GAO Highlights

401(k) PLAN INVESTMENTS

DOL Can Take Steps to Prepare for Expected Private Equity Growth

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A report to congressional requesters

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What GAO Found

Private equity is one type of investment within a broad, undefined category called alternative assets. It differs from publicly traded equity in who can invest in it, how it is valued, and what disclosures are required, among other things. GAO's review of selected research papers that analyzed private equity investment fund performance found no consensus on the performance of private equity relative to publicly traded equity, which is an important consideration when making investment decisions. GAO found a range of performance findings among research papers we reviewed, as well as ranges in data analyzed, benchmarks for performance comparisons, and methodologies. For example, one group of papers found that private equity funds outperformed publicly traded equity for the sample of funds they analyzed during the specific time-periods studied. The size of the overperformance varied widely. In one paper the benchmarks did not include a risk premium, the excess return that some experts believe a private equity investment should provide to justify higher investment risks. Another group of papers found that private equity funds underperformed publicly traded equity during the time-period studied, accounting for the underlying risk or fees, which can be higher for private equity than for publicly traded equity products. Our review of these papers also found that there is no consensus on how to effectively benchmark private equity performance. Financial regulations require open-end management investment companies (e.g., mutual funds) reporting investment performance data to include a benchmark that is the average annual total returns of an appropriate broad-based securities market index. Our review found a range of benchmarks for private equity fund returns, including several publicly traded equity indexes and custom indexes.

Given the complexity of private equity and its recent use in 401(k) plans, plan sponsor and industry association representatives GAO interviewed said that plan sponsors need education on key aspects of private equity, such as how its valuation differs from traditional investments, like mutual funds. Consumer organization representatives also told us that participants should understand certain aspects about private equity, such as its illiquidity. Under law, the Department of Labor (DOL) is authorized to provide not only regulations, but also other guidance, as needed, to promote retirement security. However, GAO found that DOL has not yet issued specific guidance to help sponsors and participants better understand basic aspects of private equity. For example, the agency has not issued guidance to plan sponsors to help these fiduciaries to better understand how private equity's liquidity and valuation differ from traditional investments, and how it is regulated, among other things. In addition, the agency has not issued guidance to participants, such as a fact sheet, to help them understand how private equity differs from traditional investments. By providing guidance to both plan sponsors and to participants, DOL can help them understand this asset type, which is expected to grow among 401(k) plan investment options.

Why GAO Did This Study

Private equity is historically reserved for certain investors, including wealthy individuals or institutional investors, like pension plans. Recent industry developments and federal actions suggest that more products offered to 401(k) plans may soon have more significant allocations to this asset class. However, little is known about the extent to which private equity is used in 401(k) plans and how its use might be communicated to plan sponsors and to participants, who rely on their 401(k) investments to safeguard retirement.

GAO was asked to review 401(k) plan investments' use of private equity.

GAO examined research on private equity investment performance against publicly traded equity benchmarks and how private equity investment information is communicated to 401(k) plan sponsors and participants, among other objectives.

To answer these questions, GAO analyzed available federal and private data sources, conducted a literature review of selected research papers, assessed a selection of disclosures, including Securities and Exchange Commission and other fund documents, and interviewed industry representatives, consumer advocates, and officials from the U.S. and four countries.

What GAO Recommends

GAO is making three recommendations to DOL, including that DOL should provide guidance to plan sponsors and participants to help them understand key aspects of private equity such as how it differs from traditional investments. DOL neither agreed or disagreed with our recommendations.