Prohibit Investment in Commodities by Pension Funds and Certain Large Institutional Investors
Proposal #3
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Background: Commodity prices, in the aggregate, have increased more over the last five years than at any other recorded period in U.S. history. Some experts argue that commodity markets are in the midst of a demand shock produced by a new source of investment money: institutional investors that seek returns based on a commodity index strategy. A commodity index provides returns based on the appreciation or depreciation of a diversified group of commodities traded on a futures exchange. Assets allocated to commodity indices by these so-called “index speculators” have grown from $13 billion five years ago to $260 billion today. Index speculators are predominantly institutional investors, such as pension funds, sovereign wealth funds, and university endowments.

The demand for oil futures contracts generated by new index speculators over the past five years is comparable to the rising demand for petroleum generated by China’s economic growth over the same period.

Investment decisions by index speculators appear generally unrelated to the changing fundamentals that affect the supply and demand for physical commodities. Rather, many institutional investors seem to adopt a “buy and hold” strategy in which a percentage of their portfolio is automatically allocated to commodity markets. Unlike traditional speculators who provide market liquidity by both buying and selling futures, price-insensitive index speculators buy and “roll” futures positions. Index speculators are generally consumers of liquidity because they adopt long-only positions in the market.

Proposal: Some analysts argue that by consuming market liquidity and increasing demand for agriculture and energy commodity futures, institutional investors contribute to the rising prices at the pump and in the grocery stores. To diminish the inflationary impact of institutional investors on food and energy prices, the proposal would:

- Prohibit private and public pension funds with more than $500 million in assets from investing in agricultural and energy commodities, whether traded on a U.S. futures exchange, a foreign exchange, or over-the-counter.

- Prohibit U.S or foreign governmental entities or instrumentalities (such as public university endowments or sovereign wealth funds) with more than $500 million in assets from investing in agricultural and energy commodities, unless the governmental investor is engaging in a bona fide hedging activity. A bona fide hedging activity by a governmental entity could include, for example, purchasing an oil futures contract to reduce the price risk associated with a government fleet’s fuel consumption.

- Prohibit institutional investors, broadly defined, with more than $500 million in assets, from investing in the commodity markets through a passively managed and broadly diversified index fund tied to physical commodities.