CARRRESEARCH

OUR TRUST IN PENSION FUNDS

The trust is essentially a procedural guarantee. It is not in any way constructed to guarantee a substantial level of financial performance that would assure a certain quality of retirement.

Socio-economist **Sabine Montagne** examines our trust in the US model of financing retirement.

When Europeans decided to reform their retirement systems in the 1990s, they took the American model of retirement financing as their major point of reference. The defining feature of the American system is that financing is shared between a public federal regime, and a private complement in the form of a pension fund. Instituting this feature in continental Europe was the primary objective of reformers during the decade of stock market euphoria that marked the 1990s.

Curiously, the effectiveness of this model has not been questioned following the market crash of 2001 or 2007, despite a series of social and economic blows suffered in the United States. What is more, the model continues to relentlessly insinuate itself into the institutional make up of continental European countries.

How can we understand this persistent belief in the virtues of the pension funds? Since the advantages of this model have proved inconclusive from a number of economic of vantage points, I have felt compelled to search for the alternative reasons that make it an attractive configuration. What is it about pension funds that makes them so hard to resist?

Macro-economic constraints and institutional interests have no doubt nourished the wave of reform on how social protection is financed. These forces have created a groundswell that is not easy to stop, even when reformers are confronted with contradictory arguments grounded in compelling empirical evidence that new solutions aren't working.

But that's because there is something else at work beyond the convergence of constraints and interests that explains the fierce adherence to the American model. There is a force built into the model, an aura of seduction, that even the current institutional collapses are unable to shake off. We must, therefore, seek to understand the assumptions woven into the very fibre of pension funds that, so long as they remain taken for granted, inhibit an internal critique from developing.

That conviction in pension funds stems at least in part from the fact that the socio-economic beliefs they are built upon are fundamental to the American economy. What pension funds convey, in effect, is the peculiar American fable that social protection and speculation can be reconciled within a single frame of action. Behind this fable there resides perhaps an even more basic myth of the Anglo-Saxon social order: that weaker individuals (in this case, the beneficiaries of these funds who are potential victims of speculation) can be assured protection through privately managed, decentralized apparatuses within which constraints of justice are imposed on strong protagonists (in this case, the employers and financial managers who engage in speculative activity).

In order to unpack this fable I have examined how pension funds concretely function and looked into the mechanisms that ground their legitimacy. What type of sectorial organisation supports confidence in these apparatuses? Based on what kind of guarantee, economic or juridical, can these pension funds be considered adequate retirement support for the majority of salaried workers? And what means are put in place by the financial sector to prudently manage these considerable savings?

The thread that guides my exploration of the pension industry's "efficacy" is a juridical structure called "the trust", a special legal form that is as distinctive as the contract or the corporation. The trust is unique to Anglo-American culture and possesses no exact equivalent in other places such as France. Over the course of time, jurisprudence as engendered a corpus of juridical rules, and has also constructed a veritable model of financial comportment that regulates all relationships within the chain of investment. The trust, therefore, is not only a specific juridical status of Anglo-American law, but its demands permeate the everyday practices of the financial world surrounding it. The trust is key to understanding the contemporary organisation of the pension industry.

In privileging the trust as an entry point for my study, I have placed the question of pension funds' legitimacy within the history of juridical economics. The idea is that pension funds inherit from the trust, a type of economic organisation and certain guaranties of comportment that participate in their legitimacy. In its generic ancestral form, the trust is designed to assure the management of an inheritance by a guardian on behalf of a minor, it thus makes sense that it might be expected to protect inexperienced investors such as salaried workers in its financial form. What I have discovered is that this institutional heritage strongly shapes the nature of the protection offered by the pension fund industry.

The trust organizes management around two central questions: the primacy of the beneficiary's interests and safeguarding the assets under care. Its preoccupation however, is essentially defensive. It is geared towards protecting beneficiaries against potential abuses by managers such as conflicts of interest or a theft of assets deposited into the trust. To provide protection from these sorts of abuses, the trust is fixated upon the decision making processes of managers and demands that they employ appropriate organisational means. This constitutes a guarantee that the management of the assets will conform to an organisational standard established by a community of professionals. The trust is essentially a procedural guarantee. It is not in any way constructed to guarantee a substantial level of financial performance that would assure a certain quality of retirement.

Legal lineage does not fully explain the organisational orientation or symbolic efficiency of the pension industry. The US federal law, ERISA (Employee Retirement Income Security Act), passed in 1974, was conceived to govern private corporate pension funds and as the general source of inspiration for asset management, profoundly renewed the principles of law that found the trust. The current organisation of the pension industry still relies on a requirement that is at the heart of trust regulation: the obligation for the strong parties (trustees) to justify themselves with regard to the weak ones (beneficiaries) under the supervision of a judge. This principle of justice re-emerges today, among investment managers and trustees alike. It is expressed through the obligation to document decision making process, and to have an investment process that can be explained to a third party. Accountability, with reference to both the results and the process of obtaining them, has become the watchword.

ERISA aimed to increase the protection of pension-fund beneficiaries through the professionalization of financial management. But by imposing the condition of due care rather than a performance bond, the law pushes the trust's "mission impossible" – of ensuring the protection of the weak by requiring the strong to justify themselves – to the absolute limit. The constant display of procedure is a means of monitoring the powerful, who themselves remain individually subject to an even higher power, the financial community, which is not shielded from systemic risk. Yet the expected protection – a predefined retirement pension – has evaporated.

On the whole, the system of delegation structured into pension funds offers no guarantee of retirement benefits. It does not ensure financial performance but simply provides a guarantee of compliance with commonly accepted procedures. This limitation of responsibility, characteristic of "procedural delegation", is a recurring component of how finance functions. Look closely and you will see that the financial world is founded upon intermediaries who provide "non-binding advice" and whose fiduciary responsibility has been attenuated.

The analysis of the American case in my book, *Les Fonds de pension, Entre protection sociale et spéculation financière* (Odile Jacob, 2006) demonstrates how Anglo-American law gave an organisational form to the financial industry. At a decisive moment of the pension fund's history this organisational form was detached from the underlying structure of the trust, so this model of retirement financing could be exported internationally. New kinds of pension funds like 401(k)s were developed in the US in the 1980s, and US financial behaviours were exported to countries which had no previous experience working with trusts. So although the trust has left a distinct mark on finance, it is difficult to see the extent of its legacy.

I have retraced the process through which the tradition of the trust has been obscured in finance so that we can better understand the contemporary international expansion of pension funds and their weaknesses as a tool for securing the future. Retirees should understand the precise nature of the guarantee that underlies our trust in pension funds.

Sabine Montagne is a socio-economist and CNRS research scholar at Université Paris-Dauphine.

Translated by **Martha Poon.**