



Highlights of [GAO-08-692](#), a report to congressional requesters

### Why GAO Did This Study

Millions of retired Americans rely on defined benefit pension plans for their financial well-being. Recent reports have noted that some plans are investing in 'alternative' investments such as hedge funds and private equity funds. This has raised concerns, given that these two types of investments have qualified for exemptions from federal regulations, and could present more risk to retirement assets than traditional investments.

To better understand this trend and its implications, GAO was asked to examine (1) the extent to which plans invest in hedge funds and private equity; (2) the potential benefits and challenges of hedge fund investments; (3) the potential benefits and challenges of private equity investments; and (4) what mechanisms regulate and monitor pension plan investments in hedge funds and private equity.

To answer these questions GAO interviewed relevant federal agencies, public and private pension plans, industry groups and investment professionals, and analyzed available survey data.

### What GAO Recommends

GAO recommends that the Secretary of Labor provide guidance on investing in hedge funds and private equity that describes steps plans should take to address the challenges and risks of these investments. Labor generally agreed with our findings and recommendation.

To view the full product, including the scope and methodology, click on [GAO-08-692](#). For more information, contact Barbara Bovbjerg at (202) 512-7215 or [bovbjerg@gao.gov](mailto:bovbjerg@gao.gov), or Orice Williams at (202) 512-8678 or [williamso@gao.gov](mailto:williamso@gao.gov).

## DEFINED BENEFIT PENSION PLANS

### Guidance Needed to Better Inform Plans of the Challenges and Risks of Investing in Hedge Funds and Private Equity

#### What GAO Found

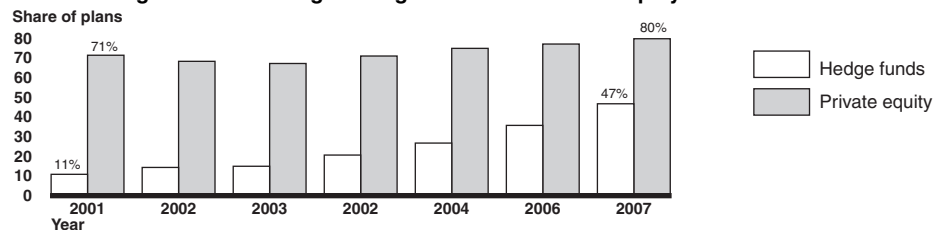
According to several recent surveys of private and public sector plans, investments in hedge funds and private equity generally comprise a small share of total plan assets, but a considerable and growing number of plans have such investments. Available survey data of mid to large-size plans indicate that between 21 and 27 percent invest in hedge funds while over 40 percent invest in private equity; such investments are more prevalent among larger plans, as shown below. The extent of investment in hedge funds and private equity by plans with less than \$200 million in total assets is unknown.

Pension plans invest in hedge funds to obtain a number of potential benefits, such as returns greater than the stock market and stable returns on investment. However, hedge funds also pose challenges and risks beyond those posed by traditional investments. For example, some investors may have little information on funds' underlying assets and their values, which limits the opportunity for oversight. Plan representatives said they take steps to mitigate these and other challenges, but doing so requires resources beyond the means of some plans.

Pension plans primarily invest in private equity funds to attain returns superior to the stock market. Pension plan officials GAO spoke with generally had a long history of investing in private equity and said such investments have met expectations for returns. However, these investments present several challenges, such as wide variation in performance among funds, and the resources required to mitigate these challenges may be too substantial for some plans.

The federal government does not specifically limit or monitor private sector plan investment in hedge funds or private equity, and state approaches to public plans vary. Under federal law, fiduciaries must comply with a standard of prudence, but no explicit restrictions on hedge funds or private equity exist. Although a federal advisory council recommended that the Department of Labor (Labor) develop guidance for plans to use in investing in hedge funds, Labor has not yet done so. While most states also rely on a standard of investor prudence, some also have legislation that restricts or prohibits plan investment in hedge funds or private equity. For example, one state prohibits plans below a certain size from investing directly in hedge funds.

Share of Large Plans Investing in Hedge Funds and Private Equity



Source: *Pensions & Investments*' 2007 annual survey.