TESTIMONY OF WILLIAM F. QUINN

ON BEHALF OF THE

THE COMMITTEE ON THE INVESTMENT OF
EMPLOYEE BENEFIT ASSETS

BEFORE A HEARING OF THE

SENATE HOMELAND SECURITY AND GOVERNMENTAL
AFFAIRS COMMITTEE

ON

ENDING EXCESSIVE SPECULATION IN
COMMODITY MARKETS: LEGISLATIVE OPTIONS

June 24, 2008

Testimony of William F. Quinn,
Chairman

on behalf of
The Committee on the Investment of
Employee Benefit Assets

Before a Hearing of the Senate Homeland Security and
Governmental Affairs Committee

Washington, DC
June 24, 2008

Mr. Chairman, Ranking Member Collins, and other members of the Committee, my name is William Quinn. I am the Chairman of CIEBA.

Thank you for providing this opportunity to testify. The Committee on Investment of Employee Benefit Assets -- CIEBA -- is the voice of the Association for Financial Professionals on employee benefit plan asset management and investment issues. CIEBA was formed in 1985 to provide a nationally recognized forum and voice for ERISA-governed corporate pension plan sponsors on fiduciary and investment issues. CIEBA members are the chief investment officers of most of the major private sector retirement plans in the United States. CIEBA represents 110 of the country's largest pension funds and its members manage more than $1.5 trillion of defined benefit and defined contribution plan assets, on behalf of 17 million plan participants and beneficiaries nationwide. According to Federal Reserve data, the $966 billion managed by CIEBA members in defined benefit plans represents half of all private defined benefit plan assets.

The pension system has served millions of Americans for over half a century and tens of millions of retirees rely on defined benefit and defined contribution pension plans as a critical element of their retirement security. We owe it to working Americans and their families to ensure that any contemplated policy changes, no matter how well intentioned, do not undermine their retirement.

The record prices for food and energy in the U.S. and abroad are of great concern to all of us. We are sensitive to the urgency with which this issue must be addressed and we applaud the need to investigate this critical problem. Nonetheless, we are deeply concerned about the prospect of any legislation that would bar pension plans from investing in certain types of assets.

Congress has long recognized that direct government regulation of pension plan investments is ill-conceived. ERISA – the primary law that regulates the investment of pension assets – takes a very different tack. Rather than requiring or prohibiting specific investments, ERISA imposes rigorous fiduciary responsibilities on the persons that manage pension plan assets. These rules require a plan's fiduciary to act prudently, and to diversify plan investments so as to minimize the risk of large losses. In addition, ERISA requires that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to the plan's participants. Fiduciaries who violate these obligations face a range of civil and criminal penalties.

The sole instance in which ERISA directly regulates pension investments is with respect to investments in employer securities – an area where there are clearly unique considerations, including potential conflicts of interest and the possibility of excessive concentrations of investment risk. In fact, private pension plans today invest in a wide range of different asset classes, including U.S. and international equities, U.S. and international fixed income, emerging markets, real estate, private equity, and natural resources. Plan fiduciaries use a variety of investment techniques and tools, including derivative instruments, to mitigate risk and enhance returns. Further, when presented with emerging asset classes and investment strategies, the Department of Labor – the federal agency with oversight responsibility for pension investments – has consistently given its blessing as long as the investment is prudent and for the exclusive benefit of participants and beneficiaries.[1]

Other countries have taken different approaches to the investment of pension plan assets. Historically, some U.S. state government and some European defined benefit plans had rigid investment guidelines, prohibiting certain types of investments and requiring others. Many of these rigid investment rules were eventually discarded because of the negative impact such guidelines had on investment returns and thus on employees' retirement security. Even today, European pension funds subject to more restrictions on plan investments have been shown to be consistently outperformed by funds subject to regimes such as ours, which pair investment flexibility with strict fiduciary obligations. Put simply, mechanical approaches do not work as well as the American approach. It is critical that pension plans have the ability to invest in accordance with modern portfolio theory and pursue the best investment strategy available. The investment marketplace is constantly changing and pension plans need to be able to adapt and evolve accordingly without having to comply with lists of permitted and impermissible investments.

Our concern is both with specific restrictions on pension plan investments in commodities and with the precedent that action will set for allowing the government to intrude on pension investment decisions. Today, commodities investments are not a significant part of most pension plan investments. Preliminary results for CIEBA's 2007 profile survey show that plans have less than one percent of assets invested directly in commodities and a similar amount invested in natural resources. It may be that the actual percentage of assets invested in commodities is modestly greater through indirect investment vehicles, such as hedge funds. However, in total, CIEBA members reported that only 3.15 percent of their assets were invested in the broad category of hedge funds in 2006. We firmly believe that commodities may be part of a prudent, well-diversified investment portfolio by providing a hedge against inflation and minimizing volatility, but

[1] *See, e.g.,* Department of Labor Information Letter to Eugene Ludwig, Comptroller of the Currency (Mar. 21, 1997) (permissibility of investing pension assets in derivatives).

our primary concern is with the principle that the government should not micromanage pension plan investments.

Pension plans are long-term investors, not speculators. The most successful plans do not ‘chase’ returns. Rather they have disciplined strategies for minimizing risk and enhancing returns so that plan sponsors can fulfill the promises they make to their employees.

Political temptation to intervene in pension investments is not unprecedented. Congress in the past has considered legislation that would bar plans from investing in particular investments or, conversely, would require plans to invest in particular investments. There are numerous instances in which there has been a first instinct to require pension plans to make investment decisions with a view to promoting social or political goals, such as protecting the environment or stimulating business activity in certain geographic areas.

Congress, however, has consistently rejected legislation that would subjugate the retirement security of millions of Americans and their families to other social or political concerns, no matter how worthy. In fact, when confronted with whether pension plans may take into account social goals in considering economically targeted investments, the Department of Labor interpreted “the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.”[2]

Moreover, the case for limiting pension investments in commodities has simply not been made. As others, including the Commodity Futures Trading Commission (“CFTC”), have testified, it is far from clear that institutional investors in the commodities market are driving the surging prices. The allegations that institutional investors engage in harmful speculation in the commodities markets have been almost entirely anecdotal and we are not aware of any substantial analysis that supports the allegations. Before acting, it is imperative that Congress step carefully and allow the CFTC to analyze the commodities markets and gather data to facilitate an informed approach.

Various proposals to restrict investments in commodities do not define commodity investing with any specificity. If interpreted broadly, these restrictions could apply to direct investment in commodities, any commodities futures transactions, commodity indexes and even publicly-traded companies who produce or distribute energy or agricultural commodities. Compliance with such a prohibition would significantly disrupt pension plans’ overall investments, thereby hurting plan participants.

Finally, regardless of one’s view of whether institutional investors as a whole have been a driver of rising prices, it is apparent that pension investments have not been a material cause of the rising cost of food and energy. As previously mentioned, investments in commodities are a small fraction of CIEBA member pension funds’ assets. Further, most

[2] 29 C.F.R. § 2509.94-2.

plans will rebalance their investments periodically to assure that they stay within their guidelines and do not inadvertently get over-exposed to any single asset class. Plans with exposure to commodities or commodity indexes are very likely to sell when prices rise and buy when prices fall in an effort to maintain a constant weighting with respect to the whole portfolio.

Regulating pension investments would make it difficult for pension plans to adequately diversify investments to hedge against market volatility and inflation and, consequently, would put at risk the retirement funds of the very workers the proposal is intended to help. In effect, such a proposal could be a case of robbing Peter to pay Paul.

Again, thank you for this opportunity to testify. Please let me know if there is additional information that you would like to receive from us. We are happy to help you in any way we can.