Congress of the United States
Washington, DC 20515
April 25, 2012

Secretary Hilda Solis
Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Dear Madam Secretary,

We are writing with respect to investments in commodity index funds by a number of pension funds subject to regulation by the Department of Labor pursuant to the Employee Retirement Income Security Act (ERISA).

We have two primary concerns. First, we are concerned about the security of the long-term returns from such funds for participants and retirees. And second, we are concerned about the role such investments play in speculation in oil markets and the resulting spike in gasoline prices from such oil speculation. We appreciate your assistance in learning more about the impact on retirees and consumers from large pension fund investments in these highly complex, volatile, and increasingly popular funds.

As you know, ERISA requires a fiduciary to "discharge his duties with respect to a plan solely in the interests of the participants and beneficiaries." [1] Additionally, a fiduciary must act like a "prudent man."[2] This means a person must act with the same care and skill as another person in a comparable position.

A 1996 letter from your Department states that futures, swaps and derivatives, such as commodity index funds, may be used as an investment by pension funds under ERISA.[3] However, the letter noted that:

> …investments in certain derivatives, such as structured notes and collateralized mortgage obligations, may require a higher degree of sophistication and understanding on the part of plan fiduciaries than other investments. Characteristics of such derivatives may include extreme price volatility, a high degree of leverage, limited testing by markets, and difficulty in determining the market value of the derivative due to illiquid market conditions.

Commodity index funds appear to have extreme price volatility and are often highly leveraged, and although they have been existence for a little more than 20 years, they have grown dramatically in the last decade. These investments appear to be among the riskiest financial products available, on par with the housing-related derivatives that destroyed the American housing market and have left millions of homeowners owing more on their mortgages than their

[1] 29 U.S.C. § 1104(a)(1).
[2] Id.
[3] Available at http://www.dol.gov/ebsa/regs/ILs/il032196.html

houses are worth. While originally considered to be a lucrative investment strategy, commodity index funds have not performed well of late. And their very existence drives up oil and energy prices for all consumers. Considering that plan beneficiaries of pension funds are almost all on fixed-incomes, price spikes in gasoline hurt plan beneficiaries even more than the ordinary citizen.

Commodity Index Funds Are Hurting Consumers

Commodity index funds have a big impact on our commodities markets. These funds, which are typically a basket of different commodities futures, have grown explosively since they were first created by Goldman Sachs in 1991. At present, commodity index traders collectively comprise the single largest group of non-commercial participants in commodity markets. According to consumer group Better Markets, commodity index traders now possess approximately 30% of the contracts in wheat futures, while all other speculators posses about the same percentage of contracts.

The fact that this one type of fund controls such a large share of our commodities markets would be troubling even if commodity index funds were benevolent. Yet, there is clear evidence that these funds are disrupting both our commodities markets and our economy.

Most futures contracts are for a set period of time and must inherently expire. For instance, on April 19, 2012, the futures contracts for delivery of West Texas Intermediate crude oil in May expired, meaning that the contract will no longer be traded on the New York Mercantile Exchange. As a result, if a trader in possession of a May futures contract wanted to purchase a futures contract for oil again, she had to sell her April futures contract before it expired and purchase a new contract for delivery in a month further in the future, such as one for delivery in June 2012, July 2012, December 2012, or September 2013. This practice, which is known as "rolling" is critical to the functioning of commodity index funds. Yet, because practically all commodity index funds always roll between the 5th and 9th business day of each month, many traders know to expect this and plan accordingly. As Better Markets CEO Dennis Kelleher stated in recent testimony before the House Natural Resources Committee, "Predictable trading in large amounts always attracts other traders seeking to take advantage of and profit from that predictable trading. It is legal front-running made easy. It is almost the commodity market equivalent of shooting fish in a barrel."

All told, the "rolling" process reportedly leads to between \$200 billion and \$400 billion in liquid trades occurring in our commodities markets each month. The huge amounts of liquidity churning in our commodities markets due to rolling increases the prices of precious commodities like oil and wheat, thereby driving up prices for consumers. Indeed, Better Markets has analyzed oil markets and found that, according to their CEO, Dennis Kelleher, since 2004, "the upward price bias in the West Texas Intermediate crude oil futures market was correlated at a 99% level with the Roll."

Worse, this speculation is having a real impact on consumers. Testimony recently submitted to the Natural Resources Committee suggests that speculation may be increasing prices at the pump by as much as 25 percent. That means that American consumers are paying a speculation premium of up to 71 cents on every gallon of gas they buy. So, when an American is filing up his 2012 Ford Taurus, he has to give the oil companies an additional $13.49 because of Wall Street's speculative gambling.

Commodity Index Funds Are Highly Volatile and Not Necessarily Good Performers

In addition to the negative effect commodity index funds have on consumers' wallets and the commodities markets, these investments recently have performed poorly for their investors. Unfortunately, it is difficult to know the full performance history of commodity index funds but we would welcome any information you could provide to us on this matter. What we do know is that a person who invested $1000 in the S&P 500 at the start of 2011 would have $1080 as of mid-April 2012. However, a person who invested $1000 at the start of 2011 in the Goldman Sachs Commodity Index (GSCI), which is the most popular commodity index, would only have $999.60 as of mid-April 2012. Worse, if a person invested $1000 at the start of 2011 in the Dow Jones-UBS Commodity Index, which is the second most popular commodity index, she would only have $852.60 as of mid-April 2012.

Because commodity index funds are highly susceptible to rumors and news, such as a rumor that an oil pipeline had been destroyed or that a crop of wheat was infested with insects, these investments are highly volatile, increasing the risk to pension investors dependent on secure long-term returns.

Additionally, commodity index funds at times involve complex trading strategies, "often-untested innovations," and can be subject to "sharp reversals in an already risky asset class."[4] These features seem to have the potential to create significant risks for investors.

Pension Plans Are Prime Players in Commodity Index Funds

Despite the above, it has come to our attention that pension funds are a significant investor in Wall Street's commodity index funds. Commodity index funds have been marketed to pension

[4] Pleven, Liam. March 4, 2012. *Wall Street Journal*. "New Recipes for Commodity Investing."

funds, and they have become a key part of many pension funds' investment portfolio. According to a 2008 CFTC report, institutional investors, such as private and government pension funds and endowment funds, held 42% of commodity index funds. Given that sovereign wealth funds, such as government-run pensions, held another 9%, a majority of the commodity index funds were held by either pension funds or funds with similar characteristics.

Commodity index funds also have become significant holdings for a number of pension funds as well. For instance, the largest pension fund in America, the California Public Employees' Retirement System (CalPERS), has 1% -- or more than $2 billion -- of its entire holdings invested in Standard and Poor's Goldman Sachs Commodities Index.[5] While CalPERS is not an ERISA-regulated fund, we understand that many such private funds may be invested in commodity index funds.

This trend is likely to significantly increase in future years. According to Better Markets, "Pension funds who have pledged up to 6% of their portfolios to commodities are typically just 2-3% invested now, meaning they are on average likely to roughly double their investments over the next few years."

We Request the Department of Labor's View on Commodity Index Funds

We would like to have the benefit of the Department of Labor's view on this matter. In order to better understand pension plan investments in such funds and ERISA's requirements relating to investments in them, we also request that you respond to the following:

1) Has the Department of Labor reviewed pension plan investments in commodity index funds and the circumstances under which it a) might require additional guidance to plan fiduciaries and b) might constitute a violation of ERISA? If so, what has the Department concluded or what actions has the Department taken in response?

2) Do any of the ten largest private pension plans have 1% or more of their total assets invested in or benchmarked to commodity index funds?

3) What information does the Department have about the nature and size of private pension plan investments in commodity index funds?

4) What information does the Department have regarding the nature and size of investment in commodity index funds by non-ERISA pension funds?

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[5] While CalPERS' benefit programs are exempt from ERSIA, they generally follow its provisions. *See Retirement Security in California - CalPERS Benefit Primer* (October 2009), available at http://www.calpersresponds.com/downloads/Pension_Primer.pdf

Thank you for your assistance and cooperation in this matter. Please provide us with a written response by May 15, 2012. If you have any questions, please contact Justin Slaughter on the Natural Resources Committee's staff at (202) 225-6065 and Michele Varnhagen on the Education and the Workforce Committee's staff at (202) 225-3725.

Sincerely,

Edward J. Markey
Ranking Member
Committee on Natural Resources

George Miller
Ranking Member
Committee on Education and the Workforce