

"Pension Talk"

March 2003

3 – The Threat of P3s

Economies of scale, transparency of management and budgeting, and democratic accountability offered by the broader public sector make it a crucial component of the Canadian economy.

In the past, pension funds have been partners with the public sector. While pension fund portfolios have often included investments in both the private and public sector, the purchase of both short and long-term bonds from all levels of government has been a very important source of financing for viable public infrastructure.

As large and long-term institutional investors, pension funds have also been perfectly positioned to invest in the securities of governments needing to finance budgetary deficits. These partnerships have allowed important public projects and programs to proceed on a financed basis, while providing very good returns to the pension funds doing the investing. Until recently, all of the Canada Pension Plan reserve fund was devoted to such public sector investment.

Despite this successful partnership, recent political attacks on government and public sector management have resulted in proposals to privatize public institutions and management functions which had long been public. Whereas the focus of "privatization" was once on relatively smaller components of public sector employers (such as the contracting-out of cleaning services, laundry, or residential garbage collection), the scope has now been broadened to much larger sectors such as electrical utilities and lab services. Some recent incarnations have included the transfer of ownership and control of schools, hospitals, highways, and municipal sewage infrastructure to private ownership. This form of privatization has often come under the guise of "public-private partnerships" or "P3s". This very vague label is often given to any range of privatization efforts where the relationship between a public or government entity and one or more private companies can be tagged a "partnership".

Ironically, these privatization "partnerships" undermine the traditional "partnership" between the public sector and workers' pension funds. Pension funds are being actively solicited as a source of investment in these same privatization initiatives. Funds which in the past may have been invested in a low-risk but reasonable rate-of-return provincial bond are now being sought by private companies looking to take over the ownership and management of public infrastructure and services.

CUPE, other public sector unions, and the labour movement in general will continue to fight these developments. However, we are also very aware that having our pension funds involved in financing P3s and other forms of privatization has devastating consequences for many pension plan members and workers. It raises the prospect of one worker's pension fund financing a company which is actively seeking to privatize her job – or that of her neighbour.

This short document will discuss this investing in P3s development in relation to the Borealis case, and conclude by considering how we can gain control over our pension funds to ensure they are invested in accordance with our broader interests as public sector workers.

Borealis and the OMERS Pension Fund Case

In mid-1999, CUPE realized that we were confronting a fundamental problem. Our members in the school board sector were contending with a proposal from the Nova Scotia provincial government that a large number of new schools (some 55) would be built under a so-called P3 arrangement.

Worse yet, it was organized through a "lease-back" arrangement, under which the new schools were to be owned and operated by a private company "partner" and leased from this partner by the province for a fixed 20-year period. By structuring the financing arrangement in this way, the province was able to label all of the construction costs as "operating expenses" under the lease

arrangement, thereby giving the appearance that the province was not borrowing (i.e. going into debt). This method of off-book financing was actually used as a rationale for the entire P3 model.

It was especially disturbing to learn, after having begun to respond to this move on a political level, that one of the key forces behind the various consortia competing for the financing/ construction business on the new P3 schools was, in fact, OMERS – the main pension plan for our Ontario municipal and school board members.

How did this happen? In 1998, OMERS established a subsidiary company called Borealis Funds Management Limited. While such pension companies have long been used by pension funds as a means of “holding” and managing real estate and other properties of the pension fund, the mandate of Borealis was much broader. The mandate, initially described vaguely as managing “investment in the area of infrastructure development”, eventually became clarified as seeking out, developing, and financing public-private “partnerships” in nearly every jurisdiction of the broader public sector including: schools, electrical utilities, recreation, water and waste water treatment, highways and roads, hospitals, nursing homes – there is almost no part of the public sector untouched by the Borealis mandate.

The basic background to this story runs as follows. Borealis pro-actively put together a consortium of private sector partners to present bids on the school-construction-management projects in Nova Scotia. A key element of the rationale for how they as a private sector operator could offer low-cost financing was their incorporation as a “pension corporation”. Because they do not pay taxes on their earnings, Borealis (and other similar companies) is able to offer financing rates that are less than what a normal private tax-paying company could do. This competitive advantage makes Borealis uniquely situated to be the “owner” from whom the province can lease the school.

CUPE has fought these deals and projects from the very beginning. Not only did we point out that this arrangement would cost the government more, over time, than the traditional means of borrowing from the bond market, we were able to use the financial analysis of the province’s own Auditor General to show that the “off-book” financing (and avoidance of debt) was fiction.

In September 1999, the new provincial government announced that they would not continue with the previous government’s intention to hide the school debt in this way. At the same time, they put a freeze on the P3 school construction, and indicated that the entire plan would be put under review.

To top it off, OMERS-Borealis are now active participants in the Canadian Council on Public-Private Partnerships (CCPPP), a private-industry lobby group established with the explicit objective of sharing notes on how to overcome the public’s and various governments’ distrust of privatization and P3s. CCPPP is the political mouthpiece for enormous corporate privatizers like United Water, Arthur Andersen, EDS Systemhouse, Laidlaw Inc., SNC-Lavalin, Thames Water, and Société Générale (Canada), all actively seeking to take over chunks of the Canadian public sector.

Our response to these developments has had three primary elements:

- 1) We are redoubling our efforts to expose the flawed logic behind P3s and other privatization initiatives. Much as the pressure to privatize has increased in recent years, we continue to build and publicize strong evidence that privatization leads to greater costs for the public, reduced accessibility, and loss of democratic control and accountability.
- 2) We are attempting to exercise what control we have over OMERS itself to reverse its active support for P3s and privatization. In the meantime, through its Borealis subsidiary, OMERS has continued to move forward, seeking out P3 and other privatization initiatives to finance in the rest of the country. They have actively sought involvement in the privatization of Mississauga Hydro, and regretted not being able to participate in the toll highway 407. They have invested significantly in the Toronto District Heating Corporation, a previously municipally-owned infrastructure facility providing heat to downtown Toronto hospitals and the University of Toronto.
- 3) We are continuing to work to establish true meaningful control over the rest of our pension plans in order to ensure that funds are not being invested in ways that undermine our own members’ jobs, and the public sector in general.

Gaining Control Over Pension Investments

OMERS/Borealis are not alone in investing to become the actual owners of private or privatized public schools. Most of the large pension funds in Canada – of both public and private sector employees – have already been approached to finance similar P3 projects. And it will continue to happen without the vast majority of the pension plan members even being aware of it.

So what can we do, as a union and a movement, to prevent it? While we can be confident that positive investment alternatives to P3 and privatization projects exist, how can we ensure that our own pension fund “administrators” and money managers will act in our interests?

This question focuses our attention on who has the responsibility for developing and implementing investment policy for our pension plans.

Defined Benefit Plans

Within defined benefit pension plans, CUPE has been a strong advocate of the Joint Trusteeship model of plan governance, and has succeeded in establishing it in the hospital sectors in Ontario, Manitoba, Saskatchewan and New Brunswick in recent years. We are actively pursuing the same model in broader public sector plans in British Columbia and Alberta, and with our troubled OMERS plan. Joint Trusteeship is a clear path to gaining at least 50/50 shared control over the development of investment policy, which would at least allow us to bring the issue to the decision-making table.

Trust Plans

There are some plans that are structured as Trusts and are entirely “trusteed” by the unions that represent plan members. These plans exist most commonly in the construction and building trades sector, but also in the nursing home sector in Ontario, among others. Within these plans, there would appear to be very clear scope for developing an approach to pension investment which at least aims **to avoid financing privatization or P3 projects**.

Bargaining

There are also plans over which control can be exercised through collective bargaining. While this may be more difficult, and investment policy issues have not yet been widely taken up by trade unions that bargain over pensions, there is no reason that investment policy could not also be subject to the negotiation process.

While there are, of course, important limits on how pension funds can be invested (see document on “fiduciary duty”), the development of investment policy is not mechanical and a wide range of options and approaches exist within these important legal constraints.

Plans Over Which We Have Little Or No Formal Control

This does not mean that there is no hope. First and foremost, in many such situations, it may be possible to begin to incorporate pension issues to the collective bargaining agenda. Secondly, if bargaining is not a viable option, the Joint Trust model described above may be possible. Of course, both of these options involve some work and commitment. In the meantime, there is no reason that existing employer-only “sole trustee” type plans can not hear loud and clear messages communicated from the union or unions representing plan members regarding how they want their pension funds invested. Such an approach can be frustrating (as member representatives on pension “committees” generally do not have real power) but any pension “fiduciary” – including employer-only situations – has a serious legal responsibility to take account of and represent the full interest of plan members.

How Do We Exercise Control Over Our Plans?

In practical terms, how can we balance the fiduciary obligation to seek a reasonable rate of return from pension investment with socially responsible investing?

The particular means of eliminating or avoiding such investments will probably have to depend on the particular plan and how it is governed. For the purposes of this section, we will not assume any particular structure. Here are some general steps to consider:

Statement of Investment Policies and Goals or Procedures – All pension plans must have a statement of investment policy filed with their respective regulator (i.e. their Superintendent of Pensions, the Office of the Superintendent of Financial Institutions for the federal sector, or the Financial Services Commission in Ontario). The policies, labelled differently in different jurisdictions, formally state the investment objectives of the pension plan, and will often describe in some detail the types of investment that are explicitly allowed or excluded. Ideally, these policies could be written in a way that explicitly acknowledges an effort to invest in ways that will support the interest in employment security of the plan members. At the very least, particular investments such as “private placement bonds” or “infrastructure bonds” (common names for P3 investments) should be automatically referred to the Board of Trustees for formal approval. In some cases, the form of investment might also be a direct ownership stake in the shares of a company which is carrying out the privatization.

One way or another, we must ensure that the authority for placing such investments must not be delegated to the money manager, as they will invariably pay no attention to the impacts of their investments, either on plan members or the broader public. Our information indicates that an explicit exclusion of a certain type of investment (such as private placement bonds or equities) is probably not acceptable from a legal point of view. However, clearly the decision must rest with the body with fiduciary responsibility, and therefore delegation of such decisions must not be allowed.

Selection and Monitoring of Money Managers (see also attached “Questions for Money Managers”) – The process of selecting and interviewing money managers can also be an opportunity to determine whether the pension portfolio currently holds P3 privatization investments, or whether there exists any restrictions. Generally, money managers should be monitored – including in person interviews – by the administrator of a plan on a regular basis. This monitoring offers a valuable opportunity for expressing concerns over investment policy.

Development of “Socially Responsible” Investment Policy – There are a number of plans that have developed some form of socially responsible or ethical investment policy. While still far too rare, such policies allow the establishment of “screens” or other investment restrictions which will avoid support for companies or governments that have a terrible record on human rights issues, environmental issues, respect for workplace health and safety, or basic worker rights. There are an increasing number of screening services that can help to develop lists of investments which avoid certain types of these high-risk investments, while maintaining investment in alternatives. There is a growing body of evidence to suggest that such screens may actually focus the investment policy on corporate securities that will offer better returns. It is possible that such “socially responsible” screens or policies could also capture the issue of respect for the public sector and unionized public sector workers.

Active Shareholding – Another avenue for exercising control is the active use of proxy votes. As owners of corporate stock, pension funds have the right to actually vote on key corporate issues on behalf of the plan members. Unfortunately, most plans (i.e. trustees) abdicate this crucial ownership right, and delegate their voting rights to the money manager, who will in turn vote however the company’s management wants. In some cases, this leads to the bizarre prospect of a shareholder vote on whether the CEO should pocket a huge bonus (with management recommending yes), or whether the company should implement an employment equity program (with management recommending no), and the unionized pension plan members having their stock voted for them by the money manager. Clearly, other votes could come to shareholders about other elements of corporate policy, including participation in privatization initiatives.

It is also possible for the fund trustees to actually place a proposal to other shareholders at corporate shareholder meetings. This involves following the appropriate corporate procedures for circulating a proposal and attempting to build support for it among other shareholders – pension funds in particular. Once again, this more active role can also be justified as a component of what we consider to be fiduciary obligation to represent the interests of plan members. At certain times, this interest may include this kind of active involvement in corporate decision-making.

Review of Specific Investments – Sometimes P3 projects seek pension fund financing on a project-by-project basis, in which the proponents will approach a fund or a Board of Trustees to pitch their investment. In general terms, this method avoids the need to follow the common regulatory procedures associated with public bond issues, and keeps the investment process relatively “quiet. It also means that trustees can be approached with a “you-can’t-lose” type of offer, with very high rates of return promised along with the touted security of a public guarantee (since this is a “partnership”). This opens up a number of opportunities to oppose such investments. How much risk is associated with the government guarantee? Could a quick political decision change either the risk or the return associated with the investment? Are there other risks associated with the project which have not been fully examined, such as environmental impacts, community reaction, or new hazards to public health? All of these considerations can be useful reference points for developing effective arguments against investing in a P3-type project. CUPE-nominated trustees have already had some success using this approach.

Political Action – Depending on the issue and the situation, it may also be worth considering making an objectionable investment the subject of political action directed at either of the employer, the plan administrator (if different from the employer), or the company at issue. For example, there is no reason that individual members of OMERS, or their locals (regardless of which union), could not write letters to the OMERS Board of Directors expressing their strong objection to the investment policy that gave

birth to Borealis. The same letters can be directed to their own employer, the provincial government, and Borealis itself. All such correspondence could also be shared with the media. Other circumstances may suggest other approaches. The point is that there is no reason that pension plan members must stay quiet if they feel their interests are not being represented in the investment of their funds.

Conclusion

Pension fund investment issues are not simple. However, this does not mean that the labour movement or individual workers and plan members can avoid or ignore them. When CUPE and the labour movement have raised these kinds of issues in the past, we often hear that the issue is “too technical”, legally complicated, or not a high priority. The objection is also raised that in owning such a small portion of a company’s stock or bonds, the actions of any one pension plan would be hopeless.

The reality is that trusted pension funds now invest over \$500 billion in trust property, and it is being invested on our behalf. Much of this money is being invested on behalf of unionized workers – who have a clear interest in seeing this money invested in ways that support domestic employment, unionization, discrimination-free workplaces, health and safety, sustainable economic practices, etc. Our goal is to meet the challenge of making this happen.