998, the trust's investments have generated:

- 18.7 million hours of work for Building Trades members across the country;
- \$390.4 million in personal income for Building Trades members;
- \$58.6 million in pension contributions paid back into union-sponsored pension funds, the lion's share going back into Building Trades funds that invest in MEPT;
- \$2.9 billion in total economic output in those 26 metro areas, stimulating a total of 60 million work hours in all industries and paying total compensation of \$1.1 billion

MEPT's management team is also raising capital for a new closed-end Real Estate Investment Trust (REIT) that will make equity investments in union-built properties.

ULLICO's Account "J For Jobs": Commercial Mortgages

The Union Labor Life Insurance Company's **J For Jobs** mortgage account is, along with the AFL-CIO Housing Investment Trust, one of the oldest and largest union-oriented alternative investment funds. J For Jobs is a pooled real estate debt fund designed to provide multi-employer pension funds with a nationally diversified portfolio of high-quality mortgage loans on income-producing properties. The fund yields the added benefit of financing new construction or renovation projects built 100% union, generating substantial jobs and hours targeted to benefit investing plan beneficiaries on a "best efforts" basis.⁹⁶

At year-end 1998, J For Jobs had a total market value of \$1.1 billion. Most of J's 110 holdings are first mortgages against income-producing commercial and multifamily properties. According to the fund's most recent audit, 45% of the mortgage portfolio is secured by office buildings, 31% by shopping centers, 10% by industrial buildings and about 10% by apartment buildings.⁹⁷

⁹⁶ Interview with Jim Kennedy, Vice President, ULLICO, Jan. 25, 1999.

⁹⁷ ULLICO, *Separate Account J: Report on Audits of Financial Statements*, two years ended Dec. 31, 1997.

Net assets increased by 21% in 1998 alone, half of which came from new investors attracted by the fund's market-beating income yield, which is between 2% and 4% greater than alternative fixed income vehicles.⁹⁸ Last year the account posted a gross return of 11.6%, outpacing the Lehman Aggregate Mortgage Index by 2.9%.⁹⁹ The fund's total return consisted of a 9% income yield plus capital appreciation of 2.5% (due primarily to falling interest rates).

Targeted Corollary Benefits

Although J For Jobs takes the relatively conservative approach of holding permanent (long-term) mortgages, it still ensures a substantial flow of new union-built construction. ULLICO implements its union construction policy by requiring borrowers to sign a "certification of union construction" covering all contractors and subcontractors. ULLICO then contacts the local building trades council and verifies that the builders are signatory to collective bargaining agreements before locking in its forward commitment to provide permanent mortgage financing.¹⁰⁰

In 1998, the J account issued 25 new loan commitments, totaling over \$735 million in project financings. ULLICO estimates that these new commitments alone will generate an additional 15 million hours of union construction work.¹⁰¹ Over the past three years, ULLICO estimates that the J account's \$1.5 billion in new loan commitments will create at least 21,000 construction jobs. Since Union Labor Life seeks to make mortgage loans on new construction within the geographic jurisdiction where pension investor participants are actually employed, a high proportion of the fund's activity confers extra benefits directly on plan participants, while simultaneously strengthening plan sponsors.¹⁰²

⁹⁸ Interview with Kennedy, *supra* note 96. Commercial mortgage loans typically provide higher yields than publicly-traded bonds. In 1997, prime commercial mortgages yielded an average 160 basis point spread (1.6%) over 10-year Treasury bonds and a 55-point spread over AAA-rated corporates. Commercial mortgage loans also tend to be less sensitive to interest rate fluctuations, since they frequently call for adjustable rates, and reduce prepayment risk by imposing penalties. See General American, Commercial Mortgage/Plus Fund, *Prospectus*.

⁹⁹ ULLICO, *Overview: Mortgage Separate Account "J for Jobs,"* Jan. 1999.

¹⁰⁰ *Ibid.*

¹⁰¹ Interview with Steed, *supra* note 37.

¹⁰² Interview with Kennedy, *supra* note 96.

Carpenters' Commercial Mortgage/Plus Fund

The St. Louis-based **Commercial Mortgage/Plus Fund** is similar to ULLICO's J account, except that it targets smaller commercial projects, such as strip malls, office buildings and industrial sites. In 1997, about the same time that the St. Louis Council of Carpenters allowed *ProLoan* (described above) to expand into a geographically diverse mutual fund, they decided to target a new market segment that tends to go non-union in most areas — small commercial projects.

The Carpenters' logic is that in good union towns like St. Louis, Chicago and Detroit, the big downtown projects in the \$30 to \$100 million range tend to go union no matter how the financing gets done. But small retail and industrial construction in the \$1-to-\$5 million range frequently is built non-union.¹⁰³ So just as the Carpenters financially colonized the St. Louis residential market with *ProLoan*, they are beginning to influence the small commercial construction market with Mortgage/Plus.

Mortgage/Plus opened 18 months ago and currently has \$35 million invested in commercial first mortgages based on forward commitments. It is managed by the General American Mortgage Company, the mortgage investment specialist that managed *ProLoan* during its first decade as a private pooled fund. The fund's gross return in its first full year was 9.2% (8.4% net of expenses). The Laborers Fund for central Illinois has also become an investor. The fund hopes to track the geographical expansion of the *ProLoan* fund, which would improve diversification and liquidity as the fund grows larger.¹⁰⁴

Amalgamated Bank's Longview Index Funds: Active Proxy Strategies

It should not be surprising that a union-owned bank created the first stock index fund that achieves all the advantages of a "passive" index, while adding extra value using active ownership strategies. Taft-Hartley plan trustees, along with several public pension funds, have led a virtual shareholder rights revolution over the past decade that is widely-credited with making corporate

¹⁰³ Interview with Frank Tocco, Senior Regional Vice President, General American, Feb. 19, 1999.

executives and boards more accountable and more focused on adding value for the benefit of shareholders. In five years the Amalgamated Bank of New York, founded in 1923 by the Amalgamated Clothing Workers of America (and now owned by UNITE), has harnessed this new “enhanced indexing” strategy to attract some \$5 billion into its series of five “actively governed” index funds.¹⁰⁵

The Bank’s original Longview Fund, which is designed to replicate the investment performance and low costs of a conventional S&P 500 composite index, currently has more than \$3 billion in assets. Over the five-year period through Dec. 31, 1998, this LongView 500 LargeCap Index Fund has returned 24.15% annually, a bit better than the 24.07% return on the nearly identical S&P 500 Composite Index. The Bank has added three additional equity index funds that permit greater diversification by company size: the LongView 400 MidCap Index, the LongView 600 SmallCap Index and the LongView 1500 Total Market Index, which is a composite index based on the other three. According to the Bank, the gross returns on all four equity index funds slightly exceeds the return on the corresponding S&P composite index over the most recent three-year period.¹⁰⁶

Adding Value by Managing Proxy Assets

By taking full advantage of the valuable ownership rights that attach to public stock ownership, Longview Fund managers attempt to add extra value over the intermediate-to-long-term time horizon that corresponds to a pension fund’s position in a passive index trust.¹⁰⁷ The Department of Labor has repeatedly stated that ERISA requires pension fiduciaries to regard

¹⁰⁴ *Ibid.*

¹⁰⁵ Interview with Ron Luraschi, Senior Vice President, Pension Trust Dept., Amalgamated Bank of New York, Feb. 18, 1999.

¹⁰⁶ Amalgamated Bank of New York, *America’s Labor Bank*, presentation folder (1999), at tab 4. Amalgamated Bank also offers a Core Bond Index Fund which, like the Carpenters’ *ProLoan* fund, attempts to replicate the returns of the Lehman Aggregate Bond Index. It does not appear to have any specific strategy to generate corollary benefits.

¹⁰⁷ Although one or two companies may be added to or deleted from the S&P 500 index in a particular year, the composition is generally stable. Indeed, the widely-accepted efficient market theory maintains that passive indexing should yield higher returns than the average actively-managed portfolio over long periods, net of expenses. Other benefits associated with indexing include broad diversification, lower transaction costs and investment fees.

shareholder voting rights as plan assets and to manage them accordingly.¹⁰⁸ Indeed, because an indexing strategy forecloses the option of “exiting” (selling) individual stocks that perform poorly due to faulty governance, there is a strong argument to be made that active ownership strategies are a fiduciary obligation when they can be done on a cost-effective basis.

Unlike many passive index funds, the LongView funds monitor both corporate performance and corporate policies to identify companies that under perform compared to other firms in their industries due to a lack of management accountability or other governance failings. Strategies to enhance long-term shareholder value include the active voting of proxies, the initiation of shareholder proposals, organizing coalitions of other institutional investors, and communicating, by letter or in meetings, with company officials about problems the Funds have identified using fundamental analysis.

This strategy has been shown to increase returns to large public plans that pursued it on a targeted basis. A Wilshire Associates study of the so-called “CalPERS Effect” of corporate governance activism examined the performance of 62 companies targeted by the large California public employees pension fund over a five-year period. While the stock of these companies trailed the S&P 500 Index by 85% over the five-year period before CalPERS initiated shareholder activism, the same stocks outperformed the index by 54% over the following five years. This added \$150 million annually in additional returns to the fund — a return on investment far greater than the market’s return on purely passive stock holdings.¹⁰⁹ While it is far more difficult to quantify the value added to an index fund by active governance strategies, the LongView approach can only benefit pension investors since overall costs are no higher than other investors pay for a purely passive index.

¹⁰⁸ See the “Avon letter,” Department of Labor Opinion Letter (Feb. 23, 1988), *reprinted in* 15 Pens. Rep. (BNA), 391; and the “Monks letter,” Department of Labor Opinion Letter (Jan. 23, 1990), *reprinted in* 17 Pens. Rep. (BNA), 244. ERISA requires trustees to monitor investment managers to ensure that proxies are voted on a timely basis in the best interest of plan participants.

¹⁰⁹ Wilshire Associates, Inc., *Long-Term Rewards from Corporate Governance*, a report commissioned by CalPERS Board of Trustees (1994). The CalPERS Corporate Governance Program, which continues to target relatively poor-performing large companies for shareholder activism, is described at www.calpers.ca.gov/invest/corpgov/corpgov.htm.

In 1999 LongView plans to target between 20 and 25 companies for shareholder resolutions on issues ranging from poison pills, golden parachutes, equal employment opportunity, board independence and high performance workplace practices. While majority votes for shareholder proposals opposed by management remain fairly rare, in 1997 the Funds, working with UNITE and other Taft-Hartley activists, won a clear majority vote at four companies — including Columbia/HCA, J.C. Penney, Rite-Aid and Consolidated Natural Gas — demanding that companies either redeem or allow shareholder votes on poison pill anti-takeover provisions.¹¹⁰

IBEW-NECA Equity Index Fund: Focused Proxy Voting

Two years ago the IBEW established its own S&P 500 index trust exclusively for electrical industry multi-employer pension funds. The fund, which invests \$4 billion in assets for 37 plans, is primarily focused on minimizing costs. While even the largest institutional investors pay between 4 and 8 basis points for passive indexing, the **IBEW-NECA Equity Index Fund** charges just 1.5 basis points (.015%), or \$150 per million invested. It is managed by the First National Bank of Maryland, which concedes that the fund is priced to barely cover costs because it provides a business development opportunity for the Bank and its investment advisory subsidiary, Allied Investment Advisers.¹¹¹ The fund has outperformed the S&P 500 by 10 basis points (0.1%) since its inception in April, 1997.¹¹²

Although the IBEW index fund does not employ the full range of active governance strategies used by the LongView funds to enhance value, it does generate a corollary benefit by delegating proxy voting authority to the Marco Consulting Group of Chicago. Marco has developed an in-house capacity to track and analyze the impact of corporate proxy issues and generally follows the AFL-CIO's Proxy Voting Guidelines.¹¹³

¹¹⁰ Investor Responsibility Research Center, *Corporate Governance Highlights* (vol. 8, no. 21), May 23, 1997.

¹¹¹ Interview with Ronald Perrone, Managing Director, Allied Investment Advisors, Feb. 19, 1999.

¹¹² IBEW-NECA Equity Index Fund, *Update* (through Jan. 31, 1999).

¹¹³ The AFL-CIO's *Model Guidelines for Delegated Proxy Voting Responsibility* were adopted by the AFL-CIO Executive Council in February, 1991. They are designed specifically for the occasion when proxy voting authority is delegated by plan trustees to an investment manager or other fiduciary, to ensure that shareholder rights are

MFS Union Standard Equity Fund: Screened Mutual Stock Fund

Five years ago Bob Eason, a longshoreman and trustee of his union's pension fund, decided to find an investment company that would — for the first time — create a “socially responsible” mutual fund that screened out companies with poor labor relations. The fund — the MFS Union Standard Equity Fund — seeks long-term capital appreciation by selecting from among a screened universe of more than 500 large-cap companies judged to be “labor sensitive.” MFS, one of the nation's oldest and largest mutual fund companies, actively manages the portfolio, no less than 65% of which must be selected from companies approved by a Labor Advisory Board that includes 20 Taft-Hartley trustees and labor-friendly academics. In 1997 MFS opened the fund to individuals as well as institutions, helping to push net assets above \$100 million by year-end 1998.¹¹⁴

The Union Standard Equity Fund's performance puts it in the top quartile of domestic stock funds over the past three years. Its five-year return since inception is just under 20% annually. Because of its focus on large unionized companies, the fund's sector weightings are heavily skewed toward industrial goods, consumer staples, utilities and communications — and away from technology and financial services companies. This weighting has also given the fund a lower risk rating (beta), since basic industry stocks are less volatile.¹¹⁵ Its largest holdings at year-end included Bristol Meyers Squibb, Phillip Morris, General Electric, Exxon, Bellsouth and Johnson & Johnson.

“I invest in a list of companies that meet certain criteria that are labor-friendly,” explains portfolio manager Mitchell Dynan.¹¹⁶ The fund's Labor Advisory Board applies guidelines, or screens, that apply specific criteria to determine if a company is sufficiently labor sensitive to be included in the universe of eligible investments. If a company meets the criteria, it is added to the

exercised on behalf of plan participants and not neglected or voted in unthinking deference to corporate managements.

¹¹⁴ MFS Union Standard Equity Fund, *Prospectus*, Feb. 1, 1999.

¹¹⁵ MFS, *MFS Union Standard Equity Fund: Investing in Labor-Sensitive Companies*, January 1999.

¹¹⁶ Kenneth Gilpin, “A Labor-Friendly Fund Helps to Channel the Power of Unions,” *The New York Times*, September 6, 1998.

universe of approximately 530 companies from which Dynan selects what he judges to be the best potential financial performers going forward. The fund's labor criteria include:

- at least 5% of the company's workers must be unionized;
- no current labor strife, such as strikes or lockouts;
- no pattern of outsourcing or unjustified plant closings;
- compliance with labor and occupational health and safety laws;
- no products on AFL-CIO boycott list;
- degree of foreign ownership or control.

The value of steering union-influenced investment toward large, publicly-traded companies with good labor relations — and away from other public companies with negative labor policies — may be less controversial as an investment strategy than it as a labor strategy. First, modest additional demand for a large cap stock like General Motors or Phillip Morris is unlikely to lower the firm's cost of capital, or otherwise promote an expansion of its domestic workforce. Likewise, shunning the stock of companies like Walmart is unlikely to have a tangible impact on the operations of companies with poor labor relations.

Second, to the extent that a fractional share of a company's widely-traded public stock gives an investor any leverage at all, it is a *negative* power that is typically exercised via shareholder activism. As a result, screened funds have no ownership rights or other influence at the companies they most want to change.

Finally, although from a labor perspective a high performance screen may be preferable to giving money managers complete discretion, union trustees may be able to achieve a far greater impact by focusing their demands for alternative investing on *private placements* in smaller, non-public companies where they can own sizeable stakes and negotiate union-sensitive covenants that shape a growing company's policies into the future.

IV. Strategies to Expand Union-Led Alternative Investing

As the brief profiles above suggest, labor-oriented investment programs have expanded rapidly over the past five years and are now an option in every asset allocation category — from real estate and core fixed-income, to stock index funds and private placement equity. The leading union-led alternative investing programs demonstrate a remarkable ability to match, and in some cases to substantially exceed, their benchmarks on conventional measures of financial return in relation to risk. The three largest union-built construction trusts, for example, have adopted three very different investment models that have each consistently delivered market-rate returns at relatively low risk for periods exceeding ten years. Although union-oriented funds are relatively new to private equity, ULLICO’s track record (three years for Separate Account P, six years in its general account) has outperformed all but a handful of U.S. investment funds of any type, while simultaneously achieving covenants concerning the fair treatment of workers at the rapidly expanding young companies in which it invests.

How can these union-initiated intermediaries be replicated and expanded? Could there be five more funds like ULLICO’s Separate Account P, financing the expansion of middle-market companies and seeding positive labor relations in a raft of entrepreneurial “new economy” enterprises? After all, despite these sparkling track records, less than 5 percent of multi-employer plan assets are committed to union-friendly investment programs — and virtually no public or single-employer plan assets, with the notable exception of state retirement systems invested in HIT. What affirmative steps by the labor movement could increase the number of fund options and assets committed — particularly in the potentially potent category of private equity and debt placements?¹¹⁷

¹¹⁷ For a more detailed discussion of the obstacles to alternative investing and some strategies to expand pension ETIs, see the paper in this collection by Jayne Elizabeth Zanglein, “Overcoming Institutional Barriers on the ETI Superhighway” (April 1999).

Some Common Characteristics of Successful Union-Friendly Investment Funds

To determine whether the labor movement could take any further affirmative steps to expand on the most successful of these labor-friendly investment models, it may be helpful to summarize some of the characteristics that many of these funds have in common. These include:

- ***Commingled Funds, with Professional Management:*** Very few pension funds are large enough to support an in-house staff with enough skill, experience and contacts to identify, analyze and monitor alternative investments. Pooled funds can provide the resources and incentives to attract top talent. Second, a commingled fund run by a qualified plan asset manager has advantages vis-a-vis ERISA; as noted above, individual fund investments are not treated as plan assets, allowing the fund far more latitude and insulating trustees. Third, the professionals managing a pooled fund acquire a degree of independence that helps to avoid the sort of bias, conflicts of interest or wishful thinking that might influence a fund making direct investments in its own industry. The trustees' role is limited to a procedural due diligence focused on whether fund managers have the qualifications to deliver market-rate returns and agreed-upon collateral benefits.
- ***Geographic Diversification, with Reciprocal Targeting:*** One reason the St. Louis Council of Carpenters have expanded their ProLoan residential mortgage program into a multi-state vehicle is to reduce risk, since entire real estate markets tend to rise or fall depending on variations in local or regional economic conditions. This makes national pools like HIT, ULLICO's "J for Jobs" and MEPT more attractive, particularly since they use best efforts to target an equivalent amount of investment back into the jurisdiction of the pension funds investing in their pool. Targeted or strategic funds may nevertheless find it more practical, as the St. Louis Carpenters did, to begin with a local fund and then broaden its focus as assets grow and a favorable track record is documented.
- ***Other Risk Reduction Strategies:*** Union-oriented funds tend to be, within their asset class, on the lower end of the risk spectrum. This probably reflects the reality of marketing to less sophisticated and more risk-averse multi-employer plan trustees, but it also reflects concerns that critics, with 20/20 hindsight, will claim that the secondary objectives (e.g., union-built construction) led to unexpected losses. An good example of a union-led fund structured to minimize risk is the AFL-CIO's HIT, which has attracted a very large asset base by holding almost exclusively mortgage-backed securities that are insured or guaranteed against default by government-sponsored entities. HIT is expert in using public subsidies and credit enhancement in a variety of ways to allow pension investment where the risk might otherwise be perceived as too high. The Carpenter's ProLoan core fixed-income mutual fund is similarly "risk neutral," despite its aggressive

organizing profile. Even ULLICO's Separate Account P avoids entry-level venture capital and is quite diversified for a fund of its type.

- ***Economies of Scale, Reducing Costs:*** Another obvious reason for pension funds to pool assets through an intermediary is cost. Since alternative investing tends to be very information- and labor-intensive, the cost of top talent and other overhead will tend to decline, as a percent of assets, as assets rise. For example, HIT/BIT has been able to steadily reduce its fee schedule as assets increase, even though it has expanded its staff overall.
- ***Partnering with Private Investors:*** Most union-oriented funds — in real estate, private equity and project finance — frequently co-invest alongside other investors, preferably for-profit concerns. This serves several purposes. First, in practical terms it provides confirmation that the fund's due diligence is solid, since presumably other investors are analyzing the same information. Second, in legal terms it provides further evidence that the expected return on investment met market standards irrespective of collateral benefits (which presumably would not be factored in by the other investors). In this respect, ULLICO's Separate Account P is constantly in 'good company,' since in most cases it invests alongside wealthy individuals, hedge funds, insurance companies and others who have independently judged the company a good risk purely on its financial merits.
- ***Comparability to Benchmarks:*** Many union-friendly funds have structured their investments so that pension consultants can compare their performance very directly with standard benchmarks. For example, the ProLoan/Builders Fixed Income Fund mirrors the risk and return characteristics of the Lehman Aggregate Bond Index, so that trustees can easily justify using it as part of their core fixed-income allocation. Similarly, HIT can be compared directly to a GNMA bond index, since it holds primarily mortgage-backed securities with a similar risk and return profile, while MEPT can be compared directly to real estate equity indexes. Rough benchmarks also exist for the different slices of the more volatile private equity market (i.e., venture capital, mezzanine financing) and are useful to the degree that a fund specializes in a particular style.
- ***Collateral Benefits:*** Finally, all the union-sensitive funds are either structured to generate collateral benefits with every investment (the union-built construction trusts), or are dedicated to generating social benefits on an opportunistic basis (viz., the private equity funds), depending on the company and their degree of financial leverage.

The flip-side of these common positive characteristics are negative features that should typically be avoided. These include:

- insufficient diversification, both geographically and with respect to the number of different investment situations underlying the allocation;

- real or apparent self-dealing, which is far more worrisome and difficult to defend when trustees have direct control over investments benefiting or harming companies or unions in the same industry or geographic area;
- lack of adequate in-house expertise or oversight, or at the opposite extreme, unnecessarily high overhead or consulting costs when a similar investment is available on a commingled basis at a far lower cost;
- large commitments to investments that are “opaque” because risk and projected returns are unusually difficult to quantify or assess.

Other Strategies to Expand Labor-Friendly Pension Investing

While the AFL-CIO and a number of national unions have devoted considerable staff time and resources to promoting shareholder activism, relatively little has been done until recently to encourage more options and more assets for progressive pension investing. Because multi-employer defined-benefit plans are steadily shrinking as a share of U.S. pension assets, without a fairly ambitious and well-coordinated program with support across a range of unions, it is unlikely that labor’s “pension power” will grow by relying on market forces alone. The sort of affirmative strategies that could increase the share of pension investments generating collateral benefits include:

- ***Educating Trustees and Other “Gatekeepers”:*** When the Carpenters union decided last year to launch their private equity “fund of funds,” they knew they needed to make sure the concept would not be nixed by the consultants and attorneys relied upon by local Carpenter plan trustees. So in January, 1999, the Carpenters hosted a conference to discuss private equity investing and their new fund with leading Taft-Hartley pension consultants.¹¹⁸ Much of the reluctance of multi-employer plans to make alternative investments (whether or not they yield extra non-portfolio benefits) is thought to stem from a lack of understanding that alternative investments are well-established among a wide range of institutional investors, including corporate and public pension funds. Plan attorneys, plan administrators and management-side trustees are other critical groups that could be targeted for education and discussion of union-friendly investments.
- ***Establishing New Intermediaries:*** Today’s labor leaders look back approvingly on the foresight of Gompers and the AFL-CIO leadership that created ULLICO in the 1920s and

¹¹⁸ Interview with John DeCarlo, General Counsel, United Brotherhood of Carpenters, Feb. 25, 1999.

HIT in the 1960s. Yet no comparable new investment model has been spurred by the labor movement itself in recent years. For example, with the recent explosion of opportunities to do direct private equity and debt investments, it seems a particularly good time to grant or lend the resources necessary to create one or more new vehicles to expand the sort of dual-purpose private placement strategy being pursued by ULLICO.

- ***Building a Cadre of Alternative Investment Professionals:*** Over the past decade a group of rookie investment managers have become the proven stars running multi-billion dollar union-led vehicles such as HIT and ULLICO’s Separate Account P. Yet there is apparently no conscious effort by the labor movement to develop the pro-union investment managers of the future. While there is no easy way to do this, two small steps come to mind. First, union staff and multi-employer plan trustees with the skills and inclination could be offered “scholarships” to learn investing skills (e.g., part-time MBA programs). Second, investment firms that rely on unions as clients, including the existing union-led investment programs, could be urged to hire these recruits and others known to be sympathetic to labor’s agenda.
- ***Establishing an Information Clearinghouse:*** As noted above, the “ETI Clearinghouse” announced by DOL in 1994 was defunded the following year after the Republicans took control of Congress. Yet the need remains. a clearinghouse that would track, evaluate and benchmark the performance of various types of progressive alternative investments would reduce information costs for pension funds and their advisers. It could offer technical assistance and become a kind of cooperative that is eventually self-financing from subscriptions and fees paid by both pension funds and investment managers.
- ***Encouraging New Federal and State Programs that Leverage Pension Capital:*** During President Clinton’s first term, HIT/BIT’s Steven Coyle played a major role in persuading HUD Secretary Henry Cisneros to structure Section 8 public housing subsidies to leverage far larger amounts of private pension capital that would be guaranteed against default. a similar Cisneros initiative leveraged Section 108 community development block grants with pension funds. In both programs HIT was a major investor and able to condition its participation on union-built construction. Various proposals have also been floated to finance public investment in infrastructure by issuing *taxable* bonds, which would appeal to tax-exempt pension funds, that would also be guaranteed against default and securitized by future streams of user fee revenue.¹¹⁹ On a national level such schemes will likely need to await a more favorable political climate.

¹¹⁹ One of many such proposals during the early 1990s was put forward by the National Infrastructure Investment Commission, created under the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991. In January, 1993, the Commission called for a \$30 billion investment in sewage plants and fiber optic information highways funded by federal guarantees for bonds acquired voluntarily by pension funds. The AFL-CIO supported this approach, provided that “guarantees and other credit enhancements” ensured that pension funds received a market-rate of return. *See* testimony of Thomas R. Donahue, Secretary-Treasurer, AFL-CIO, before the Commission on Infrastructure Investment (Nov. 19, 1992).

- **Expand Worker Choice in Defined-Contribution Plans:** Union members increasingly control some of their own investment allocations through 401(k) and other defined-contribution accounts. Unions and workers themselves could push to have the typically plain-vanilla mutual fund choices expanded to include one or two more socially-responsible options, such as the Builders Fixed-Income Fund or the MFS Union Standard Equity Fund, which are both profiled above. Since defined-contribution plans represent a growing majority of new private pension savings, it is important to find ways to give individual workers a choice to participate in funds that achieve targeted economic or social benefits.
- **Expand Worker Voice in Single-Employer DB Plans:** Finally, unions face the challenge of addressing a goal dating back to the newly merged AFL-CIO's original ten-point pension benefit bargaining guide of 1956, which is joint trusteeship (or at least some participation) in the management of single-employer pension plans.¹²⁰ It remains unclear whether in recent years any union in a strong bargaining position has seriously tested management determination to avoid even a single union trustee on the company plan for rank-and-file workers. Given the evolution of ERISA and the track record of jointly-trusted multi-employer plans, it seems at least possible that at some firms unions would not need to give too much to win some voice. Legislatively, the issue could be revisited, at least incrementally. In 1990 Rep. Peter Visclosky (D-IN) introduced legislation that would have required an equal number of elected worker trustees on all private single-employer plan boards. While the legislation failed, it did receive the vote of most House Democrats, suggesting it could be revisited in some form when the political tides shift.

V. Conclusion

Private pension assets allocated to union-friendly alternative investing programs have more than tripled since 1994. The number of competing alternative investing vehicles are increasing at a rapid pace and now provide an option in every asset allocation category. The largest and most well-established examples of alternative investments targeted to create extra benefits for plan participants are the leading union-built construction financing funds.

A recent, but potentially more powerful trend, involves *direct* private equity investing in smaller, typically non-public companies. Large corporate and public pension funds have long realized the *financial* potential of private equity and now allocate an average of almost 5% of total assets to private placements. In contrast, few union-sponsored pension funds make private

¹²⁰ See Ghilarducci, *Labor's Capital*, *supra* note 4, at 40-41.

equity allocations at all. This gap should narrow now that ULLICO's "Separate Account P" has demonstrated that the direct investment of sorely needed expansion capital in entrepreneurial young companies — and in growing middle-market companies — can yield both premium financial returns and "social" leverage.

Unlike investments in public equity markets, private equity investors have the ability to demand special covenants requiring union neutrality and card check recognition, union-built construction, environmentally sound policies and other corollary benefits. While private equity investing offers a surprising degree of both financial *and* social leverage, as is the case with union-built real estate and other offerings, the ability of pension fund investors to generate valuable extra benefits on top of a market rate of return will depend in large part on how quickly highly-qualified and highly-trusted intermediaries can be created and successfully connected up with progressive, savvy and aggressive multi-employer and public plan trustees.