

# How pension funds lost \$100 billion

*Leif Johnson examines the track record of returns on pension-fund investment, and finds a giant swindle.*

An examination of the way that the rapidly accumulating U.S. private pension funds were managed over the past decade demonstrates that these funds were used to effect a transformation of the American economy toward a "postindustrial society," as envisioned by leading think tanks and financial institutions.

Pension funds were used to stabilize the markets while "sunset industry" securities—railroads, Northeast utilities, and heavy industrials—were dumped by financial insiders in favor of "sunrise" industries like electronics, energy, and raw materials.

Rates of return on nongovernmental pension-fund investments were so low relative to other managed funds that this result could only have been achieved by intentional dumping of weak securities into the pensions' portfolios. The resulting losses to the pension funds is conservatively estimated to top \$100 billion for the 1970-79 period.

The major managers of pension funds are insurance companies and bank trust departments, which in 1979 held \$343 billion of the total \$593 billion in private pension assets.

A review of rates of return on pensions managed by life insurance companies, compared with the general funds that include the companies' own assets (see Figure 1), shows an astonishing divergence. Pensions in life insurance company separate accounts produced an average return of 3.86 percent per year over the 1970-79 decade, while the companies' other assets, including those owned by the company, produced an average 6.41 percent return.

Pension funds managed by the life insurance companies did 40 percent worse than other funds managed by the same industries.

At an estimated loss of 3 percent of earnings on average assets of \$350 billion for the decade, the loss to the pension funds exceeds \$100 billion.

According to the A. S. Hansen Company's 1979 *Investment Performance Survey*, the Standard & Poor's 500 stock index achieved a 5.9 percent rate of return. That is, if any investor held the entire group of the S&P

500 stocks, he would have reaped a 5.9 percent return per year for the decade. In contrast, pension funds in insurance company separate accounts returned, according to Hansen, only 4 percent. Worse, 209 bank trust department-managed pension funds surveyed by Hansen achieved only 3.6 percent per annum (see Figure 2).

The Standard & Poor's 500 is simply a benchmark for how the market generally performed. Any well-managed equity fund would be expected to exceed that figure. Hansen's survey of mutual funds found a 7.0 percent return. Even fixed-income securities performed nearly twice as well as pension funds. The Salomon Brothers fixed-income funds registered a 7.0 percent annual rate of return for the decade.

One large foundation that performed notably well was the \$2.8 billion Ford Foundation endowment. For the same decade, it produced a 9.2 percent annual

Table 1

## Life insurance stated rate of return on investment income for pensions and assets, 1970-1979

Year	Separate accounts (pensions)	General accounts (other assets)
1970	3.08%	5.34%
1971	2.95	5.52
1972	2.35	5.69
1973	3.18	6.00
1974	4.48	6.31
1975	4.47	6.44
1976	3.97	6.88
1977	4.87	7.00
1978	5.82	7.39
1979	3.52	7.78

Source: American Council of Life Insurance, 1980 *Life Insurance Fact Book*, and 1980 *Pension Facts*. Note: Figures are based on ratio of net investment income (before taxes) to mean invested assets less half the net investment income. All calculations based on statement value of investments which is neither book nor market value.



Table 2

## Institutional funds investment performance, 1970-79

	Compound annual rates of return
1. 209 bank pooled trust funds (pension funds) . . . . .	3.6%
2. Insurance company separate accounts (98% pension funds) . . . . .	4.0%
3. Standard & Poor's 500 . . . . .	5.9%
4. Salomon Bros. bond index . . . . .	7.0%
5. Ford Foundation (\$2.8 billion fund) . . . . .	9.2%
6. Equitable Life (no. 4) . . . . .	12.2%

Source: A. S. Hansen, 1979 *Hansen Investment Performance Survey*, and the Ford Foundation, *Pension & Investment*, Aug. 18, 1980.

average return.

The 1973-74 collapse of the stock market, which saw the Dow Jones average plummet from over 1000 to near 600, is the reason most often given for the poor pension fund performance over the decade. Beginning in the late 1960s, pension funds were convinced to buy stocks which provided a higher yield than fixed-income securities like corporate and government bonds.

The Ford Foundation, among others, was moving in the opposite direction. The foundation was given more than 90 million Class A Ford Motor shares in 1955, which at that time represented 100 percent of the endowment's holdings. By 1974—the onset of the oil hoax—the Ford Foundation had disposed of its entire holding of Ford stock. Nor did it hold any Chrysler, General Motors, or Penn Central stock.

### Unloading the sunsets

While Ford had positioned itself for the 1970s implementation of the postindustrial society, these pension funds were used to pick up the "sunset industry" stock. Had not the pensions and other assets, including insurance and other trust accounts, been available for this purpose, the progressive bankrupting of heavy industry, including the railroads, would have caused a market collapse.

Ford Foundation, for example, sold nearly \$100 million worth of Ford stock to the Ford Motor Company Salaried Employees Saving and Stock Investment Program, a program amounting to a pension plan. The subsequent decade and a half of Naderite and Ford Foundation environmentalism, and the 1974 oil hoax, dealt multibillion-dollar losses to the auto giant, invit-

ing concern that Ford may become the next Chrysler case.

One of the most extreme examples of dumping was the unloading of Penn Central stock on the pension funds. Market insiders claim that the bankruptcy of the Penn Central was planned as early as 1965, when the New York Central and Pennsylvania railroads were in the process of merging. The ultimate purpose of bankrupting the nation's main transportation link was to disband it, pulling the Northeast-Midwest corridor's industry down in its wake.

But first it was necessary to unload the stock as insiders like Goldman Sachs investment house got out. Goldman Sachs was later prosecuted for its activities; the true purpose of the bankruptcy was not revealed.

"Penn Central was the sweetheart of the funds," recalled a pension manager, "Pensions went in heavily because the press was so favorable to the success of the merged lines, and the return was good."

The road collapsed in June 1970 only two years after the merger, during Federal Reserve Board Chairman Arthur Burns's money crunch.

In 1973 the Airline Pilots Association pension fund trustees sued the Continental Illinois Bank for having held 27,000 Penn Central stocks until the bankruptcy cost the pension fund \$1.5 million. The Pilots Association charged that since Continental was a Penn Central creditor, it knew the actual condition of the railroad. The Pilots trustees also sued to recover losses from sales of TWAS, U.S. Freight, Lum's (a fast-food chain), and Management Assistance, Inc. stocks. In two cases the bank had management control or was the principal lender and therefore both knew the condition of the

companies and profited from the pension funds' losses.

Thirteen other Chicago-based unions sued Continental in a class action for a \$21 million loss in Penn Central stock, suing separately for individual recovery of Penn Central, Lum's, TWA, and Boise Cascade stock losses.

Despite the overwhelming evidence that Continental Illinois had failed as fiduciary agent to protect the interests of the pensions, and had profited by the funds' losses, the court refused to hear the case on the grounds that the trustees had given the bank fiduciary powers, and therefore had no standing in court to sue!

This ruling was subsequently reversed on a technicality that pertained only to these cases. Yet subsequent decisions have made it nearly impossible for pension-plan trustees to sue bank trust departments and insurance companies for mismanagement or fraud in connection with the dissipation of pension funds.

### **The Teamster Central States Fund**

In contrast with the legal carte blanche allowed bank and insurance managers to dissipate pension funds is the treatment given the International Brotherhood of Teamsters' Central States Pension and Welfare Fund—the fund portrayed by the press as the epitome of union and pension corruption and fraud.

A federal investigation of the Teamster fund began

shortly after the passage of the Employee Retirement Income Security Act of 1974 (ERISA), sponsored by Senators Jake Javits (R-N.Y.) and Harrison Williams (D-N.J.) on behalf of the insurance and trust companies. ERISA served to alibi the disastrous performance of the pension plans, by mandating that the plans invest in "low risk" securities, which are also the poorest performers.

To investigate the Teamster fund, the Department of Labor, with assistance from then Deputy Attorney General Benjamin Civiletti, assembled a special investigation staff which thoroughly examined the fund's accounts. What they found was quite interesting.

The fund, which then had nearly \$1.4 billion in assets, was more than two-thirds invested in real estate, a quarter of it in Nevada. Other major holdings were in Florida and California, both growth areas. The fund had a 5.4 percent rate of return for the years 1972-76, the same period in which the common stock portfolios of pension funds were being decimated. Between 1972 and 1976 the value of common stock held by pensions dropped from \$115 to \$109 billion despite the additional stock purchases of \$21 billion.

Over this period, it is estimated that the Teamster fund performed twice as well as pensions in general.

During the 1973-76 downturn, real-estate values also went tumbling. Of the \$20 billion in real-estate invest-

## **Ford Foundation moves into 'postindustrials'**

As early 1965, the Ford Foundation reduced its common and preferred stock holdings to 26.4 percent of its portfolio. The remaining stock holdings were a cross-section of "sunrise" assets; in the largest category, utilities, 19 of the 26 listed holdings were in the high-growth areas of the South and Southwest. Only two were in New England.

The next largest category was \$112 million worth of oil and gas stocks, followed by consumer products, banks and finance, business equipment, metals, retail trade, drugs, electronics, airlines, photographic supplies, and paper. The foundation had no holdings in steel, railroads, farm equipment, machinery, or machine tools; it had minor holdings in one construction equipment company and in Ford Motor.

The foundation's keen market sense could be explained by the fact that since 1948, when former Marshall Plan administrator Paul G. Hoffman, Sidney Weinberg of Goldman Sachs, and Robert

Hutchins, president of the University of Chicago, took the foundation away from the Ford family, it has spent billions nurturing the "postindustrial" perspective, population control, and environmentalism.

The Ford Foundation is well documented as one of the major vehicles for the sunset-sunrise destruction of heavy industry and simultaneous creation of raw materials and energy shortages. It created the Resources for the Future institute in 1952 to oversee control of natural resources on the North American continent, including water, and it organized the Population Council two years later to study and apply methods of population reduction worldwide. Since 1952 it has spent over \$100 million creating environmental "movements" as field and legal strike forces for raw materials control and an end to industrial growth.

In 1979, the Ford Foundation gave large sums to the Environmental Defense Fund, Conservation Foundation, Environmental Mediation International, International Union for the Conservation of Nature and Natural Resources, Sierra Club Legal Defense Fund, the Center for the Biology of Natural Systems, and the Resources for the Future.

ment trusts held by bank trust departments, nearly half were nonperforming—not paying interest or principle, or both. Of the Teamster fund's \$900 million worth of real-estate loans and holdings, only \$8.5 million was nonperforming—less than 1 percent of the fund's holdings.

It was found that the Central States Fund could continue benefit payments for 15 years even if all contributions were to cease. Investigation of the Teamster fund also found, contrary to press reports, that the rate of acceptance of pension applications was 92.4 percent, about average for all pensions, and that payments were up to \$550 per month, granted from age 63 with reduced benefits from age 57.

The primary thrust of the Labor Department investigation, apart from continuing the "Get Hoffa" tradition of the Kennedy Justice Department, was to force the Teamsters to accept a fiduciary agent to manage the fund. In March 1977, the Teamster trustees accepted Equitable Life as fiduciary, with Victor Palmieri & Company manager of real estate west of the Mississippi. Victor Palmieri was the real-estate operator who managed the several hundred millions worth of real estate that the Penn Central Company was able to shield from the bankruptcy court.

Not satisfied, the Department of Labor next took civil action against the fund's trustees for "breach of fiduciary obligation by failing to discharge their duties with respect to the plan solely in the interest of its participants." Banks and life insurance companies have yet to be prosecuted, despite the voluminous evidence of mismanagement, conflict of interest, and fraud.

### **Pensions enter endgame**

Pension managers now hint that the funds will be shifted once again. With ongoing banking deregulation, savings and loan banks are being squeezed out of the housing market, if not out of business altogether. These banks hold billions in low interest-rate mortgages, but must pay high rates for deposits.

Some investment managers hope that the pensions could pick up as much as \$50 billion worth of low-rate mortgages, so that the savings and loan banks can be converted into money market institutions to service the credit needs of the "sunrise industries" and offshore funds. A top Treasury Department official explained to an interviewer on April 1 that the Federal Home Loan Bank board is expected to propose selling nonperforming mortgages to institutional investors including pension plans.

Others like Jeremy Rifkin and Randy Barber, authors of *The North Shall Rise Again*, propose investment in bankrupt companies and worker-owned businesses to save jobs. Last week California Gov. Jerry Brown demanded that the state's \$60 billion public pension

system, the largest in the nation, invest in mortgages, small companies, and "alternative energy sources" as a matter of social benefit rather than profitability.

These proposals represent an extension of the dissipation of the pension assets into an "endgame" where *the assets are finally locked into securities that cannot be sold.*

A deeper indication that the endgame is approaching is the continued inflationary path of the overall economy. The inflation caused by the declining productivity in the basic industries which have been starved of new capital because of "postindustrial" investment and banking policies will ultimately dissolve the pension funds themselves. Even if pension plans are actuarially sound and contributions are maintained, future pension fund benefits will approach nil value if inflation continues at the present 10 to 15 percent a year. Workers covered by a financially adequate pension plan will receive only nominal benefits 15 or 20 years from now. If inflation continues, the greatest beneficiaries of pension funds will be the present holders of the funds' reserves.

Large accruals to the plans continue, since most pension plans have not reached an equilibrium at which the maximum number of workers have retired and are receiving benefits. For example, the number of retirees receiving benefits from insurance company-held pension plans increased by 100 percent over the last decade. Those eligible to receive pensions increased by 125 percent; in the aggregate the pensions have not hit maturity. However, the reserves of these plans increased by 238 percent, an indication of the huge increase of these funds.

The Social Security system, having functioned for over 40 years, shows the opposite trend: those receiving pensions over the last decade increased by 34 percent while those eligible, but not receiving, increased 24 percent. Reserves fell by 20 percent.

Therefore, it is not surprising to find that, while in 1950 Social Security paid 28 percent of all pension benefits, it now pays nearly 60 percent. Private pension plans currently pay only 14 percent of all pension benefits, despite the enormous increase in pension-plan assets over the past two decades. This is why insurance and trust companies expend such efforts to sell pension plans.

There is nothing inherently wrong with a pension plan. It is an entirely legitimate form of social saving. If invested properly in industrial and technological expansion, the fund can provide substantial benefits to retired members of the workforce. If used by insurance and trust companies to transform the economy into a service-dominated nonmanufacturing "postindustrial" economy, the pensions, with the rest of the economy, are rendered valueless.