Private Equity Sees Trump Path to 401(k) Market

By Tom Stabile February 8, 2017

Private equity fund managers expect the new **Donald Trump** administration to boost their chances of clawing into the nation's 401(k) market – and some say it won't even require a big regulatory overhaul.

The clearest path would be the new administration encouraging retirement plan sponsors to add target date funds that use private equity strategies simply through new regulatory guidance that gives the government's blessing to the practice. A more far-reaching goal to allow stand-alone private equity strategies in retirement plans might come about if the administration were to encourage sponsors to offer programs that don't give investors daily liquidity.

A handful of firms, including **Pantheon** and **Partners Group**, have built vehicles to add private equity exposure to target date funds in recent years but they have not yet gotten traction in the market. And **Blackstone Group** has been studying ways to break into the retirement plan market with its products but has not unveiled specific plans.

That landscape may shift with the new administration, and Blackstone is expecting to push for changes that will smooth the path for private equity in retirement plans, said **Tony James**, Blackstone's president and COO, during its recent earnings call.

"I've spent a lot of time with both Republicans and Democrats on this," he said. "And I've got an awful lot of favorable reactions from both sides of the aisle. So I'm hopeful that we can make some progress on this with the new administration."

The private equity industry already sees reason for hope, with high-profile executives courted by the new administration, says **Jonathan Epstein**, president of the **Defined Contribution Alternatives Association**. Some of those names include **Cerberus Capital Management** CEO **Steve Feinberg** and **Wilbur Ross**, head of **Invesco** affiliate **WL Ross & Co.**, both of whom are in the running for posts in the new administration, as well as Blackstone CEO **Steve Schwarzman**, who is chairing the new President's Strategic and Policy Forum.

"I think it's possible the current administration would be a little bit more open to private equity," Epstein adds.

The biggest hurdle to overcome today is the unwillingness of retirement plan sponsors to bring private equity-infused target date funds on board without a clear sign they won't be subject to litigation in a market that sees frequent lawsuits over investment decisions, says **Kevin Albert**, managing director at Pantheon.

“The new administration could absolutely make a difference, and the executive branch could shine a bright light on that,” he says. “There will be something… they can do where that decision is not an automatic lawsuit.”

Blackstone has been **camped at the door** of the 401(k) market for a while, arguing that private equity should get wider access to a market with trillions of dollars on the premise that most defined contribution plans fail to match defined benefit plan returns because they don’t use alternatives. Schwarzman repeated that view during the firm’s recent earnings call, saying government action would be the key change.

“[T]here is an ability for something to get changed that could be really, really impactful,” he said.

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The quickest path into the market – easing concerns over litigation – can come with moves as simple as regulatory guidance from the **Department of Labor** that a certain practice is deemed acceptable and prudent for retirement plan fiduciaries, Epstein says. Such guidance in recent years has opened the door for defined contribution plans to use annuity products or to select strategies that follow environmental, social, and governance investing criteria, he says.

“That’s a potential avenue for private equity, a determination that the ability to invest in private markets represents an alignment with long-term investing values,” he says. “That’s one area that hasn’t been touched on yet.”

Regulatory guidance from the DOL on such topics gives breathing room for plan fiduciaries to venture beyond current practices, Epstein says.

“They feel more comfortable doing things that have been addressed [by the DOL],” he says. “That certainly helps plan sponsors from a legal standpoint.”

Pantheon has aimed at the same issues with recent changes it made to a vehicle it **developed in 2015** to add private equity to target date funds, Albert says. Last week it announced a new pricing option designed to make the product not only more attractive to investors on cost but also a safer case for plan fiduciaries to justify as a reasonable defined contribution plan choice.

“We’ve talked to people for a year, year-and-a-half, and gotten a positive response from people quite interested in taking the plunge, but there are two remaining issues,” he says, citing an unwillingness to try new investment approaches and the desire to avoid higher fees. “We needed to make one more cycle of changes.”

Pantheon’s new model pays it a performance fee on private equity investments only when the total return of its strategy beats its S&P 500 benchmark for a calendar quarter, and it accrues that revenue gradually over eight quarters. If the strategy falls short of the benchmark, Pantheon rebates a portion of the fee back to investors.

That option could make private equity sleeves in target date funds an easier choice for plan sponsors, Epstein says. “They’ve really put some time and effort into structuring something that makes private equity in their vehicles a little more appealing,” he says.

A bigger target – and one that’s likely further off – is the possibility of defined contribution programs having stand-alone private equity options, which is not viable today in most cases because the majority of retirement plans have daily liquidity as a core feature, Epstein says. But that, too, could change with regulatory guidance or a nudge from the government, because about 8% of defined contribution plans in existence – primarily “money purchase plans” – have monthly, quarterly, or annual liquidity features that are more suitable for longer-term alts investments, he says.

“I see that changing as well,” he says. “You could see stand-alone options if plans were designed for longer holds.”

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