PENSION RIGHTS CENTER
PROTECTING AND PROMOTING RETIREMENT SECURITY
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May 13, 2010

The Honorable Blanche Lincoln
Chairwoman
Senate Agriculture, Nutrition and Forestry Committee
U.S. Senate
Washington, DC 20510

Dear Chairwoman Lincoln,

As the nation's only consumer organization dedicated solely to the protecting and promoting of the retirement security of American workers, retirees, and their families, the Pension Rights Center urges you to retain important protections now included in the Restoring American Financial Stability Act ("RAFSA") for pension plans that enter into swaps involving the use of derivatives.

Section 731 of RAFSA includes a new rule that would impose on swap dealers new obligations to a pension plan that would provide important protections to the tens of millions of participants in pension plans.

For many years, pension funds and others have used derivatives for legitimate business purposes: to hedge their future liabilities, to reduce exposure to parts of the market, or to increase exposure to other parts of the market. However, more recently, as swap instruments have become more complex and difficult to understand, some instruments have resulted in dangerous levels of leverage or in risky bets on the future direction of the market.

These latter types of instruments may be appropriate for some investors, but are generally not suitable investments for pension plans. Indeed, the recent market meltdown exposed the perils that such risky and highly leveraged contracts can pose for pension and other retirement plans.

Under current law, broker dealers have little obligation to advise their plan clients of the high level of risk of some derivatives contracts or to ensure that the contracts are appropriate for the plan, even though the broker is taking the opposite side of the contract and thus has conflicting interests with its client.

Section 731would in effect require that swap dealers deal fairly and appropriately with pension and other retirement plans that are taking the opposite side of the swap dealer's bet. Indeed, one manager of a very large ERISA plan suggested to us that much of the damage that plans recently incurred because of these instruments might have been averted had the RAFSA protections been in place.

This reasonable standard is being assailed by lobbyists for trade groups and investment banks who assert that Section 731 will not merely regulate dealings between swap dealers and plans, but will put a permanent halt to them, including legitimate hedging transactions. Their contention is that RAFSA will somehow turn swap dealers into “ERISA” fiduciaries. This assertion is false.

The bill simply requires that those on the other side of a derivative instrument from a plan make full disclosure of any conflicts of interest, deal with the plan in good faith, and have a reasonable belief that the instrument is an appropriate investment for the plan. This is a straightforward and sensible standard for business conduct.

Lobbyists from the derivatives industry also argue that pension and other retirement plans are “sophisticated institutional investors” that do not need the protections proposed in the bill. However, recent market events have revealed that even some of the most sophisticated and largest funds may not have fully appreciated the risks to which they were exposed.

For this reason, we also believe that any plan that enters into a derivatives contract should retain an independent expert advisor whose compensation is not directly or indirectly contingent on whether the plan enters into a swap transaction. Some may contend that the cost of retaining such an advisor would be prohibitive to small plans that cannot afford such independent advice. But plans that cannot afford such advice should not, in our view, be participating in this complex market.

The pertinent provisions of section 731 of the Restoring American Financial Stability Act are not about stopping swap-dealers from selling products. They are about protecting pension funds that hold trillions of dollars that millions of Americans count on to ensure that they can live their retirement years with the benefits they were promised and the dignity they deserve.

We urge you to retain the provisions of Section 731 that protect these important benefits.

Sincerely,

Karen Friedman
Executive Vice President and Policy Director

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Senior Policy Consultant