COMMITTEE ON CAPITAL MARKETS REGULATION

EXPANDING OPPORTUNITIES FOR U.S. INVESTORS AND RETIREES: PRIVATE MARKETS

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The Committee thanks its research staff, including John Gulliver (Executive Director) and Connor Kortje (Executive Director of Research), for their role in the preparation of this report.

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COMMITTEE ON CAPITAL MARKETS REGULATION

Expanding Opportunities for U.S. Investors and Retirees: Private Markets

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Introduction

On August 7, 2025, President Trump issued an executive order directing the Department of Labor ("**DOL**") and the Securities and Exchange Commission ("**SEC**") to broaden access to private funds and other alternative assets investments through 401(k) accounts.[1] The order notes that over 90 million Americas now participate in defined contribution plans. However, the risk of "burdensome lawsuits" that challenge reasonable decisions by plan fiduciaries prevent such fiduciaries from offering participants investment options with exposure to private funds and other alternative assets. The order therefore specifically directs the DOL to issue a rule or other guidance, which may include a safe harbor, clarifying the duties that a fiduciary owes to plan participants under the Employee Retirement Income Security Act of 1974 ("**ERISA**") when providing plan participants with an option to invest in alternative assets.

The analysis and evidence we present in this report supports the policy rationale in the executive order. Furthermore, we provide specific recommendations for how the DOL should implement the order.

Although the executive order addresses alternative assets more broadly, this report is primarily focused on private markets. Over the past two decades, U.S. companies have raised more equity through private offerings available only to institutional and high-net-worth investors than through initial public offerings ("**IPOs**") that are available to the general public. The number of U.S. public companies has also been steadily declining, and private start-up companies are frequently reaching billion-dollar valuations without opening up to the public for investment.

In this report, *Expanding Opportunities for U.S. Investors and Retirees: Private Markets*, the Committee on Capital Markets Regulation (the "**Committee**") revisits the question of whether U.S. policymakers should expand access to investments in private companies through private equity funds. Although the primary subject of this report is private equity funds, we believe much of the analysis also applies to private credit funds.

A private equity fund is an investment vehicle that invests in the securities of private companies and with direct investment limited to high-net-worth and institutional investors. Private equity funds are not registered with the SEC as investment companies, although most fund managers are required to register with the SEC as investment advisers. The most common type of private equity fund is a buyout fund that acquires controlling stakes in businesses. By contrast, publicly available investment vehicles, such as mutual funds and closed-end funds, must register as investment companies with the SEC, and are thus subject to a variety of additional disclosure obligations and regulatory restrictions.

In its 2018 report, *Expanding Opportunities for Investors and Retirees: Private Equity* (the "**2018 Report**"), the Committee concluded that private equity funds have a well-established performance history that justifies expanding investor access to them. The report recommended specific actions that policymakers could take to bring about this expanded access, including: (1) SEC reforms to

[1] Executive Order, *Democratizing Access to Alternative Assets for 401(k) Investors* (Aug. 7, 2025).

expand access to public closed-end funds that invest in private equity funds, and (2) DOL reforms to facilitate the ability of 401(k) plans to invest in private equity funds.

In the seven years since the 2018 Report, these recommendations have not been implemented. The Committee is therefore revisiting the case for expanding investor access to private equity.

We find that since the 2018 Report, the growth of private markets has accelerated, with U.S. companies raising 10 times more equity through private markets than through IPOs for each of the last three years, and the number of multi-billion-dollar private companies reaching an all-time high. Furthermore, a substantial body of new empirical evidence has emerged confirming private equity's investment benefits in the form of higher returns and risk-reducing portfolio diversification. Similar evidence has also emerged in other sectors of private markets – particularly private credit. During this time, the Committee has also continued to support efforts to strengthen U.S. public equity markets to increase capital formation and broaden the investment opportunities available to retail investors in public markets.[2]

The percentage of U.S. households that are excluded from private equity investments has also increased since the 2018 Report. This is a result of (1) the continued exclusion of over 98% of U.S. households from direct private equity investments, (2) the continued regulatory limitations on public fund investment in private equity, and (3) the continued growth of 401(k) retirement plans, which do not provide access to private equity investment, due to liability risks that dissuade 401(k) plan sponsors from offering private equity investment options. We review multiple empirical studies demonstrating how the lack of access to private equity through 401(k) plans has had a substantial negative impact on U.S. households' retirement savings.

In addition, we expand the coverage of this report to another important segment of private markets: private credit funds. Private credit refers to privately negotiated debt financing provided by professionally managed investment vehicles to corporate borrowers. These loans are an alternative source of debt financing for companies outside the traditional bank-intermediated lending market or the public bond market. We find that there is substantial empirical evidence indicating that U.S. investors and retirement savers could benefit from broader access to private credit funds.

We therefore recommend that:

> (1) The SEC allow retail investors (i.e., investors that are non-accredited investors or that are accredited but are not "qualified purchasers" under the Investment Company Act), including through their Individual Retirement Accounts, to invest in public closed-end funds that invest more than 15% of their assets in private equity funds.

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[2] *See, e.g.*, COMMITTEE ON CAPITAL MARKETS REGULATION ["**CCMR**"], *CCMR Priorities for Financial Regulatory Policy* (Feb. 2025), https://capmktsreg.org/wp-content/uploads/2025/02/CCMR-Priorities-for-Financial-Regulatory-Policy-02-04-25.pdf; CCMR, *An Analysis of Investment Stewardship: Mutual Funds and ETFs* (May 2020), https://capmktsreg.org/wp-content/uploads/2022/11/An-Analysis-of-Investment-Stewardship-Mutual-Funds-and-ETFs-Final-for-Website-5.19.2020-1.pdf; CCMR, *Roadmap for Regulatory Reform* (May 2017), https://capmktsreg.org/wp-content/uploads/2022/11/Roadmap-for-Regulatory-Reform-1.pdf.

(2) The DOL concurrently rescind its 2021 Supplemental Letter and propose a rule creating a formal safe harbor under which 401(k) plan sponsors would automatically be deemed to have complied with the prudence and loyalty requirements under Section 404 of ERISA when offering investment options with exposure to alternative asset classes, including private equity and credit funds.

Rescission of the DOL's 2021 Supplemental Letter will immediately reinstate the efficacy of the carefully considered guidance provided in the DOL's 2020 Information Letter. As part of this rescission, the DOL should expand the scope of the 2020 Information Letter to encompass the additional alternative asset classes contemplated in the safe harbor. The rescission of the 2021 Supplemental Letter and the expansion of the 2020 Information Letter would provide fiduciaries with an immediate clarification of the DOL's policy on the inclusion of private assets in 401(k) plans. The issuance of a formal safe harbor would afford fiduciaries materially more certainty that their actions comply with ERISA when they apply a specified review methodology that is consistent with the methodologies that plan fiduciaries currently apply and would seek to ensure a robust process for selecting investment options that comply with their fiduciary duties to plan participants. The DOL should also exempt plan fiduciaries from ERISA's prohibited transaction provisions when they invest in closed-end funds and other investment vehicles that are managed by affiliates, when they abide by the same or similar requirements of the existing exemption available for investments in affiliated open-end mutual funds and exchange-traded funds.

SEC Chairman Paul Atkins recently indicated that the SEC may soon take action to implement our first recommendation. The Chairman cited the rapid growth of private markets and noted that expanding access to private funds through public closed-end funds could "increase investment opportunities for retail investors seeking to diversify their investment allocation in line with their investment time horizon and risk tolerance" while maintaining necessary investor protections.[3] The Chairman indicated that the SEC therefore intends to reconsider its policy of barring public closed-end funds available to retail investors from investing 15% or more of their assets in private funds, and the SEC's Division of Investment Management Director subsequently confirmed that SEC staff intend to abandon this policy.

In this report, we do not call for expanding access to direct investments in private companies. It is difficult to assess the performance of direct investments in private companies, as there are no indices tracking their performance, unlike for public companies. By contrast, private equity funds are a large, well-established asset class for institutional investors and have a history of consistently outperforming public markets.

Furthermore, each of our proposals would only provide access to private equity funds, and the private companies in which they invest, and other alternative assets, through a financial professional with a fiduciary duty to the investor. Specifically, in the case of public closed-end funds, the registered investment adviser owes fiduciary duties to the fund and its investors. In the case of 401(k) plans, the plan sponsor owes fiduciary duties to the plan's beneficiaries.

[3] Paul S. Atkins, *Prepared Remarks Before SEC Speaks*, SEC CHAIRMAN SPEECH (May 19, 2025), https://www.sec.gov/newsroom/speeches-statements/atkins-prepared-remarks-sec-speaks-051925.

Additionally, our proposed safe harbor for 401(k) plan sponsors would require sponsors that provide investment options with exposure to private equity funds and other alternative assets to do so through an asset allocation fund that the sponsor determines has expected net return and liquidity characteristics consistent with the needs of plan participants, is managed by investment professionals with the experience necessary to manage private equity assets, and applies industry-standard valuation practices. These requirements would further protect 401(k) plan beneficiaries who choose investment options with exposure to private equity.

Our recommendations therefore provide a safer path for retail investors and 401(k) access to private markets compared to direct investment by retail investors in private companies. We call on the DOL to act quickly on these recommendations.

Our report proceeds in four parts.

Part I ("The Growth of the Private Equity Market") presents statistics illustrating the significant and growing importance of private markets to U.S. companies and demonstrates that private equity funds are the dominant vehicles for investment in private markets.

Part II ("The Investment Benefits of Private Equity Funds") reviews the latest empirical evidence of private equity fund performance, showing that private equity funds – particularly buyout funds – generate strong investment returns and reduce the riskiness of investors' portfolios. We also review evidence related to other sectors of private markets – particularly private credit.

Part III ("Expanding Access to Private Equity Through Public Closed-End Funds") reviews the restrictions that continue to prevent the vast majority of U.S. households from investing in private equity funds directly or gaining indirect exposure to private equity funds through publicly offered funds. We review evidence that this exclusion has imposed substantial costs on these investors. We then review policy developments since the 2018 Report and find that they have been insufficient to implement our recommendation that the SEC enable public closed-end funds to invest more extensively in private equity. We therefore renew our recommendation.

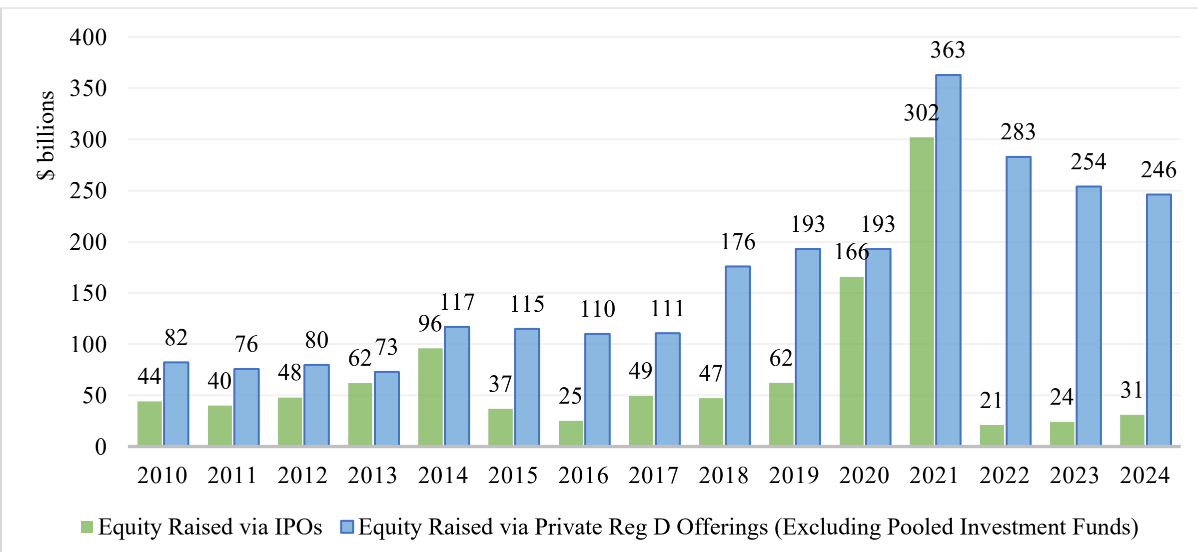
Part IV ("Expanding Access to Private Equity Through Retirement Accounts") revisits the legal liability risks that continue to dissuade 401(k) retirement plan sponsors from offering investment options in private equity. We find that a vast and growing majority of retirees now participate in 401(k) retirement plans instead of defined benefit plans, and that defined benefit retirement plans' extensive investment in private equity funds has allowed them to outperform 401(k) plans. We also review new research showing that enabling 401(k) plans to invest in private equity would allow participants to increase returns and lower the risk of their retirement portfolios. We then review relevant policy developments since the 2018 Report and find that they have been insufficient to expand access to private equity funds through 401(k) accounts. We therefore renew our recommendation that the DOL issue a clear legal safe harbor from class actions and other suits under ERISA to allow sponsors of 401(k) plans to offer investment options with private equity, private credit, and other alternative asset exposure. Our proposed safe harbor would require the sponsor to apply a specified review methodology to determine that the investment option is suitable for the plan and plan participants, and consistent with the sponsor's fiduciary duties to plan participants. Concurrently with the safe harbor proposal, we also recommend that the DOL rescind its 2021 Supplemental Letter and modernize its framework for prohibited transaction exemptive relief with respect to the inclusion of affiliated funds in retirement accounts.

Part I: The Growth of the Private Equity Market

Over the past two decades, the number of private companies in the U.S. has grown substantially, while the number of public companies has continually declined. As a result, private markets now constitute a significant component of the investable U.S. equity market and are the principal conduit through which companies raise equity capital. Private equity funds — professionally managed investment vehicles that invest in the equity of private companies — have also grown substantially and constitute a major asset class in the U.S. investment market. An investment portfolio that excludes private equity thus increasingly fails to reflect the complete U.S. equity market. The following discussion presents statistics that illustrate these trends.

Figure 1 shows that, in U.S. capital markets, companies have raised more equity through private offerings than through IPOs for each of the last 15 years, and 10 times more equity through private offerings over the past three years.[4] The amount raised through private offerings exceeded the amount raised through IPOs even in 2021, during the surge in IPOs conducted through special purpose acquisition companies.

Figure 1: Equity Capital Raised in the U.S. via IPOs vs. Private Offerings[5]

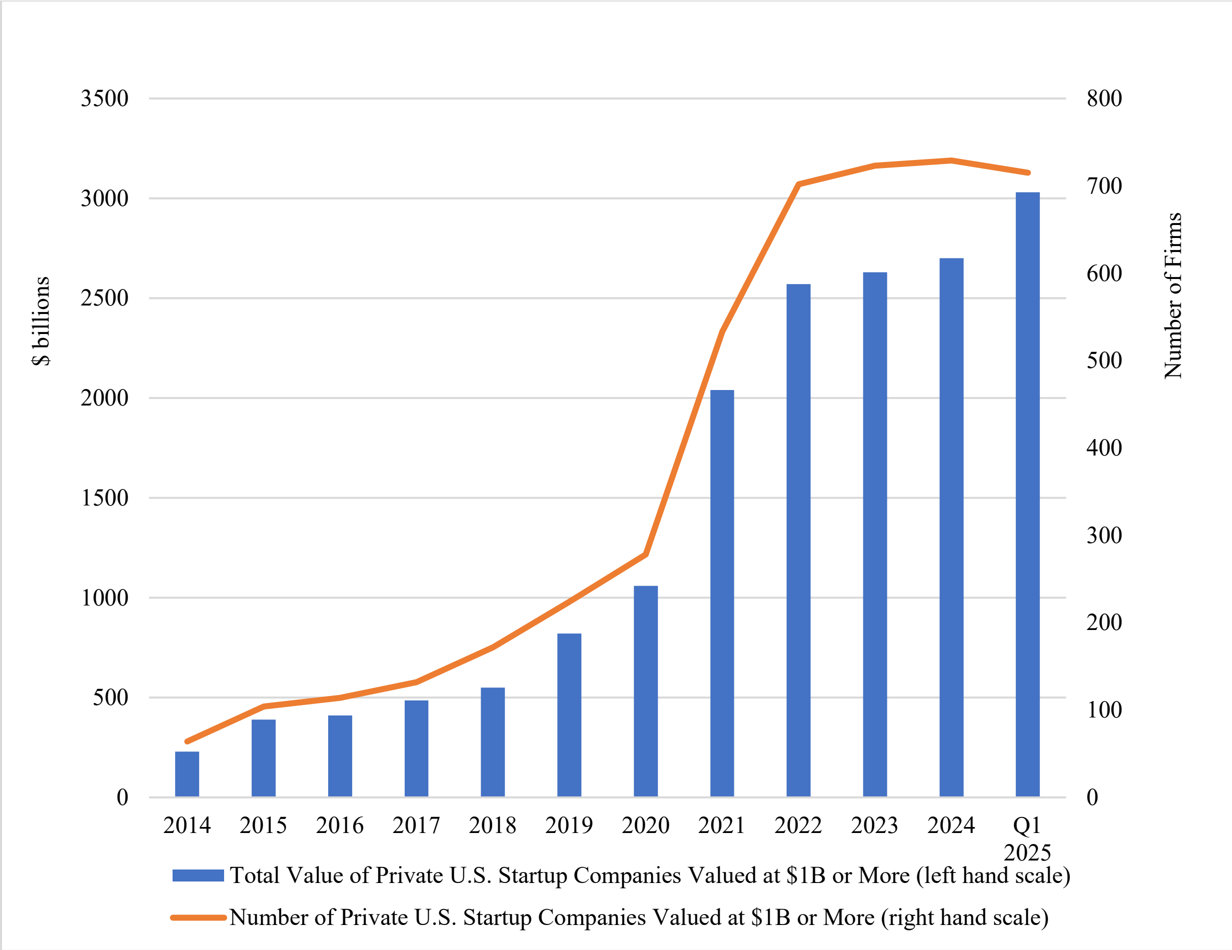


[4] Data were extrapolated from SEC, *Small Business Capital Formation Reports*, https://www.sec.gov/about/divisions-offices/office-advocate-small-business-capital-formation/small-business-capital-formation-reports; SEC, *Form D Data Sets* , SEC.gov | Form D Data Sets, and Forms D and S-1 available on the SEC's EDGAR database.
[5] *Id.*

Furthermore, the data on private offerings in Figure 1 are sourced solely from companies' Form D filings with the SEC, and thus likely understate the total private capital raised in U.S. markets.[6]

Figure 2 shows that, over the past decade, the number of private companies that achieved valuations of $1 billion or more without opening up to public investment has continually increased. In 2014, there were 64 such companies, with a total value of $230 billion. As of March 2025, there were over 700, with a total value of over $3 trillion.[7]

Figure 2: U.S Private Companies Valued at $1 Billion or More[8]



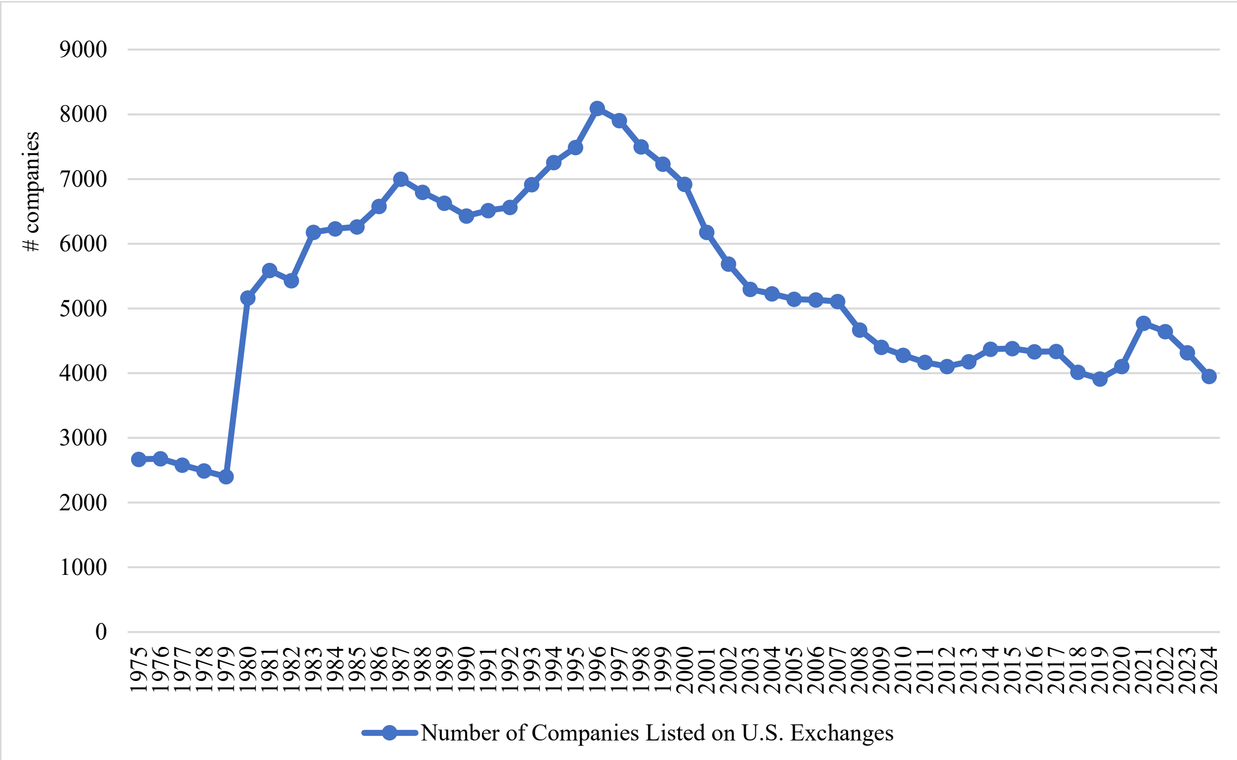
[6] *See, e.g.,* Kathleen Weiss Hanley & Qianqian Yu, *Strategic Regulatory Non-Disclosure: The Case of the Missing Form D*, SSRN WORKING PAPER (2023), https://dx.doi.org/10.2139/ssrn.4363027; Michael Ewens & Nadya Malenko, *Board Dynamics Over the Startup Life Cycle*, JOURNAL OF FINANCE FORTHCOMING (2025), https://dx.doi.org/10.2139/ssrn.3640898.

[7] PITCHBOOK, *Q1 2025 NVCA Venture Monitor* at 30 (Apr. 14, 2025), https://pitchbook.com/news/reports/q1-2025-pitchbook-nvca-venture-monitor

[8] *Id.*

In addition, the number of companies open to public investment in U.S. markets has declined. Figure 3 shows that the total number of publicly traded companies in the U.S. has declined and stagnated over the past two decades and is, as of 2024, lower than the number that existed in the early 1980s.[9]

Figure 3: Number of Companies Listed on U.S. Stock Exchanges[10]



As private companies have grown, so have private equity funds — professionally managed investment vehicles that invest in the equity of private companies. As shown in Figure 4, net assets under management ("**AUM**") of U.S. private equity funds increased from $1.4 trillion in 2013 to $6.7 trillion in 2024, reflecting an annual growth rate of 15.3%.[11]

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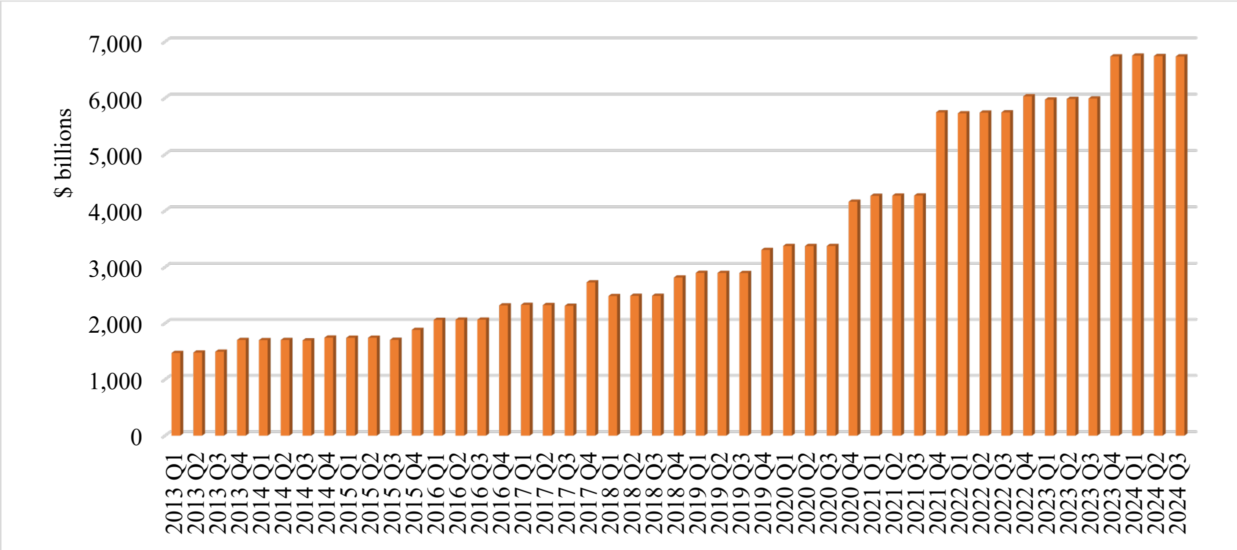
[9] Data for 1975 through 2022 are drawn from THE WORLD BANK, *Listed Domestic Companies*, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US&view=chart. Data for 2023 and 2024 are drawn from Wes Moss, *The Decline in U.S. Stocks to Choose From: What It Meant for Investors*, FORBES (Feb. 3, 2025), https://www.forbes.com/sites/wesmoss/2025/02/03/the-decline-in-us-stocks-to-choose-from-what-it-means-for-investors/.

[10] *Id*.

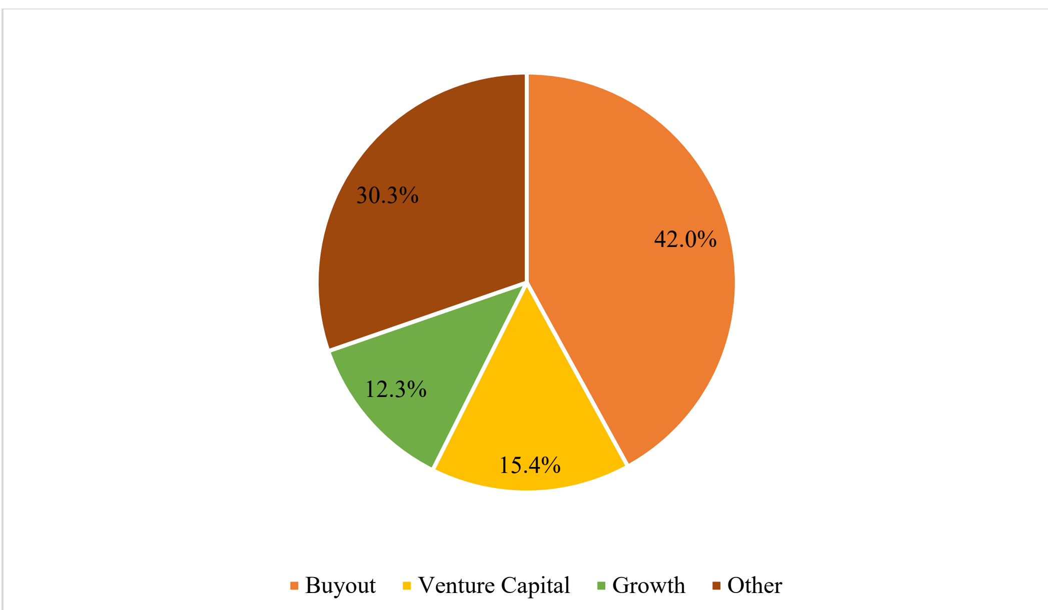
[11] Data extrapolated from various SEC DIVISION OF INVESTMENT MANAGEMENT ANALYTICS OFFICE, *Quarterly Reports on Private Funds Statistics*, https://www.sec.gov/data-research/investment-management-data.

Figure 4: Total U.S. Private Equity Funds Net Assets Under Management[12]



The largest portion of private equity fund assets is managed by private equity buyout funds. Figure 5 shows that, as of January 2025, 42% of U.S. private equity AUM is held in buyout funds, 15.4% in venture capital funds and 12.3% in growth funds (late-stage venture capital).[13]

Figure 5: Percent of Private Equity AUM by Fund Type[14]



[12] *Id*.

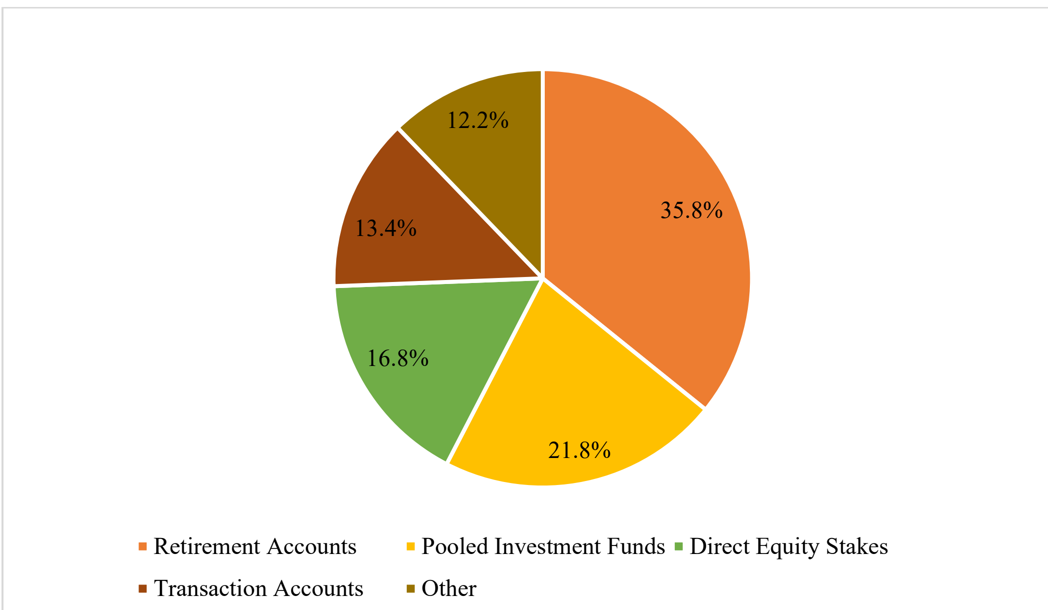
[13] Data derived from Preqin Ltd. as of January 2025.

[14] *Id*.

Despite the growing size and significance of private equity funds, the U.S. financial regulatory framework excludes the vast majority of U.S. households from investing in them. In particular, the most recent Federal Reserve data from 2022 suggest that approximately 98% of U.S. households do not meet the qualified purchaser standard required to invest in most private equity funds.[15]

In Parts II-IV below, we identify the costs of this continued exclusion and the actions that policymakers can take to safely and effectively broaden access to private equity funds. Our report focuses on expanding access to private equity funds through public funds and retirement accounts, as these are the primary investment and savings vehicles for U.S. households. Figure 6 illustrates that, according to the most recent Federal Reserve data, the financial assets of U.S. households are primarily held in pooled investment funds, such as mutual funds, and in retirement accounts, such as individual retirement accounts and defined contribution plans. Furthermore, retirement savers are inherently long-term investors (i.e., 30+ years) and are, in this respect, well-suited for private equity strategies, which, as discussed in Part II, also have longer-term investment horizons.

Figure 6: U.S. Households' Financial Assets Allocation[16]



[15] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *2022 Survey of Consumer Finances* (Oct. 18, 2023), https://www.federalreserve.gov/econres/scfindex.htm.
[16] *Id*. at 15.

Part II: The Investment Benefits of Private Equity Funds

Part II reviews empirical analyses of private equity fund performance. Our focus is on buyout funds, as the largest portion of U.S. private equity AUM is held in buyout funds, and academic studies on private equity typically focus on this segment. We find that the empirical literature consistently shows that buyout funds provide significant performance advantages and risk-reduction benefits for investors.

We begin by providing an overview of the basic investment strategy and structure of private equity buyout funds. We explain how these characteristics can allow fund managers to achieve strong performance for investors. We then summarize the most common measures of fund performance and review the findings of the relevant empirical literature.

1. **Private equity buyout funds**

Private equity buyout funds generate returns by identifying and purchasing undervalued companies, increasing the company's value, and realizing gains through a sale or public offering of the company's shares. The process of increasing a portfolio company's value and preparing the portfolio company for a sale or public offering typically takes several years, not including the time necessary to identify and conduct due diligence on a target company. Over the past decade, this period has averaged about 6 years for North American private equity funds; over the prior decade, the average was about 5 years.[17] Private equity buyout fund managers thus need access to long-term capital because their investment strategies are necessarily long-term. Investors are therefore not permitted to withdraw their capital during the fund's lifecycle, which typically spans 10 to 12 years. In the interim, distributions to investors are generally made only when the fund liquidates one of its investments. As a result, investments in private equity buyout funds are relatively illiquid compared to the traditional investment opportunities available to retail investors.

The academic literature identifies several ways in which the long-term structure and investment strategy of buyout funds have the potential to generate strong returns for investors. One of the most significant is the illiquidity premium. An illiquidity premium refers to the additional return that an investor receives in exchange for holding an illiquid asset. The less liquid the asset, the higher the illiquidity premium that investors will demand. As noted above, investments in private equity funds are relatively illiquid compared to publicly traded assets, as investors generally cannot withdraw their capital during the fund's lifecycle. Furthermore, selling an interest in a private equity fund typically requires the fund manager's approval and transaction-specific negotiations — neither of which applies when selling a security in the public markets.[18] Empirical studies provide extensive evidence of illiquidity premiums across various financial assets, including

[17] Karl Angelo Vidal & Annie Sabater, *Private Equity Buyout Funds Show Longest Holding Periods in 2 Decades* S&P GLOBAL (Nov. 22, 2023), https://www.spglobal.com/market-intelligence/en/news-insights/articles/2023/11/private-equity-buyout-funds-show-longest-holding-periods-in-2-decades-79033309.

[18] Phyllis A Schwartz & Stephanie R. Breslow, PRIVATE EQUITY FUNDS: FORMATION AND OPERATION (2ND EDITION) at 2-113 (2024).

private equity fund investments.[19] In essence, the evidence indicates that by obtaining commitments from investors to hold their fund interests for a longer period, the fund's managers obtain a stable source of capital to generate value over the long term, enabling them to achieve higher returns for investors.

Buyout funds also generate higher returns through operational improvements, multiple expansion, and the use of leverage in their portfolio companies.[20]

Operational improvements refer to changes in the operations of a firm that increase profitability or free cash flow. Several studies document how private equity-owned businesses in various industries implement operational improvements. For example, Bernstein & Sheen (2016) examined the operational performance of 101 private equity portfolio companies in the restaurant industry and found that safety and maintenance improved, and prices were reduced, at the private equity-owned restaurants relative to their non-private equity owned competitors.[21] Fracassi et al. (2022) found that private equity-owned companies in various consumer products industries increased their sales revenue by an average of 50% relative to non-private equity-owned companies, without increasing prices by introducing new products and expanding into new markets.[22] Sorenson et al. (2022) surveyed the economic literature on buyout funds and found that buyout fund managers increase the value of portfolio companies by "imparting operational and managerial expertise, increasing investment, and inducing top-line revenue growth."[23]

Multiple expansion refers to an increase in the valuation multiple that allows the fund to sell an investment at a profit (e.g., purchasing a company at a 10x earnings multiple and selling at 12x earnings). Multiple expansion can occur through improvements in the firm's future prospects or favorable market timing.[24] Private equity funds also generate returns from leverage, as using less equity to finance an investment allows for higher returns on equity.[25] While leverage has traditionally been widely used by buyout funds, its extent has declined over time. Historically, 80-

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[19] *See, e.g.* Morten Sorensen, Neng Wang & Jinqiang Yang, *Valuing Private Equity*, 27(7) THE REVIEW OF FINANCIAL STUDIES 1977 (2014), https://www.jstor.org/stable/24465669.

[20] *See* Ann-Kristin Achleitner, Reiner Braun, Nico Engel, Christian Figge & Florian Tappeiner., *Value Creation Drivers in Private Equity Buyouts: Empirical Evidence from Europe*, 13(2) THE JOURNAL OF PRIVATE EQUITY 17 at 18 (2010), https://www.jstor.org/stable/43503632. *See also* Michael Brigl, Axel Jansen, Bernhard Schwetzler, Benjamin Hammer, Heiko Hinrichs & Wilhelm Schmundt, *How Private Equity Firms Fuel Next-Level Value Creation*, BOSTON CONSULTING GROUP (Feb. 19, 2016), https://www.bcg.com/publications/2016/private-equity-power-of-buy-build.

[21] Shai Bernstein & Albert Sheen, *The Operational Consequences of Private Equity Buyouts: Evidence from the Restaurant Industry* 29(9) THE REVIEW OF FINANCIAL STUDIES 2387 (2016), https://academic.oup.com/rfs/article-abstract/29/9/2387/2583693.

[22] Ceasare Fracassi, Alessandro Previtero & Albert Sheen, *Barbarians at the Store? Private Equity, Products, and Consumers*, 77(3) THE JOURNAL OF FINANCE (2022), https://onlinelibrary.wiley.com/doi/10.1111/jofi.13134.

[23] Morten Sorensen & Ayako Yasuda, *Stakeholder Impact of Private Equity Investments*, HANDBOOK OF THE ECONOMICS OF CORPORATE FINANCE VOL 1: PRIVATE EQUITY AND ENTREPRENEURIAL FINANCE (2023), https://ssrn.com/abstract=4087778.

[24] Achleitner et al., *supra* note 20 at 21.

[25] *Id*. at 18 and 27, n.3.

90% of the initial financing for a fund's acquisition of target companies came from borrowed capital, but, as of 2024, this percentage has declined to approximately 50%.[26]

Several academic studies of private equity performance have found that operational improvements account for roughly half of the value created by private equity buyout fund managers, while leverage accounts for approximately one-third, and multiple expansion constitutes the remainder.[27] In addition, Brown & Yi (2023) analyzed a sample of 2,937 buyout fund deals from 1984 through 2018 and found that the buyout funds "reliably created value" through operating improvements and financial engineering (i.e., leverage) and that the fraction of buyout fund value creation attributable to leverage has been declining over time.[28] More recent research has shown that margin expansion accounts for 14% of value creation among the top quartile of private equity funds, and is a significant driver of private equity's outperformance.[29]

2. Measuring private equity returns

The main methodologies for estimating private equity performance are (i) the internal rate of return (the "**IRR**"), and (ii) the public market equivalent (the "**PME**"). The primary benefit of both methodologies is that they rely on actual cash flows to calculate performance, which is important given that private equity funds lack publicly listed prices. To fully evaluate a fund's performance, it needs to reach its endpoint, when it has exited all of its portfolio companies. For example, the complete performance of a 7-year fund launched in 2019 could only be evaluated in 2026, subject to any extension.

Private equity investors seeking to compare the returns achieved by different managers frequently refer to the IRR, whereas academic economists seeking to evaluate the overall performance of private equity against other asset classes typically prefer the PME. Both measures provide essential insight into private equity returns, and recent empirical studies referencing both IRR and PME find strong performance by private equity investments. The methodology for calculating each is described briefly below, followed by a summary of recent empirical findings.

A. Internal Rate of Return

The IRR is the discount rate that sets the net present value of an investment equal to zero.[30] For example, suppose an investor invests $100,000 in a private equity fund that is locked in for 10

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[26] Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23(1) JOURNAL OF ECONOMIC PERSPECTIVES 121 at 124 (2009), https://www.aeaweb.org/articles?id=10.1257/jep.23.1.121; PITCHBOOK, *U.S. PE Breakdown* at 17 (2024), https://files.pitchbook.com/website/files/pdf/2024_Annual_US_PE_Breakdown.pdf .

[27] *See, e.g.*, Achleitner et al., *supra* note 20; Fabian Soffge & Reiner Braun, *Corporate Raiders at the Gates of Germany? Value Drivers in Buyout Transactions*, 20(2) THE JOURNAL OF PRIVATE EQUITY 28 at 35 (2017), https://www.jstor.org/stable/44397507. However, others have found that leverage plays a less significant role in value creation. *See, e.g.*, Brigl et al., *supra* note 20.

[28] Gregory W. Brown & Lu Yi, *How Do Private Equity Firms Create Value*, UNC INSTITUTE FOR PRIVATE CAPITAL WORKING PAPER (2023), https://www.luluyi.net/How_do_private_equity_firms_create_value_.pdf.

[29] Hugh MacArthur, Rebecca Burack, Graham Rose, Alexander Schmitz, Kiki Yang & Sebastien Lamy, *Private Equity Outlook 2025: Is a Recovery Starting to Take Shape?*, BAIN & COMPANY (Mar. 3, 2025), https://www.bain.com/insights/outlook-is-a-recovery-starting-to-take-shape-global-private-equity-report-2025/.

[30] John Downes & Jordan Eliot Goodman, DICTIONARY OF FINANCE AND INVESTMENT TERMS 367 (9TH EDITION 2014).

years. Further suppose that the private equity fund distributes $50,000 back to the investor in year 5, and makes a final distribution of $200,000 in year 10. The IRR is the discount rate that sets the present value of the two distributions (i.e., $50,000 in year 5 plus $200,000 in year 10) equal to the initial investment of $100,000. Mathematically, the IRR is illustrated as follows:

$$\$100{,}000 = \$50{,}000/(1+IRR)^5 + \$200{,}000/(1+IRR)^{10}$$

In this case, the IRR is approximately 11%. Since the IRR methodology relies on cash flows to calculate a performance measure, valuations of the underlying portfolio companies are unnecessary. Importantly, the IRR is an *absolute measure* of performance, meaning it does not control for broader market returns (e.g., S&P 500) or other sources of risk.[31] This lack of benchmark comparison is a shortcoming of the IRR.[32] For example, whether an 11% IRR represents an attractive opportunity to an investor depends on the returns of other investment options – 11% looks strong against an S&P 500 IRR of 5%, but weak if the S&P 500 IRR is 15%.

B. Public Market Equivalent

The PME is a *relative measure* of performance that compares private equity returns to a public market benchmark, typically the S&P 500.[33] The PME is anchored to a benchmark of 1.00: A PME above 1.00 means that the private equity fund outperformed the public market benchmark, while a PME below 1.00 indicates underperformance.[34] For example, if a private equity investment has a PME of 1.25, the investor earned 25% more than they would have earned by investing in the S&P 500 over the same period. Conversely, a PME of 0.75 indicates that the investor earned 25% less than the benchmark. PME is a *cumulative* return measure over the life of the fund, rather than an annual return measure like the IRR. Thus, researchers often convert the PME into an annualized return based on the average duration of the private equity funds being analyzed. For example, a PME of 1.15 for a fund with a duration of 7 years represents an excess annual return of 2.0% above the return of the public benchmark. If that same fund alternatively had a duration of 5 years and a PME of 1.15, then the excess annual return would be 2.8%.

Converting the PME into an annualized return requires an accurate assessment of the average duration of the private equity fund. This is not always straightforward, as the duration of a private equity fund investment is not necessarily equivalent to its legal life. The distinction arises from the timing of cash flows: not all capital investments by the fund's investors occur at the fund's inception, and not all distributions are made at the end of the fund's legal term. So, while the legal life of a fund may be 10 years, the duration of the fund investment may be shorter for purposes of translating the PME into an annual return measure. Researchers must therefore review the cash flows of each private equity fund to determine the duration of the fund.

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[31] Steven N. Kaplan & Berk A. Sensoy, *Private Equity Performance: A Survey*, 7 ANNUAL REVIEW OF FINANCIAL ECONOMICS 597 at 599 (2015), https://www.annualreviews.org/content/journals/10.1146/annurev-financial-111914-041858.
[32] *See id*.
[33] *Id*. at 599-600.
[34] *Id*.

3. Empirical analysis of private equity fund performance

The 2018 Report reviewed the empirical literature on private equity fund performance and found extensive evidence that buyout funds achieve high rates of return and can also reduce the riskiness of investors' portfolios. In the seven years since the 2018 Report, further evidence supporting the strong performance of buyout funds has accumulated, which we review in this section.

In 2023, the Committee published a report that reviewed the empirical literature assessing the performance of private equity buyout funds.[35] The review showed that the empirical evidence is nearly unanimous in finding that buyout funds have performed very strongly relative to public market alternatives over the past 20 years, whether measuring performance using IRR or PME. The SEC's Asset Management Advisory Committee (the "**AMAC**") conducted a similar review and found support for the view that private equity has historically delivered better returns than public equity.[36] Below, we review several key studies in detail, including research that was published after the Committee's 2023 report. We note that each study evaluates performance *net* of fees – that is, each study's calculations reduce a fund's rate of return by the amount that the manager received in fees and carried interest.

A. Higher returns

The 2018 Report reviewed the extensive body of empirical studies available at that time, which showed that private equity buyout funds achieve high rates of return, including on a risk-adjusted basis. We note here several important examples from the 2018 Report:

- Robinson & Sensoy (2013) compared the performance of 837 buyout and venture capital funds from vintage years 1984 through 2010.[37] The analysis found that buyout funds had a PME of 1.18, which translated to an additional 3% rate of return relative to the index.
- Higson & Stucke (2012) analyzed a sample of U.S. buyout funds from vintage years 1980 through 2005.[38] The sample covered 85% of all capital raised by such funds during that period. The analysis found that the funds delivered an average excess annual return relative to the S&P 500 of 8%.
- A 2017 white paper from Voya, an independent retirement planning company, found that the average annual return to private equity over the 20-year period 1996-2016 exceeded the annual return to the S&P 500 by 4% (i.e., 12% annual return for private equity versus 8% annual return for the S&P 500).

[35] CCMR, *A Competitive Analysis of the U.S. Private Equity Fund Market* (Apr. 2023), https://capmktsreg.org/wp-content/uploads/2023/04/CCMR-Private-Equity-Funds-Competition-Analysis-04.11.20231.pdf.

[36] SEC Asset Management Advisory Committee, *Final Report and Recommendations for Private Investments* (Sep. 27, 2021), https://www.sec.gov/files/final-recommendations-and-report-private-investments-subcommittee-092721.pdf.

[37] David T. Robinson & Berk A. Sensoy, *Cyclicality, Performance Measurement, and Cash Flow Liquidity in Private Equity*, 122 (3) Journal of Financial Economics 521 (2016), https://doi.org/10.1016/j.jfineco.2016.09.008.

[38] Chris Higson & Rüdiger Stucke, *The Performance of Private Equity*, SSRN Working Paper (2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2009067.

Since the 2018 Report, additional studies of private equity performance have been published. These studies continue to demonstrate consistently that buyout funds offer significant performance benefits. We highlight here several important examples, in chronological order. We also identify one paper that claims to find contrary evidence and explain why the paper's analysis is unsound.

Brown & Kaplan (2019) compared the performance of buyout funds contained in the Burgiss Private iQ database from "vintage years" (i.e., the year a fund was established) 1988 through 2014 with the MSCI ACWI, a global index of public equities.[39] The authors found that the buyout funds had an average PME of 1.22, equivalent to an excess return of 3.5% over the public index. Moreover, each vintage year had an average PME greater than 1, indicating consistent outperformance.

In 2020, Professor Steven Kaplan presented an analysis of the investment performance of private equity buyout funds that covered funds from vintage years 1991 through 2015.[40] The analysis compared the average net-of-fee returns achieved by funds from each vintage year across their entire lifecycles with the returns of several comparable U.S. public equity indices over the same period. The buyout funds outperformed each of the public indices by substantial margins. In particular, both the average and median buyout fund PMEs relative to the S&P 500 index (an index of large cap public stocks) were greater than 1 (indicating outperformance) for all except three of the vintage years. For several vintage years the PME against the S&P 500 was as high as 1.6. The analysis also calculated PMEs against two indices of small cap stocks — the Russell 2000 and the Russell 2000 Value — both of which have historically outperformed the S&P 500 and found that the buyout funds consistently outperformed both indices — achieving a PME of greater than 1 for each vintage year.

A 2021 report by Cambridge Associates analyzed the connection between the returns obtained by institutional investors over the 2010-2020 period and the extent of the investors' exposure to private equity.[41] The analysis concluded that the median return achieved by institutional investors that allocated at least 30% of their portfolios to private equity funds was 2 percentage points higher than the median return earned by investors that allocated less than 10% of their portfolios to private equity funds.

Jenkinson et al. (2021) surveyed the academic literature on buyout fund performance, and the majority of studies surveyed found a PME for buyout funds greater than 1.[42]

Giommetti & Jorgensen (2021) compared the performance of a sample of 1,866 U.S. private equity funds from vintages 1978 through 2009 against the S&P 500 using a modified version of the PME

[39] Gregory W. Brown & Steven N. Kaplan, *Have Private Equity Returns Really Declined?* 22(4) THE JOURNAL OF PRIVATE EQUITY 11 (2019), https://www.jstor.org/stable/26864432.
[40] Steven N. Kaplan, *What Do We Know Really About Private Equity Performance?*, GUEST LECTURE AT MIAMI HERBERT BUSINESS SCHOOL (Jan. 30, 2020), https://news.miami.edu/miamiherbert/stories/2020/01/kaplan.html.
[41] David Thurston, *Building Winning Portfolios Through Private Investments*, CAMBRIDGE ASSOCIATES (Aug. 2021), https://www.cambridgeassociates.com/insight/building-winning-portfolios-through-private-investments/.
[42] Tim Jenkinson, Hyeik Kim & Michael S. Weisbach, *Buyouts: A Primer*, NBER WORKING PAPER 29502 (2021), https://www.nber.org/papers/w29502.

metric, the Generalized Public Market Equivalent (the "**GPME**"). The GPME quantifies the value of additional risk-adjusted profit an investor earns over the course of an investment relative to a public market benchmark, as a portion of the investor's capital. The analysis found that private equity funds provided investors with 20 cents of additional profits per dollar of committed capital on a risk-adjusted basis.[43] Huether et al. (2024) applied the GPME metric to the performance of 1,219 U.S. buyout funds from vintages 1980 through 2017 and found that the private equity funds provided 24 cents of risk-adjusted additional profits relative to a public market index.[44]

Phalippou (2022) claims that private equity funds have not offered superior net performance relative to public markets. This conclusion contrasts with the findings of the author's earlier study, Phalippou (2014), which found that buyout funds had an average PME of 1.20, equivalent to an excess annual return of 5.7% relative to the S&P 500 index.[45] Furthermore, as the Committee explained in its 2023 report, the 2022 study suffers from several critical methodological flaws.[46] First, the analysis selectively applies a narrow comparison period during which public stock performance was abnormally high and private equity performance was abnormally low. Second, whereas other studies measure the performance of different types of private equity funds separately (particularly buyout funds), Phalippou (2022) conflates the performance of buyout funds with other private equity funds — namely real estate, natural resources, and infrastructure funds. The analysis then compares the combined performance of these funds against the S&P 500, an index of equities. But an equity index is not a meaningful benchmark for the performance of these other types of funds, which invest in disparate asset classes. Professor Kaplan's 2020 analysis concluded that if Phalippou (2022) had corrected these flaws, it would have found that buyout funds outperformed public equities, consistent with other studies.

Korteweg (2023) surveyed the empirical literature on private equity returns and concluded that leveraged buyout funds on average outperformed public equity on a risk-adjusted basis over the period since the 1980s.[47]

Harris et al. (2023) analyzed the performance of a sample of 929 U.S. private equity buyout funds across the vintage years 1994 through 2015, taking into account the funds' performance through 2019. The authors found that the average PME relative to the S&P 500 was 1.18, equivalent to approximately 3.4% in additional annual return relative to the index. Furthermore, the average PME for each vintage year was greater than 1, indicating that none of the vintage years

[43] Nicola Giommetti & Rasmus Jørgensen, *Risk Adjustment of Private Equity Cash Flows*, SSRN WORKING PAPER at 15 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3980121.
[44] Niklas Huether, Lukas Schmid & Roberto Steri, *Credit Market Equivalents and the Valuation of Private Firms*, USC MARSHALL SCHOOL OF BUSINESS RESEARCH PAPER at 25-26 (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3463333.
[45] Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18(1) REVIEW OF FINANCE 189 (2014), https://doi.org/10.1093/rof/rft002.
[46] CCMR, *supra* note 35 at 24-25.
[47] Arthur Korteweg, *Risk and Return in Private Equity*, 1(1) HANDBOOK OF THE ECONOMICS OF CORPORATE FINANCE 343 (2023), https://www.sciencedirect.com/science/article/abs/pii/S2949964X23000085.

underperformed public equities.[48] The authors performed an equivalent analysis of a sample of 1,408 venture capital funds and found an average PME of 1.29. The study's results corroborate the findings of the authors' equivalent 2014 and 2016 studies, both of which conducted equivalent analyses for earlier periods and found that buyout and venture capital funds consistently and significantly outperformed public equity. The analysis found an even greater outperformance among the best buyout fund managers: the top 25% of private equity buyout funds had an average PME of 1.29.[49]

Brown et al. (2024) measured the performance of 1,600 U.S. buyout funds from 1987 to 2022. The analysis concluded that buyout funds delivered 2.1% in added annual risk-adjusted returns relative to public equities.[50] A 2024 industry analysis found that the returns to U.S. private equity funds exceeded the returns of the S&P 500 and Russell 3000, as well as an index of global public equities (the MSCI World Index), on a risk-adjusted basis from 2008 through 2023.[51]

Korteweg & Nagel (2024) analyzed the returns of a sample of 1,073 U.S. buyout funds from vintages between 1978 and 2016.[52] The analysis found that buyout funds, particularly those in the top quartile by size, significantly outperformed their public market equivalents.[53]

Brown et al. (2025) examined the performance of a sample of 7,816 private funds from vintage years 1988 through 2019 using a range of performance metrics, including IRR and PME. The analysis concluded that buyout funds consistently generated "reliable excess returns regardless of the benchmark or risk model."[54]

Balloch et al. (2025) conducted a similar analysis specific to private equity investments by individual high-net-worth investors and found comparable evidence of strong performance. The study analyzed the performance of 65,000 private equity investments by 17,900 individual investors across 4,500 buyout funds, venture capital funds, and funds-of-funds closed between 2000 and 2020.[55] The analysis concluded that the private equity investments in each class of fund

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[48] Robert S. Harris, Tim Jenkinson, Steven N. Kaplan & Ruediger Stucke, *Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds*, 81 JOURNAL OF CORPORATE FINANCE (2023), https://www.sciencedirect.com/science/article/pii/S092911992300010X .

[49] *Id*.

[50] Gregory W. Brown, Andrei S. Goncalves & Wendy Hu, *The Private Capital Alpha*, FISHER COLLEGE OF BUSINESS WP NO. 2024-03-020 (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4967890.

[51] HAMILTON LANE, *Private Wealth Perspectives: Analyzing Trends in Private Markets* at 5 (2024), https://www.hamiltonlane.com/en-us/strategies/evergreen-strategies.

[52] Arthur Korteweg & Stefan Nagel, *Risk-Adjusted Returns of Private Equity Funds: A New Approach*, THE REVIEW OF FINANCIAL STUDIES (Oct. 11, 2024), https://academic.oup.com/rfs/advance-article-abstract/doi/10.1093/rfs/hhae067/7818355?redirectedFrom=fulltext.

[53] *Id*. at Table VIII.

[54] Gregory Brown, Christian Lundblad & William Volckmann, *Risk-Adjusted Performance of Private Funds: What Do We Know?*, INSTITUTE FOR PRIVATE CAPITAL at 2 (Mar. 27, 2025), https://uncipc.org/wp-content/uploads/2025/03/Private-Risk-Adjusted-Returns-1.pdf.

[55] Cynthia Balloch, Federico Mainardi, Sangmin Oh & Petra Vokata, *Democratizing Private Markets: Private Equity Performance of Individual Investors*, Fisher College of Business Working Paper No. 2025-03-017 (2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5319498.

on average performed similarly to private equity investments by institutional investors and exceeded the returns to public markets on a risk-adjusted basis.

Furthermore, Kaplan (2023) found the outperformance benefits of private equity prevail across the asset class, contradicting the claim that obtaining superior investment performance from private equity is contingent on investing with the highest-performing managers. [56] Specifically, Kaplan's review of recent buyout fund performance found that the difference between the performance of the lowest and highest quartiles of private equity funds narrowed significantly between 2015 and 2023, and that even the lowest quartile of buyout fund performers still outperformed public equity. The study attributes this phenomenon to heightened competition among private equity fund managers. The findings of the Committee's 2023 study on competition in the U.S. private equity fund industry provide further support for the conclusion that increased competition is driving better performance in the private equity industry.[57] The study found that the market for private equity fund managers is characterized by low industry concentration and low barriers to entry, that the number of managers and variety of investment strategies are increasing, and that managers compete for investor capital by lowering fees and providing higher returns.

i. The Long-Term Effect of Private Equity Outperformance on Investor Wealth

The consistently high performance of private equity has major implications for the difference between the potential returns obtained by investors who are able to allocate a portion of their portfolio to private equity and those who are not.

Figure 7 shows a hypothetical result of investing $10,000 in year 1 in an account that invests for 35 years entirely in public equity compared to an account that invests entirely for 35 years in private equity buyout funds.

We estimate the annual return on public equity as 11.7%, which is the annual return on the S&P 500 from 1984 through 2024. We estimate the annual return on private equity buyout funds relative to the return on the S&P 500 using the findings of Harris et al. (2023), who found a 3.4% excess annual return. This implies an annual return of 15.1%. We use the findings of Harris et al. (2023) for this purpose because it is the most recent study of private equity performance published in a peer-reviewed journal. Notably, the 3.4% excess return is also among the *lowest* measured in the studies discussed above, and, as such, may underestimate the excess return that buyout funds achieve. We apply a 35-year time horizon to approximate the period that an individual saves for retirement. As shown in Figure 7, investing in public equity at an 11.7% annual return results in an end value of $481,000. Investing in buyout funds at a 15.1% annual return results in an end balance of $1.4 million, nearly three times the public equity investment.

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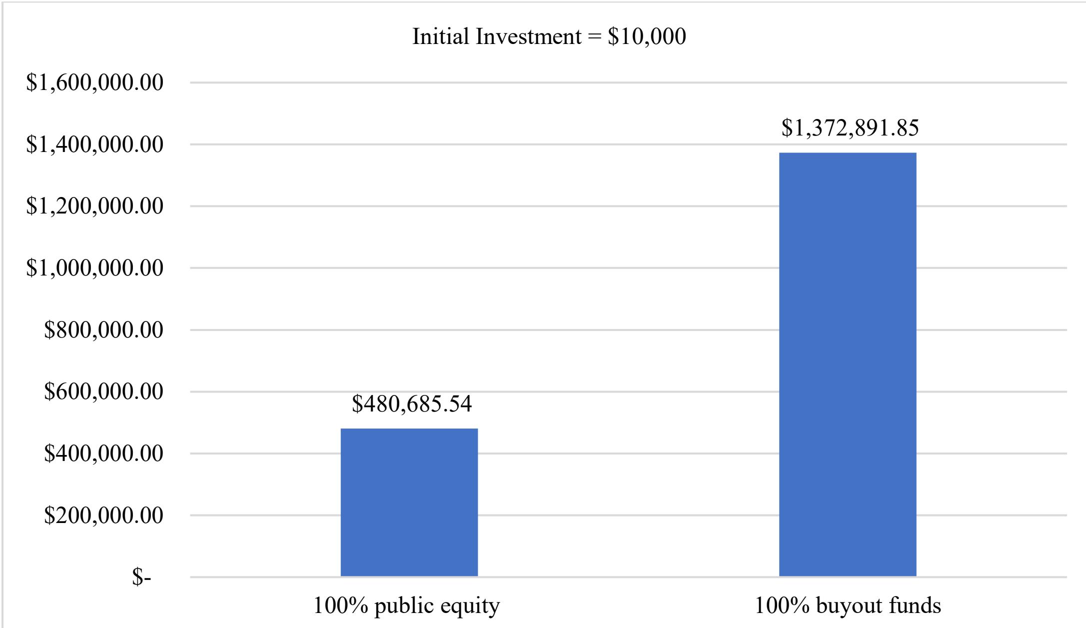
[56] Steven N. Kaplan, *Private Equity: Past, Present, and Future*, PRESENTATION TO THE SEC INVESTOR ADVISORY COMMITTEE MEETING (Mar. 2023), https://www.sec.gov/files/kaplan-iac-presentation.pdf
[57] CCMR, *supra* note 35.

Figure 7: Account Value After 35 Years - Public Equity vs. Buyout Funds



B. Reduced risk

Modern portfolio theory indicates that an optimal portfolio should maximize returns for a given level of risk. "Standard deviation," or "volatility," is a common measure of risk for this purpose. These terms refer to the likelihood that the investment will generate gains or losses significantly greater or less than the investment's target rate of return. The higher the standard deviation or volatility, the greater the likelihood of extreme outcomes. "Diversification" refers to the fact that an investment portfolio's volatility (i.e., risk) can be reduced by introducing other asset classes or investments that are not correlated with the risks of the portfolio's existing investments.

The empirical evidence that examines the risk-related effects of private equity investments consistently substantiates the benefits of such investments. Specifically, the studies show that (1) the returns to buyout funds are not riskier than the returns to public equity, and (2) private equity investment provides diversification, so adding private equity to a portfolio of public equity and fixed income investments reduces the portfolio's overall risk.

i. ***The returns to private equity are less volatile than public markets***

Multiple studies indicate that buyout funds' higher returns are less volatile than the returns of public market indices.

A 2017 white paper from Voya found that the riskiness of private equity returns was *lower* than that of public equities.[58] Specifically, the standard deviation of private equity returns during the 1996-2016 period was 14.5% versus 17.2% for the S&P 500.[59]

In addition, Czasonis et al. (2021) found that the relatively higher leverage employed by buyout fund-backed companies does not increase the volatility of returns to buyout funds and that the volatility of buyout fund returns is in fact comparable to that of public equity.[60] The authors suggest that this phenomenon may be attributable to buyout fund managers' preference for less risky businesses that can bear higher leverage. The findings indicated that the returns to the buyout funds were less volatile than the returns to the S&P 500. In addition, Kaplan's 2023 overview of the empirical data on private equity performance summarizes that private equity's outperformance "does not appear to be caused by higher risk."[61]

ii. Private equity reduces portfolio risk through diversification

Several studies have tested the risk-related effect of adding private equity to an existing portfolio of public equity and bonds. The results indicate that the addition of private equity investments reduces the portfolio's overall volatility. We highlight here several important examples.

The Voya white paper referred to above found that over the 20-year period 1996-2016, a hypothetical portfolio that consisted of 60% public equities and 40% public debt *without* a private equity component returned 7.1% annually with a standard deviation of 5.7%.[62] Alternatively, if a 20% private equity investment had been added to the portfolio by replacing 20% of the public equity investment (i.e. 40% public equity, 40% public debt, and 20% private equity), then the portfolio return would have risen to 8.9%, and its standard deviation would have dropped to 4.8%.[63] The results thus showed that the addition of private equity to an investor's portfolio not only increases the rate of return but also reduces the overall riskiness of the portfolio.

Goetzmann et al. (2019) analyzed the returns of a sample of over 5,000 private equity funds and found that investing in private equity complements exposure to public markets by providing exposure to a broader and more representative segment of the U.S. equity market and thereby reduces portfolio risk.[64]

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[58] VOYA INVESTMENT MANAGEMENT, *An Overview of Private Equity Investing* at 7 (2017).
[59] *Id*.
[60] Megan Czasonis, William Kinlaw, Mark Kritzman & David Turkington, *Private Equity and the Leverage Myth*, 23(3) JOURNAL OF ALTERNATIVE INVESTMENTS (2021), https://globalmarkets.statestreet.com/research/portal/insights/article/41f0ec64-0eea-41c9-9147-9514088ecb08.
[61] Kaplan, *supra* note 56.
[62] Voya, *supra* note 58 at 8-9.
[63] *Id*. at 9.
[64] William N. Goetzmann, Elise Gourier & Ludovic Phalippou, *How Alternative Are Private Markets?* (2019), https://www.phd-finance.uzh.ch/dam/jcr:47a000ea-61ae-41e1-8d42-b8e855b31ed1/FS_fall19_paper_phalippou.pdf.

Cosic et al. (2021) reviewed the academic literature and found that the addition of private equity to a portfolio consisting of public equity and bonds reduces the overall riskiness of the portfolio.[65] The study observes that the decline in the number of issuers available for public investment on U.S. stock exchanges —a trend noted in Part I —is likely a driving factor, as it has made private equity an increasingly important conduit for investment exposure to the small capitalization segment of the U.S. equity market.[66]

Most recently, a 2022 Boston College study tested the effect of private equity investments on the volatility of returns to public pension fund portfolios over the 2001 to 2022 period and found that the addition of private equity did not increase volatility and that it often reduced portfolio volatility.[67]

iii. Private equity investment provides protection against market stress

Furthermore, studies have found that private equity outperforms in a market crisis and that adding a private equity component to an investment portfolio can provide protection in times of market stress. In particular, the Voya white paper shows that during the dot-com crash from January 2000 to September 2002, a portfolio with a private equity component would have outperformed a portfolio without private equity by 4.3% (the portfolio with private equity returned -19.1%, while the portfolio without private equity returned -23.4%).[68] During the Global Financial Crisis from January 2008 through June 2009, the private equity portfolio outperformed the portfolio without private equity by nearly 2% (-18.6% for the portfolio with private equity and -20.5% for the portfolio without private equity).[69]

The findings of Lavery & Wilson (2024) suggest that the resilience of private equity returns originates in part with the ability of private equity managers to select portfolio companies that are operationally resilient during crises.[70] The authors compared the performance of a sample of companies during the COVID-19 pandemic across several measures including sales, assets, employment, and earnings. The comparison found that private equity-backed companies outperformed non-private equity-backed peers across each of these metrics. Bernstein et al. (2019) found that private equity-backed companies invest more in productive activities compared to peer companies during periods of economic stress when capital formation is lower; the analysis links

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[65] Damir Cosic, Karen E. Smith, Donald Marron & Richard W. Johnson, *How Might Investing in Private Equity Funds Affect Retirement Savings Accounts?,* URBAN INSTITUTE (2021), https://www.urban.org/research/publication/how-might-investing-private-equity-funds-affect-retirement-savings-accounts.
[66] *Id*. at 5.
[67] Jean-Pierre Aubry, *Public Pension Investment Update: Have Alternatives Helped or Hurt?,* CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE (Nov. 22, 2022), https://crr.bc.edu/public-pension-investment-update-have-alternatives-helped-or-hurt/.
[68] Voya, *supra* note 58.
[69] *Id*.
[70] Paul Lavery & Nick Wilson, *The Performance of Private Equity Portfolio Companies During the COVID-19 Pandemic*, 89 JOURNAL OF CORPORATE FINANCE 102641 (2024), https://www.sciencedirect.com/science/article/pii/S0929119924001032.

the phenomenon to private equity-backed companies' "superior access" to financing and their lower cost of debt.[71]

4. Long-term institutional investors have increased investment in private equity

Major investors in private equity funds include defined benefit pension plans, university endowments, sovereign wealth funds, and private foundations. These long-term institutional investors are taking advantage of the potential performance and diversification benefits that private equity has to offer, and private equity makes up an increasingly significant component of their investment portfolios. According to a survey by the investment manager Natixis, as of 2024, 60% of institutional investors planned to increase their private equity holdings.[72] We briefly review institutional investors' allocations to private equity funds below.

As of December 31, 2023, the largest institutional investors in private equity funds were public defined benefit pension plans, which accounted for 50.3% of the global aggregate institutional capital invested in private equity.[73] Over the past two decades, public pension plans have significantly increased their exposure to private equity, allocating 15% of their investments to this asset class in 2023, nearly five times their average allocation as of 2003 (3.8%).[74]

Sovereign wealth funds ("**SWF**s") have also increasingly engaged in private equity investing. As of December 31, 2023, SWFs accounted for 25.1% of the global aggregate institutional capital invested in private equity,[75] and in 2023, the aggregate target allocation to private equity for the 85 largest sovereign wealth funds was 7.4% (up from 4.5% in 2016).[76] For example, as of December 31, 2023, Mubadala Investment Company, Abu Dhabi Investment Authority, and Hong Kong Monetary Authority allocated $101.9 billion, $98.4 billion, and $52.7 billion to private equity, respectively.[77] These investments represented 34%, 10%, and 10%, respectively, of the funds' total assets under management.[78] Similarly, the Australian Future Fund had increased its private equity exposure to $21.7 billion as of December 31, 2023, accounting for 15% of the total fund portfolio (compared to 12% in 2017).[79] The Alaska Permanent Fund, a sovereign wealth fund

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[71] Shai Bernstein, Josh Lerner & Filippo Mezzanotti, *Private Equity and Financial Fragility During the Crisis*, SSRN WORKING PAPER (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3004594.

[72] Dave Goodsell, *2024 Private Assets Report*, NATIXIS (Apr. 22, 2024), https://www.im.natixis.com/en-us-offshore/insights/investor-sentiment/2024/private-assets-report.

[73] Katrina Lau, *The World's Largest PE Investors*, PRIVATE EQUITY INTERNATIONAL DATABASE (Jul. 1, 2024), https://www.privateequityinternational.com/the-worlds-largest-pe-investors/.

[74] Aaron M. Cunningham, *2024 U.S. Public Defined Benefit Plan Alternatives Hires Data Report and Analysis*, PENSION & INVESTMENTS (Oct. 17, 2024), https://www.pionline.com/rcblog/2024-us-public-defined-benefit-plan-alternatives-hires-data-report-and-analysis.

[75] Lau, *supra* note 73.

[76] INVESCO, *2023 Invesco Global Sovereign Asset Management Study* (Jul. 2023), https://www.invesco.com/content/dam/invesco/apac/en/pdf/insights/2023/july/igsam-main-study-july-2023.pdf.

[77] PRIVATE EQUITY INTERNATIONAL, *Global Investor 150 2024: The Full Ranking* (Jul. 1, 2024), https://www.privateequityinternational.com/global-investor-150-2024-the-full-ranking/.

[78] *Id*.

[79] *Id*.; CCMR, *Expanding Opportunities for Investors and Retirees: Private Equity* at 21 (Nov. 2018), https://capmktsreg.org/wp-content/uploads/2022/11/Private-Equity-Report-FINAL-1-1.pdf.

for the State of Alaska, has also significantly increased its allocation to private equity, more than doubling its private equity investments from 7% in 2017[80] to 19% of its portfolio in 2023.[81]

Endowments[82] and foundations[83] also make material allocations to private equity. As of December 31, 2023, endowments and foundations accounted for 7.4% of the global aggregate institutional capital invested in private equity.[84] Some of the largest global endowment funds allocate around 1/3 or even more of their assets to this asset class. As of November 2024, the largest contributor, the University of Texas Investment Management, allocated $22.2 billion — 30% of its assets — to private equity.[85] As of the same date, Harvard Management Co. allocated 39% of its assets, or $19.7 billion, to private equity.[86] By the end of 2023, Yale University allocated almost half (45%) of its endowment fund to private equity,[87] up from 31% in 2017.[88] Princeton University and the University of Pennsylvania have followed similar trends, increasing their private equity allocations from 32% and 16.3% in 2016[89] to 42% and 34% in 2023, respectively.[90]

Major foundations also invest intensively in private equity. For example, as of December 31, 2023, the Hewlett Foundation invested $4.9 billion, or 33% of its portfolio, in private equity[91] — a substantial increase from 25% in 2016 and 16% in 2009.[92] Similarly, as of December 31, 2023, the Howard Hughes Medical Institute invested 28% of its assets in private equity,[93] up from 18% in 2017.[94]

Lastly, while institutional investors, such as retirement plans, sovereign wealth funds, endowments, and foundations, represent the vast majority of the aggregate capital invested in private equity funds, high-net-worth individual investors can also invest in private equity funds and constitute a small but significant percentage. For example, as of the first quarter of 2024, according to the SEC's private fund statistics, individual investors owned approximately 6.5% of

[80] CCMR, *supra* note 79.

[81] PRIVATE EQUITY INTERNATIONAL, *supra note* 77.

[82] Endowments are pools of assets that are invested and used for the benefit of a particular institution, often for a specified purpose (e.g., education). *See* John Downes & Jordan Eliot Goodman, DICTIONARY OF FINANCE AND INVESTMENT TERMS (9TH EDITION 2014).

[83] Foundations are nonprofit organizations that make investments and distribute the income from their investments for one or more specified purposes (typically charitable). *See id.*

[84] Lau, *supra* note 73.

[85] Joyce Guevarra & Shambhavi Gupta, *Texas, Harvard Endowments Lead the Pack in Private Equity Allocations*, S&P GLOBAL (Nov. 14, 2024), https://www.spglobal.com/market-intelligence/en/news-insights/articles/2024/11/texas-harvard-endowments-lead-the-pack-in-private-equity-allocations-86225931.

[86] *Id*.

[87] PRIVATE EQUITY INTERNATIONAL, *supra note* 77.

[88] CCMR, *supra* note 79 at 22.

[89] *Id*.

[90] PRIVATE EQUITY INTERNATIONAL, *supra note* 77.

[91] *Id*.

[92] CCMR, *supra* note 79 at 23.

[93] PRIVATE EQUITY INTERNATIONAL, *supra note* 77.

[94] CCMR, *supra* note 79 at 23.

the aggregate capital invested in U.S. private equity funds.[95] We also note that family offices—wealth management advisory firms that serve high-net-worth investors — maintain a significant target allocation to private equity. According to a Deloitte survey, as of December 31, 2023, private equity accounted for 30% of the average family office portfolio –the most significant allocation in family offices' portfolios — surpassing public equities at 25%.[96] Furthermore, nearly half of family offices (47%) plan to invest in private equity in 2025.[97]

5. Evidence from other sectors of private markets: private credit funds

While our focus in this report is private equity, we briefly review the empirical evidence here indicating that U.S. investors and retirement savers could benefit from broader access to another important segment of U.S. investment markets: private credit funds.

Private credit refers to privately negotiated debt financing provided by professionally managed investment vehicles to corporate borrowers. These loans are an alternative source of debt financing for companies outside the traditional bank-intermediated lending market or the public bond market. The investment vehicles that provide these loans are known as private credit funds. The private credit fund market is growing rapidly, from less than $600 billion in AUM in 2016 to over $1.7 trillion as of 2024.[98]

Most private credit funds are, like private equity funds, limited to qualified purchasers and are thus unavailable to retail investors for direct investment. Additionally, 401(k) plan sponsors do not provide private credit funds as investment options. However, Congress has permitted retail investors to invest in private credit through public closed-end funds and "business development companies" ("**BDC**s"), which are a special type of public closed-end fund permitted to invest primarily in illiquid private credit of small issuers, as a means to increase the supply of financing available to small- and mid-sized U.S. companies. BDCs are subject to relatively relaxed restrictions on the ability to pay incentive fees to their managers. As of Q1 2025, BDCs managed approximately $475 billion in AUM, representing a 38% increase year-over-year.[99] Retail

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[95] *See* SEC, *Annual Staff Report Relating to the Use of Form PF Data* at Table 4.8 (Jan. 17, 2025), https://www.sec.gov/files/2024-pf-report-congress.pdf. The SEC's statistics cover only those funds with an adviser that has at least $2 billion in private equity fund assets under management.

[96] Rebecca Gooch, *The Family Office Insights Series – Global Edition*, DELOITTE (Dec. 9, 2024), https://www.deloitte.com/global/en/services/deloitte-private/research/family-office-insights-series-global-edition.html.

[97] Robert Frank, *Family Offices Are the Most Bullish They've Been in Years, Survey Says*, CNBC (Sep. 20, 2024) https://www.cnbc.com/2024/09/20/family-offices-most-bullish-in-years.html.

[98] Regarding 2016, *see* IMF, *The Rise and Risks of Private Credit* (Apr. 16, 2024), https://www.elibrary.imf.org/display/book/9798400257704/CH002.xml. As for the actual AUM of private credit markets, we calculate $ 1.71 trillion by adding the AUM of all U.S. private credit funds ($1.29 trillion) – Preqin, Ltd. estimate - to the AUM of all Business Development Companies invested in private credit ($0.42 trillion) – *see* Andrew Berlin, *BDC Quarterly Wrap: 1Q25,* LSTA (Jun. 2, 2024), https://www.lsta.org/news-resources/bdc-quarterly-wrap-1q25/.

[99] Andrew Berlin, *BDC Quarterly Wrap: 1Q25,* LSTA (Jun. 2, 2024), https://www.lsta.org/news-resources/bdc-quarterly-wrap-1q25/.

investors thus have relatively more options for gaining exposure to private credit than private equity.[100]

A. Empirical Evidence of Private Credit's Investment Benefits

An emerging body of empirical evidence indicates that private credit funds offer high returns when compared to publicly traded debt, particularly during periods of rising interest rates, and market distress, as well as diversification benefits by providing investors with exposure to a broader segment of the market. Some of this evidence also indicates that private credit funds that are unavailable to retail investors outperform publicly available BDCs. This evidence suggests that there could be substantial benefits to retail investors from access to a broader range of private credit funds through public closed-end funds and 401(k) accounts. We provide several important examples of this research here.

Brown et al. (2025) analyzed the performance of a sample of 892 private credit funds from vintages 2002 through 2019 and found that private credit funds provide "consistently positive excess returns . . . across strategies and geographies."[101]

The SEC AMAC's 2021 report on private markets compared the historical performance of private credit relative to public markets based on data provided to AMAC by several consultants to institutional investors. AMAC concluded that private credit funds have outperformed several public market indices, including the Credit Suisse High Yield Index, the Bloomberg Barclays GOV Bond/Credit Index, the Bloomberg Barclays Corp HY/FTSE Index, and the Russell 3000 Index, over 3-, 5-, 10-, 15-, and 20-year periods, with greater outperformance over longer periods, though the report does not quantify the degree of outperformance.[102] The analysis notes that this outperformance may be attributable to an illiquidity premium associated with private credit fund investments.[103]

A comparison of the performance of an index of private credit investments against an index of publicly traded bonds (the Bloomberg USD HY Corporate Index) found that private credit outperformed the bond index in 14 of the 20 years from 2005 through 2024,[104] and that loss rates on private credit were lower than for publicly traded bonds during periods of market stress, including 2008.[105] Similarly, an analysis by Hamilton Lane compared the performance of private credit from 2015 through 2024 with the performance of two indices of publicly traded bonds – the

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[100] Peter Madigan, *The Inexorable Rise of Private Credit*, BNY MELLON (Jun. 26, 2024) https://www.bny.com/corporate/global/en/insights/rise-of-private-credit.html.
[101] Brown et al., *supra* note 54 at 2, 26 *et seq*., Table 1.
[102] SEC ASSET MANAGEMENT ADVISORY COMMITTEE, *supra* note 36.
[103] *Id.* at 12.
[104] BROOKFIELD, *Private Credit: Opportunity Rising* at 15 (May 2024), https://www.brookfieldoaktree.com/sites/default/files/2024-05/private-credit-opportunity-rising.pdf.
[105] *Id*.

ICE BofA U.S. High Yield Index and S&P UBS Leveraged Loan Index. The comparison found that private credit outperformed both by more than 2% annually.[106]

A Morgan Stanley analysis found that since the 2008 financial crisis, private credit has achieved higher returns and lower volatility relative to publicly traded debt.[107] Private credit's outperformance has been even greater during periods of rising interest rates. In seven such periods between 2008 and 2023, private credit yielded average returns of 11.6%, compared with 6.8% for high-yield bonds. Private credit also sustained fewer losses than publicly traded debt during the COVID-19 market turmoil (1.1%, compared with 2.2% for high-yield bonds).

Morningstar data on private credit returns provide further support for the conclusion that private credit offers investors less risky returns relative to public debt investments: the volatility of annual returns to private credit from 2014 through 2023 has averaged approximately 3%, whereas the volatility of annual returns to investment-grade bonds, leveraged loans, and high-yield bonds has averaged approximately 5%, 6%, and 8%, respectively.[108]

Munday et al. (2018) analyzed the performance of a sample of 476 private credit funds from 2004 to 2018 and compared it against several benchmark indices. The analysis found that private credit achieved superior or comparable returns relative to other debt markets, but that BDCs achieved lower and more volatile rates of return compared to the funds in the sample limited to qualified purchasers.[109] Cumming et al. (2018) analyzed the performance of 400 private credit loans over the 2001-2015 period. The analysis found that private credit investments achieved an average monthly return of 1.53%, compared to 0.58% for an index of publicly traded debt.[110]

Davydiuk et al. (2025) found that BDCs perform a monitoring function with respect to the management of the companies they invest in, thereby lowering those companies' cost of debt.[111]

In view of the emerging body of evidence discussed above, policymakers should also consider the potential benefits of expanding retail investor access to private credit funds.

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[106] HAMILTON LANE, *2025 Market Overview* (Mar. 12, 2025), https://www.hamiltonlane.com/en-us/insight/2025-market-overview.

[107] MORGAN STANLEY, *Understanding Private Credit* (Jun. 20, 2024), https://www.morganstanley.com/ideas/private-credit-outlook-considerations.

[108] Morningstar data measuring returns to the Cliffwater Direct Lending Index, Bloomberg US Corporate High Yield Bond Index, and Morningstar LSTA US Leveraged Loan Index ,from January 1, 2014 through December 31, 2023.

[109] Shawn Munday, Wendy Hu, Tobias True & Jian Zhang , *Performance of Private Credit Funds: A First Look*, SSRN WORKING PAPER (2018), https://dx.doi.org/10.2139/ssrn.3173688.

[110] Douglas Cumming, Grant Fleming & Zhangxin (Frank) Liu, *The Returns to Private Debt: Primary Issuance vs. Secondary Acquisitions,* 75(1) FINANCIAL ANALYSTS JOURNAL (2018), https://rpc.cfainstitute.org/research/financial-analysts-journal/2018/0015198x-2018-1547049.

[111] Tetiana Davydiuk, Isil Erel, Wei Jiang & Tatyana Marchuk, *Common Investors Across the Capital Structure: Private Debt Funds as Dual Holders*, JOHNS HOPKINS CAREY BUSINESS SCHOOL RESEARCH PAPER NO 25-17 (2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4992219.

Part III: Expanding Access to Private Equity Through Public Closed-End Funds

Part III reviews the legal restrictions that continue to prevent the vast majority of U.S. households from investing in private equity and recommends reforms that would allow these investors to invest in private equity through public closed-end investment funds.

Throughout this Part III, we use "private funds" to refer to investment funds that are exempt from registration under the Investment Company Act of 1940 (the "**1940 Act**") and that offer securities that are exempt from the registration requirements under the Securities Act of 1933 (the "**Securities Act**"). By contrast, we use "public funds" to refer to investment funds that are registered under the 1940 Act and that offer shares that are registered under the Securities Act. We focus initially on the legal and regulatory restrictions on access to all private funds because these restrictions also apply to private equity funds, which are a subtype of private fund. The other well-known subtype of private fund is a hedge fund. This report does not focus on expanding access to hedge funds, because their primary investment strategy does not involve investing in the securities of private companies.

1. **Restrictions on U.S. household investment in private equity funds**

A. The Accredited Investor Standard

Under the Securities Act, sales of securities must generally be registered with the SEC and are subject to extensive public disclosure requirements. However, certain exemptions from the Securities Act's registration requirements exist, so long as securities are offered to a more limited audience. One of these exemptions is Regulation D ("**Reg D**"), which exempts sales of securities (including private fund interests)[112] from the Securities Act's registration and disclosure requirements if they are only made to "**accredited investors**."[113]

Investments in private funds are typically executed under Reg D and are therefore only made available to accredited investors.[114] The Securities Act directs the SEC to define an accredited investor,[115] and the SEC has established a wealth-based standard whereby individuals whose net worth exceeds $1 million (excluding the value of their primary residence) or whose income

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[112] Private funds are typically structured as limited partnerships. An investor in a private fund, referred to as a limited partner, is given interests—analogous to shares in a company—in the private fund in exchange for the investment.

[113] Private funds typically rely on Rule 506 of Reg D. *See* 17 C.F.R. § 230.506. Technically, under Rule 506, an issuer can sell to up to 35 unaccredited investors. However, in order to do so, the issuer must provide extensive disclosure—similar to that for a public offering—to any unaccredited investors. *See* 17 C.F.R. § 230.502(b). This disclosure requirement is quite burdensome, so, as a practical matter, private funds operating in compliance with Rule 506 of Reg D only allow accredited investors to invest.

[114] Additionally, to meet the private offering restrictions related to the 1940 Act, a private fund generally must only take on accredited investors to avoid being an "investment company" under the 1940 Act. The 1940 Act subjects investment companies to extensive disclosure requirements and restrictions on their investment activities, which private funds seek to avoid. Private funds typically avoid investment company status by falling under certain exemptions under the 1940 Act (discussed in more detail below). *See* 15 U.S.C. § 80a-3(c)(1) & (7). These exemptions require private funds to not publicly offer themselves to potential investors. Complying with Rule 506 of Reg D—including its accredited investor rules—meets this requirement.

[115] Subject to certain statutory limitations. *See* 15 U.S.C. § 77b(a)(15).

exceeds $200,000 (or $300,000 with a spouse) for at least two years are deemed accredited investors.[116] In 2020, the SEC expanded the definition of "accredited investor" to include individuals possessing certain investment industry-related professional credentials.[117] As of 2022, SEC data indicate that approximately 81% of U.S. households did not meet the accredited investor standard.[118]

B. The Qualified Purchaser Standard

Not only must all investors in private funds be accredited, but the 1940 Act separately requires private funds to either take on: (i) no more than 100 persons; or (ii) only investors that are "**qualified purchasers.**"[119] Private funds organized to meet the 100-investor requirement are Section 3(c)(1) funds, and private funds organized to meet the qualified purchaser requirement are Section 3(c)(7) funds. If a private fund does not satisfy one of these requirements, then it is considered an "investment company" and is subject to the 1940 Act's extensive disclosure requirements and applicable regulations under the 1940 Act and the Investment Advisers Act of 1940 (the "**Advisers Act**").[120] These regulations include restrictions on affiliate transactions[121] and on charging performance fees,[122] both of which are incompatible with the business model of private equity funds.[123]

[116] *See* 17 C.F.R. § 230.501(a).
[117] SEC, *Amendments to Accredited Investor Definition* (Dec. 7, 2020), https://www.sec.gov/resources-small-businesses/small-business-compliance-guides/amendments-accredited-investor-definition.
[118] SEC, *Review of the "Accredited Investor" Definition under the Dodd-Frank Act* at 23 (Dec. 14, 2023), https://www.sec.gov/files/review-definition-accredited-investor-2023.pdf.
[119] *See* 15 U.S.C. § 80a-3(c)(1) & (7).
[120] There are other exemptions that allow investment funds to avoid being deemed an investment company. However, Section 3(c)(1) and 3(c)(7) are the most commonly used exemptions for private equity funds, venture capital funds, and hedge funds.
[121] Pursuant to Section 17 of the 1940 Act and the applicable SEC regulations, any affiliate of a registered investment company, or any affiliate of such affiliate, is generally prohibited from (i) engaging in transactions (including loans or purchases/sales of property or securities) with the fund or a company it controls, or (ii) participating in any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which the fund, or a company it controls, is a participant. *See* 15 U.S.C. § 80b-17(a) & (d); 17 C.F.R. § 270.17a-6; 17 C.F.R. § 270.17d-1. The SEC has, however, granted relief in this area regarding certain affiliate co-investments.
[122] Investment advisers to registered investment companies are generally prohibited from charging their clients performance fees. *See* 15 U.S.C. § 80b–5(a)(1). *But see id*. at (b)(2) (exempting fulcrum fees). *See also* 17 C.F.R. § 275.205-3 (exempting performance fees for qualified clients). Investment advisers to business development companies, on the other hand, can charge performance fees, subject to certain limitations. 15 U.S.C. § 80b–5(b)(3).
[123] A memo from Gardner, Carton & Douglas prepared for the Senate Subcommittee on Securities as part of the hearings on bills that became the Small Business Investment Incentive Act of 1980 noted that "venture capital companies, unlike traditional investment companies, are compelled to deal regularly with affiliated persons in the ordinary course of their doing business. Virtually any transaction of this kind . . . is therefore potentially in violation of Section 17(a) [of the 1940 Act]." *See Federal Securities Laws and Small Business Legislation: Hearings on Senate*

The 1940 Act defines a qualified purchaser to include "any natural person . . . who owns not less than $5,000,000 in investments."[124] Thus, for a private fund seeking to take on more than 100 investors, all investors must meet the $5 million investment test in addition to being accredited investors. We note that, in practice, the vast majority of private funds are Section 3(c)(7) funds, which only accept qualified purchasers.[125] Due to the greater prevalence of Section 3(c)(7) funds, access to these types of private equity funds is the sole focus of this report.

As noted in Part I, Federal Reserve data suggest that approximately 98% of U.S. households do not meet the qualified purchaser standard.[126] This percentage has not changed significantly since 2018, indicating that direct access to private equity fund investments among U.S. households has not increased. For simplicity, we refer collectively to investors that are accredited investors but do not meet the qualified purchaser standard and those who do not meet the accredited investor definition as "**retail investors**."

C. The Qualified Client Standard

The Advisers Act prohibits investment advisers from charging performance fees to clients.[127] Performance fees are standard practice for private equity funds. However, the SEC has exempted investment advisers from this prohibition to the extent that their clients are "qualified clients."[128] Section 3(c)(7) funds are qualified clients,[129] so the performance fee restriction does not apply to investment advisers to private equity funds that are Section 3(c)(7) funds. Additionally, the qualified client standard does not "look through" Section 3(c)(7) funds to investors in the fund.[130] A "look-through" provision would mean that the investors in the fund would have to meet the qualified client standard in their own capacity. Accordingly, there is no reason to further address the Advisers Act's restriction on performance fees in this report, as it does not restrict access to private equity funds.

1533 Before the Senate Subcommittee on Securities of Senate Committee on Banking, Housing, and Urban Affairs, 96TH CONGRESS at 375–402 (1980). *See also* Steven M. Davidoff, *Black Market Capital*, COLUMBIA BUSINESS LAW REVIEW 172 at 176 (2008), https://doi.org/10.7916/cblr.v2008i1.2952, ("The [SEC] has refused to accommodate the differing structure and operation of … private equity. Instead, the [1940] Act and its related regulation effectively prevent . . . private equity from accessing the public market for investors. [P]rivate equity consequently avoid[s] application of the [1940] Act . . . .").

124 15 U.S.C. § 80a-2(a)(51).

125 Based on CCMR staff conversations with attorneys from Cleary Gottlieb Steen & Hamilton LLP.

126 *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *supra* note 15.

127 15 U.S.C. § 80b-5(a)(1).

128 *See* 17 C.F.R. § 275.205-3.

129 The Section 3(c)(7) fund is the client of the investment adviser and so must meet the qualified client test. Qualified clients include: (i) individuals and companies with at least $1,000,000 under the management of the investment adviser; (ii) individuals and companies with a net worth greater than $2 million; and (iii) individuals and companies that are qualified purchasers. *Id*. at (d).

130 *See* 17 C.F.R. § 275.205-3(b) & (d). *See also* PROSKAUER ROSE LLP, *SEC Amends the Advisers Act Performance Fee Rule to Tighten Standards for "Qualified Clients" and Adopt "Grandfathering" Provisions* (Mar. 8, 2012), https://www.proskauer.com/alert/sec-amends-the-advisers-act-performance-fee-rule-to-tighten-standards ("Look through is not necessary for funds that rely on the Section 3(c)(7) exemption from registration under the [1940] Act").

2. Restrictions on public fund investment in private equity

Public funds are registered as investment companies under the 1940 Act and issue shares that are registered under the Securities Act. As a result, retail investors may invest in public funds, and public funds are a potential vehicle for providing retail investors with exposure to private equity funds. However, not all public funds are necessarily appropriate for investing in private equity funds. Public funds generally fall into two broad categories—open-end funds and closed-end funds.[131] Under the 1940 Act, open-end funds, such as mutual funds, must issue redeemable shares to their investors, meaning that mutual funds must regularly provide their investors with the opportunity to exit their investment at the per-share net asset value of the fund.[132] The 1940 Act establishes a maximum seven-day period for a mutual fund to pay the proceeds from a redemption to an investor, and in practice, mutual funds typically allow for redemptions on a daily basis.[133] Conversely, the 1940 Act does not impose any redemption requirements on closed-end funds.[134]

A. Mutual Funds

Mutual funds can allow for daily redemption while still offering investors exposure to illiquid assets, such as private equity funds, so long as the mutual fund holds sufficient liquid assets to meet daily redemptions. In practice, mutual funds generally hold cash buffers to satisfy investor redemptions.[135] However, if a mutual fund lacks sufficient liquid assets to satisfy daily redemptions, then it could be forced to quickly sell its illiquid assets at a significant discount, which would mean significant losses for its investors. In a severe case, a mutual fund may even need to request permission from the SEC to halt redemptions and liquidate.[136] Therefore, the SEC has determined that mutual funds generally cannot hold more than 15% of their net assets in illiquid investments, including private equity funds.[137] The purpose of the SEC's rule is to ensure that shares in mutual funds are in fact readily redeemable as mandated by statute.[138]

We believe that the existing 15% threshold on illiquid assets for mutual funds is appropriate, considering that investors frequently enter and exit their mutual fund investments. Indeed, monthly

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[131] 15 U.S.C. § 80a-5(a).
[132] 15 U.S.C. § 80a-5(a)(1) & 80a-2(a)(32). *See also* 17 C.F.R. § 270.22c-1.
[133] 15 U.S.C. § 80a-22(e). *See also* John Morley, *The Regulation of Mutual Fund Debt*, 30 YALE JOURNAL ON REGULATION 343 at 347 (2013), https://openyls.law.yale.edu/bitstream/handle/20.500.13051/4452/30YaleJonReg343.pdf.
[134] *See* 15 U.S.C. § 80a-5(a)(1) & (2).
[135] *See* Shelly Antoniewicz, Hammad Qureshi & Matt Thornton, *The SEC's Liquidity Proposal is Arbitrary and Harmful to Investors*, ICI VIEWPOINTS (Jan. 12, 2024), https://www.ici.org/viewpoints/24-view-liquidity-proposal. ("Over the past four decades, 99.94% of [mutual] funds have met redemptions, including every single fund during the 2008 global financial crisis and the 2020 *dash for cash*.").
[136] *See id*. at 31-32, 58.
[137] 17 C.F.R. § 270.22e-4(b)(1)(iii) & (iv).
[138] *See* SEC, *Investment Company Act Release No. 33-9922, 80 FR 62273* at 281 (Oct. 15, 2015), https://www.sec.gov/rules-regulations/2016/10/investment-company-liquidity-risk-management-programs.

net outflows from mutual funds often exceed 10% of total assets during periods of stress.[139] We therefore do not recommend any regulatory changes to expand retail investor access to private equity funds through mutual funds.

B. Public Closed-End Funds

Public closed-end funds are well-positioned to invest in private assets with less liquidity because shareholders in closed-end funds generally have limited or no rights to redeem their shares. Traditionally, most closed-end funds have traded on exchanges and provided no redemption rights. In these cases, investors can only obtain liquidity for their shares through secondary markets. More recently, another class of closed-end funds has emerged—often referred to as a "perpetual" or "evergreen" fund—that provides shareholders with periodic opportunities to redeem their shares, typically quarterly or monthly. As detailed above, many of the BDCs that provide retail investors with access to the private credit market provide shareholders with this partial liquidity. By limiting shareholders' redemption rights, closed-end funds would be able to devote a greater percentage of their assets to illiquid private equity funds. But by providing some redemption rights at periodic intervals, perpetual funds enable investors to more easily rebalance or liquidate portions of their portfolios, which can be more important for retail investors, who often have greater liquidity needs. We therefore believe that closed-end funds, and particularly "perpetual funds" that provide periodic liquidity, can be an effective publicly available investment vehicle for providing retail investors with exposure to private equity funds. However, we must first assess whether the qualified purchaser standard and accredited investor standard restrict closed-end funds from providing retail investors with access to private equity funds.

Under the 1940 Act and applicable SEC rules, the qualified purchaser requirement "looks through" a public closed-end fund to its shareholders only if the closed-end fund was "formed for the specific purpose" of investing in a *specific* private fund.[140] A "look-through" means that investors in a public closed-end fund must also be qualified purchasers and would therefore prevent retail investors from investing in such funds. In a no-action letter, the SEC indicated that the determination of whether an entity was formed "for the specific purpose" of investing in a specific private fund depends on a facts-and-circumstances analysis.[141] The SEC stated that whether an

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[139] *See, e.g.*, Jack Pitcher & Justin Baer, *The $55 Billion Customer Exodus Rocking Franklin Templeton*, THE WALL STREET JOURNAL (Nov. 15, 2024), https://www.wsj.com/finance/the-55-billion-customer-exodus-rocking-franklin-templeton-183496b7, Tania Mitra, *Mutual Funds in the Red for Third Consecutive Year*, CITYWIRE (Jan. 15, 2015), https://citywire.com/pro-buyer/news/mutual-funds-in-the-red-for-third-consecutive-year/a2457856.

[140] *See* 15 U.S.C. § 80a-2(a)(51)(A)(iii); 17 C.F.R. § 270.2a51-3(a) ("a company shall not be deemed to be a qualified purchaser if it was formed for the specific purpose of acquiring the securities offered by a [Section 3(c)(7) fund] unless each beneficial owner of the company's securities is a qualified purchaser.").

[141] AMERICAN BAR ASSOCIATION, *SEC No-Action Letter Ref. No. 97-666* at 19-20 (Apr. 22, 1999), https://www.sec.gov/divisions/investment/noaction/1999/aba042299.pdf. (" [W]e believe that the determination that an entity is formed for the specific purpose of investing in a . . . Fund will depend upon an analysis of all of the surrounding facts and circumstances, and while the percentage of an entity's assets invested in the . . . Fund is relevant, exceeding a specified percentage level, by itself, is not determinative.").

entity invests more than 40% of its committed capital in a specific private equity fund is relevant, but not determinative.[142]

The Securities Act and the SEC's rule defining an accredited investor contain no provision that "looks through" to investors in a public fund.[143] However, the SEC Staff has issued comment letters to closed-end funds indicating that only accredited investors may invest in a public closed-end fund that invests more than 15% of its assets in Section 3(c)(7) funds.[144] The SEC Staff has not stated the legal or policy basis for effectively applying the accredited investor standard on a look-through basis to such funds, nor has the SEC itself ever stated a view on this question. We therefore find that the SEC Staff positions severely restrict retail investor access to public closed-end funds that invest in private equity funds.

3. Policy developments since the 2018 Report

A. Regulatory developments

Between 2019 and 2021, there were several indications that the SEC was considering expanding retail investor access to private equity by permitting publicly offered closed-end funds to invest more extensively in private equity. To date, however, this has not happened. This section summarizes key developments.

In June 2019, the SEC issued a concept release seeking comment on ways to improve the framework for exempt offerings.[145] As part of the release, the SEC sought feedback on whether and how to expand retail access to private funds — for instance, by allowing retail investment upon the advice of a financial adviser intermediary or by expanding registered closed-end fund offerings.[146] The SEC acknowledged the benefits of private fund investments to retail investors, including "the ability to have an interest in a diversified portfolio that can reduce risk," and the fact that such securities "may have returns that are less correlated to the public markets."[147] In response to the release, the Committee submitted a comment letter proposing (as it did in the 2018 Report) that the SEC rescind its informal 15% limit on public closed-end fund investment in

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142 *See id*. *See also* Cornish & Carey, *SEC No-Action Letter Ref. No. 96-105-CC* at 3 (Jun. 2, 1996), https://www.sec.gov/divisions/investment/noaction/1996/cornishcarey022696.pdf.

143 *See* 15 U.S.C. § 77b(a)(15)(i); 17 C.F.R. § 230.501(a)(1).

144 *See, e.g.*, David J. Baum, *SEC Comment Response Letter* (Dec. 17, 2014), https://www.sec.gov/Archives/edgar/data/1586009/000114420414074464/filename1.htm. *See also* WILDERMUTH ENDOWMENT STRATEGY FUND, *SEC Comment Letter* (Oct. 11, 2013); CROSS SHORE DISCOVERY FUND, *SEC Comment Response Letter* (Sept. 17, 2015); RESOURCE REAL ESTATE DIVERSIFIED INCOME FUND, *SEC Comment Response Letter* (Oct. 19, 2012); OXFORD LANE CAPITAL CORPORATION, *SEC Comment Response Letter* (Aug. 17, 2015). We note that the 15% limitation applies to all public funds. However, as a practical matter, given the liquidity limitations imposed on open-end funds by Rule 22e-4, any public fund that invests more than 15% of its assets in private equity funds is likely to be structured as a closed-end fund. *See* 17 C.F.R. § 270.22e-4(b)(1)(iii) & (iv).

145 SEC, *Concept Release on Harmonization of Securities Offering Exemptions*, 84 FEDERAL REGISTER 30,460 (Jun. 26, 2019), https://www.federalregister.gov/documents/2019/06/26/2019-13255/concept-release-on-harmonization-of-securities-offering-exemptions.

146 *Id*. at 30512-17.

147 *Id*. at 30512.

private equity funds.[148] The letter provided detailed guidance to the SEC as to the policy, legal, and practical issues related to the proposal.

In November 2019, the SEC formed the AMAC to consider issues pertinent to the asset management industry and advise the SEC. In early 2020, the AMAC established a subcommittee specifically to review the topic of retail access to private investments ("**PI Subcommittee**"). Then in July 2020, the Director of the SEC Division of Investment Management, Dalia Blass, gave a speech highlighting the potential of target date funds (such as those included in 401(k) plans) and of closed-end funds to serve as vehicles for retail access to private funds.[149] Director Blass indicated that the Division was re-examining the informal SEC requirement that closed-end funds with more than 15% of their assets in private funds restrict sales to accredited investors.[150]

In January 2021, the Committee submitted a letter to AMAC and the PI Subcommittee highlighting that the registered funds structure provides sufficient investor protections to expand access to private equity funds, as registered funds are managed by registered investment advisers subject to fiduciary duties and are sold by intermediaries who must act in the best interest of the investor.[151] The Committee suggested additional safeguards for registered closed-end funds offered to retail investors, including that such funds should invest in private funds that are sponsored by managers who meet threshold scale and experience criteria, and that, with respect to the portion of a registered fund of private funds' assets invested in private funds, the registered fund be required to invest more than 80% of such assets in private funds that accept more than 50% of their capital commitments from qualified purchasers that are not natural persons or registered investment companies.[152] The Committee further suggested that registered funds of private funds open to retail investors should provide periodic liquidity events, meet conditions designed to encourage diversification, and limit certain fees applicable to retail investors.[153] In March 2021, the Committee submitted a supplemental letter to provide additional information on how registered closed-end funds of private equity funds could be made accessible to retail investors by listing on an exchange.[154]

As part of its response to the 2019 concept release, in August 2020, the SEC adopted a revised "accredited investor" definition, expanding the ways individuals can qualify beyond traditional

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148 CCMR, *Comment Letter to SEC re: File Number S7-08-19: Concept Release on Harmonization of Securities Offering Exemptions* (Sept. 19, 2019), https://capmktsreg.org/wp-content/uploads/2019/09/CCMR-Comment-Letter-Submission-File-Number-S7-08-19.pdf.

149 Dalia Blass, *Speech: PLI Investment Management Institute*, (Jul. 28, 2020), https://www.sec.gov/newsroom/speeches-statements/blass-speech-pli-investment-management-institute.

150 *Id*.

151 CCMR, *Letter to the Asset Management Advisory Committee Re: AMAC Recommendation on Registered Funds of Private Funds* at 3 (Jan. 13, 2021), https://capmktsreg.org/wp-content/uploads/2021/01/CCMR-Letter-to-AMAC-PE-Access-01.13.2021.pdf.

152 *Id*. at 3.

153 *Id*. at 3-6.

154 CCMR, *Letter to the Asset Management Advisory Committee Re: File No. 265-33: Further Information on Registered Funds of Private Funds* (Mar. 18, 2021), https://capmktsreg.org/wp-content/uploads/2021/03/CCMR-Second-Letter-to-AMAC-PE-Access-03.18.2021.pdf.

wealth-based criteria, including by way of professional knowledge or certifications.[155] However, the revised definition only modestly expanded the universe of individuals eligible to invest in private funds.[156]

In September 2021, the PI Subcommittee issued a final report, concluding that the "SEC should consider permitting retail investors access to a wider range of private investments."[157] The report outlined recommendations for how wider access could be structured to ensure proper protection for retail investors,[158] which were largely aligned with the recommendations provided by the Committee in its January 2021 letter. The PI Subcommittee recommended that retail access to private funds should: (i) be "chaperoned" by independent investment advisers or broker-dealers with duties to the investor, or by "requir[ing] any private investment that retail investors have access to also have material participation in the fund or investment from more sophisticated institutional investors," such that retail investors could benefit from the diligence conducted by those investors;[159] (ii) provide some type of liquidity features; (iii) include sufficient and standardized disclosures; and (iv) be diversified, both with respect to the investor's portfolio of private investments and with respect to the investor's overall portfolio.[160] The report noted that the existing registered funds framework already incorporates some of these features (including intermediation by an independent investment adviser or broker-dealer and a standardized disclosure regime) and could potentially serve as the basis for expanding retail access to private funds. The report recommended that the SEC should consider abandoning the position that investments in registered closed-end funds holding more than 15% of their assets in private funds should be limited to accredited investors.[161]

Despite the agency's extensive analysis and public dialogue on the topic, the SEC has not created new pathways for direct retail access to private equity through public closed-end funds.

However, in May 2025, SEC Chairman Paul Atkins indicated that the SEC will soon reconsider its policy limiting public closed-end funds' exposure to private equity funds. The Chairman cited the rapid growth of private markets and noted that expanding access to private funds through public closed-end funds could "increase investment opportunities for retail investors seeking to diversify their investment allocation in line with their investment time horizon and risk tolerance," while maintaining necessary investor protections.[162] The following day the Director of the SEC's Division of Investment Management confirmed that SEC staff will "no longer provide comments limiting the ability of retail investors to invest in registered closed-end funds that invest in private

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[155] SEC, *Order Designating Certain Professional Licenses as Qualifying Natural Persons for Accredited Investor Status*, 85 FEDERAL REGISTER 64234 (Oct. 9, 2020), https://www.federalregister.gov/documents/2020/10/09/2020-19188/order-designating-certain-professional-licenses-as-qualifying-natural-persons-for-accredited.

[156] *See, e.g.*, Taylor Tepper, *SEC Rule Change Gives More People Access to Riskier Investments*, FORBES (Aug. 27, 2020), https://www.forbes.com/sites/advisor/2020/08/27/sec-definition-change-accredited-investor/.

[157] SEC ASSET MANAGEMENT ADVISORY COMMITTEE, *supra* note 36 at 2.

[158] *Id*. at 19-21.

[159] *Id*. at 20.

[160] *Id*. at 19-20.

[161] *Id*. at 3, 21-22.

[162] Atkins, *supra* note 3.

funds."[163] These statements indicate a welcome change in position from the SEC. The details of the SEC's revised approach with respect to such funds (e.g., requirements with regard to disclosures, liquidity, and fee structures) will remain to be seen until a public closed-end fund investing in private funds successfully completes the registration process under the new policy.

B. Legislative developments

In recent years, several bills have been proposed that sought to expand retail investor access to private equity, but none have become law. In December 2023, Ann Wagner (R-MO) and co-sponsor Gregory Meeks (D-NY) introduced the "Increasing Investor Opportunities Act" ("IIOA") in the House. The bill would have prevented the SEC from limiting the amount of assets a closed-end fund can invest in private funds, and from conditioning or restricting the sale of closed end funds that invest in private funds unless such restriction "is unrelated to the underlying characteristics of a private fund or the status of a private fund as a private fund."[164] However, the bill did not advance to a vote in the House.

A separate bill addressing retail access to private equity investments was introduced in the Senate in September 2024 by the Ranking Member of the Senate Banking Committee, Timothy Scott (R-SC), with several other Republican co-sponsors. The four-part "Empowering Main Street in America Act of 2024" was aimed at promoting economic growth on several fronts. Title II focused on bolstering retail investment opportunities and would have expanded the scope of individuals who qualify as "accredited investors" and required the SEC and Secretary of Labor to study the impact on investors from the existing limits on retail and defined contribution plan investment in private placements. It also incorporated the provisions of the IIOA restricting the SEC from limiting closed-end fund investment in private funds. The bill was referred to the Senate Committee on Banking, Housing, and Urban Affairs, but did not progress further.

4. Summary of retail investors' access to private equity and debt investments

The chart on the following page summarizes the legal restrictions detailed above and presents an overall comparison of the current availability of private equity and private debt investments to retail investors. The comparison shows that although public funds open to retail investors can invest in the equity of private companies, regulatory restrictions prevent public funds from directly replicating the investment strategies of private equity buyout funds. Furthermore, as outlined above, SEC policy prevents public funds from obtaining significant exposure to buyout strategies by investing in buyout funds. The inability of retail investors to gain significant exposure to buyout fund strategies specifically is important because of the substantial empirical evidence, reviewed above, of the potential performance and diversification benefits of private equity buyout fund strategies.

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[163] ROPES & GRAY, *SEC Drops 15% Limit in Private Funds for Retail Closed-End Funds* (May 23, 2025), https://www.ropesgray.com/en/insights/alerts/2025/05/sec-drops-15-limit-in-private-funds-for-retail-closed-end-funds.

[164] 118TH CONGRESS 1ST SESSION, *H.R.2627 – Increasing Investor Opportunities Act* (Dec. 12, 2023), https://www.congress.gov/bill/118th-congress/house-bill/2627/text.

By comparison, public funds can more closely replicate the investment strategies of private debt funds, for which there is also extensive evidence of performance and diversification benefits. This is because private debt strategies do not require the acquisition of controlling stakes in a business and typically involve more limited uses of leverage and performance-based compensation. The comparison thus underscores the greater restrictions on the ability of retail investors to obtain exposure to private equity buyout fund strategies relative to both publicly traded asset classes and other private asset classes.

Can retail investors invest:		
	Equity	*Debt*
Directly in private companies' equity or debt securities?	No	Yes, if the debt is SEC-registered. No, if the debt is not SEC-registered.
Directly in private equity or debt funds?	No <u>Investment strategy</u>: Acquires controlling equity interests in private companies; actively manages portfolio companies; unrestricted use of leverage and performance-based compensation for managers. Extensive evidence of performance and diversification benefits. **AUM: $6.7 trillion**[165]	No <u>Investment strategy</u>: Acquires debt interests in private companies; does not control management of portfolio companies; less extensive use of leverage and performance-based compensation for managers. Extensive evidence of performance and diversification benefits. **AUM: $1.2 trillion**[166]
In public funds that invest primarily in the equity or debt securities of private companies?	Yes – via BDCs and other closed-end funds <u>Investment strategy</u>: Acquires non-controlling equity interests in private companies; no active management of portfolio companies; use of leverage and performance-based compensation for managers restricted. **AUM: ca. $130 billion**[167]	Yes – via BDCs and other closed-end funds <u>Investment strategy</u>: Acquires debt interests in private companies; does not control management of portfolio companies; restrictions on leverage and performance-based compensation less relevant, given the less extensive use of such features in private credit strategies. **AUM: ca. $520 billion**[168]
In public funds that invest primarily in private equity or debt funds?	No (SEC guidance limits funds with >15% exposure to accredited investors)	No (SEC guidance limits funds with >15% exposure to accredited investors)

[165] *See supra* note 11.
[166] *See supra* note 98.
[167] Investment Company Institute, *Closed-End Funds and Their Use of Leverage* (Apr. 28, 2025) https://www.ici.org/faqs/faqs_closed_end.
[168] *Id*.

5. How to expand access to private equity through closed-end funds

In our view, retail investors would benefit from access to public closed-end funds that invest more than 15% of their assets in private equity funds. Moreover, we believe that sufficient regulatory protections exist to ensure that retail investors can safely invest in these funds. We therefore recommend that the SEC not apply the accredited investor standard on a look-through basis to public closed-end funds that invest more than 15% of their assets in private equity funds. Below, we set forth the benefits to retail investors of access to public closed-end funds that invest more than 15% of their assets in private equity funds and explain why existing regulations—with a specific focus on disclosures—provide sufficient protection to retail investors interested in such access.

First, as explained in Part II, private equity funds have historically outperformed public equity markets, and including private equity funds in a portfolio can *reduce* the risk of the portfolio.[169] Indeed, the empirical studies that we reviewed in Part II show that a 20% allocation to private equity funds can lower the risk of a portfolio of assets.[170] Many investors in private equity, including university endowments, private foundations, and family offices, have allocated over 20% of their assets to private equity funds.[171] Therefore, the 15% threshold prevents retail investors from obtaining the total exposure to private equity funds through public closed-end funds that is preferred by many sophisticated investors in private equity and that studies have shown can actually lower the risk of a portfolio of assets.

Second, the 15% cap prevents retail investors from investing in public closed-end funds that diversify their investments among private equity funds, so-called "**funds of private equity funds**," which seek to obtain returns that are more consistent with the performance of the private equity fund industry generally. Funds of private equity funds exist today and have $427 billion in assets under management, constituting approximately 9.6% of the total U.S. private equity fund assets under management. Critically, the performance of funds of private equity funds has also been impressive. According to PitchBook, from 2000 to 2023, U.S. funds of private equity funds have outperformed the public stock market, with a PME of 1.013 against the S&P 500 and 1.016 against Morningstar US.[172] We note that funds of private equity funds are typically organized as private funds, however, we have identified certain public closed-end funds that invest in private equity funds on a diversified basis. For example, the iDirect Private Markets Funds (the "**iDirect fund**") is a public closed end fund investing in private equity with approximately $787 million in net assets.[173] Of course, funds such as the iDirect fund are only available to accredited investors, because more than 15% of their assets are invested in private equity funds.

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[169] *See supra* notes 35-67 and accompanying text.

[170] *See supra* notes 62-63 and accompanying text.

[171] *See supra* notes 72-97 and accompanying text.

[172] PITCHBOOK, *Funds of Funds Benchmarks Q2 2024* at 49 (Jan. 9, 2025), https://pitchbook.com/news/reports/q2-2024-pitchbook-benchmarks-with-preliminary-q3-2024-data.

[173] IDIRECT PRIVATE MARKETS FUND, *Form N-2* (Jul. 26, 2024), https://www.sec.gov/ix?doc=/Archives/edgar/data/0001606789/000158064224003915/idirect-private_n2.htm.

Third, there would be little reason for the SEC to raise liquidity concerns regarding public closed-end funds that invest in private equity funds. Congress has expressly determined that retail investors may invest in public closed-end funds, which, like the private equity funds that they would invest in, have traditionally provided investors with no redemption rights.[174] Moreover, as explained above, closed-end funds now commonly offer to redeem investors' shares at regular intervals. Public closed-end funds, including perpetual funds that invest in other sectors of private markets (e.g., real estate, private credit) are a well-established asset class for retail investors. As of December 2023, public closed-end funds had $544 billion in assets.[175] Congress has also permitted retail investors to invest in business development companies, a type of public closed-end fund that primarily invests in the debt securities of private companies.[176] As of the third calendar quarter of 2024, business development companies had roughly $407 billion in assets under management.[177]

Fourth, a registered investment adviser to the public closed-end fund would make the determinations regarding investments in certain private equity funds. These investment advisers are financially sophisticated and have a fiduciary duty to the fund and its investors.[178] Therefore, retail investors investing in a public closed-end fund that invests in private equity funds would have the benefit of a financial professional with a fiduciary duty to them, which should address policy concerns regarding retail investors' financial sophistication.

We also believe that the existing disclosure requirements that apply to public closed-end funds would ensure that retail investors have sufficient information to make an informed investment decision with respect to a public closed-end fund that invests more than 15% of its assets in private equity funds.

Public closed-end funds are subject to the extensive disclosure requirements of the 1940 Act and the Securities Act.[179] The SEC requires a public closed-end fund that invests in private equity funds to provide investors with disclosures as to its performance and its investment objectives and

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[174] We also note that public funds available to retail investors do not have any limitations on the types of securities in which they can invest, and many public closed-end funds invest in instruments that retail investors are not otherwise qualified to invest in.

[175] INVESTMENT COMPANY INSTITUTE, *ICI Research Perspective: The Closed-End Fund Market 2023* (May 2024), https://www.ici.org/system/files/2024-05/per30-05.pdf.

[176] *See generally* MORRISON & FOERSTER, *Frequently Asked Questions About Business Development Companies* (2018), https://assets.contentstack.io/v3/assets/blt5775cc69c999c255/blt8030c797d99266b7/65c115b9fb34d0b7151af7c0/faq-business-development-companies.pdf. Business development companies may invest in any type of security of private U.S. issuers, but business development companies invest primarily in debt securities. *See* BUSINESS DEVELOPMENT COMPANY UNIVERSE, *Closed-End Fund Advisors* (May 21, 2025), https://cefdata.com/bdc/ (showing that the vast majority of business development companies' assets are invested in debt). Business development companies must hold 70% of their assets in certain types of investments, which do not include private funds, so business development companies cannot be a fund of private equity funds. *See* 15 U.S.C. § 80a–54(a).

[177] *See* Berlin, *supra* note 99.

[178] *See Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). *See also* 15 U.S.C. § 80a-35.

[179] *See generally* 15 U.S.C. § 77g, 80a-24 & 80a-29.

policies.[180] The SEC also requires that a public closed-end fund disclose the principal risk factors associated with its investment strategies,[181] and, in its quarterly, semi-annual and annual reports filed with the SEC and available to the public, disclose its portfolio of investments at the end of the reporting period, including the name of each issuer and the value of each holding.[182]

For example, the iDirect fund provides extensive disclosure to investors on its investment objective, philosophy, and strategies, including its expected portfolio allocation broken down by the type of private equity fund investment (e.g., primary vs. secondary), the strategy of the funds in which it invests (e.g., buyout vs. growth), and the funds' geographic region.[183] The iDirect fund also provides lengthy disclosure on the risks of the private equity funds in which it invests.[184] In its annual shareholder report, the iDirect fund provides an updated overview of its historical operating performance and the composition of its portfolio of private equity funds.[185]

The SEC has also established extensive disclosure requirements as to the fees charged by public closed-end funds. The registration statement for a public closed-end fund must include a summary of the fund's expenses in a fee table, with total annual expenses listed as a percentage of net assets.[186] Public closed-end funds must also disclose an estimate of the expenses on a $1,000 investment, assuming a 5% annual return.[187] Additionally, if a public closed-end fund invests in other investment funds (including private equity funds), then the fee table must disclose the fees and expenses incurred indirectly by the public closed-end fund as a result of these investments.[188] Specifically, the public closed-end fund must disclose these fees as a percentage of its average net assets, based on the total annual operating expense ratio for each private equity fund, the average invested balance in each private equity fund, and the number of days invested in each private equity fund.[189] Public closed-end funds must also disclose certain performance fees charged by the private equity funds in which they invest.[190]

Table 1 below presents the annual expenses portion of the iDirect fund's fee table and is intended to show that existing disclosures by public closed-end funds that invest in private equity funds are comprehensive and easy to understand.[191]

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[180] *See* SEC, *Reference Copy of Form N-2* at Items 4 & 8, https://www.sec.gov/files/formn-2.pdf.
[181] *See id*. at Item 8, Instruction 3.
[182] *See* SEC, *Reference Copy of Form N-Q* at Item 1, https://www.sec.gov/files/formn-q.pdf; SEC, *Reference Copy of Form N-CSR* at Item 6, https://www.sec.gov/files/formn-csr.pdf. *See also* 17 C.F.R. §§ 210.12-12-14.
[183] iDirect Private Markets Fund, *supra* note 173.
[184] *See id*.
[185] iDirect Private Markets Fund, *Form N-CSR* (Mar. 31, 2024), https://www.sec.gov/Archives/edgar/data/1606789/000158064224003117/idirect_ncsr.htm.
[186] *See* SEC, *Reference Copy of Form N-2* at Item 3, https://www.sec.gov/files/formn-2.pdf.
[187] *Id*.
[188] *Id*. at Instruction 10; SEC, *Staff Responses to Questions Regarding Disclosure of Fund of Funds Expenses* (May 23, 2007), https://www.sec.gov/divisions/investment/guidance/fundfundfaq.htm.
[189] See SEC, *Reference Copy of Form N-2* at Item 3, Instruction 10.b., https://www.sec.gov/files/formn-2.pdf.
[190] *Id*. at Instruction 10.g.
[191] iDirect Private Markets Fund, *supra* note 173.

Table 1

Annual Expenses (as a percentage of the fund's net assets)	
Management Fees	0.90%
Acquired Fund Fees and Expenses[192]	0.46%
Interest Payments on Borrowed Funds	0.13%
Other Expenses	0.42%
Total Annual Expenses	2.51%

In conclusion, we recommend that the SEC not apply the accredited investor standard on a look-through basis to public closed-end funds that invest more than 15% of their assets in private equity funds. We believe that retail investors should have the opportunity to enhance their investment returns through these funds. To the extent additional protections for retail investors are deemed appropriate, we note that the SEC could adopt such protections by simply restricting the private equity funds that public closed-end funds could invest in. For example, the SEC could implement a principles-based approach that would only allow public closed-end funds to invest in private equity funds where the public fund determines that the private equity fund's manager possesses proportionate scale, experience, and stability to manage the fund's investments effectively, given the nature, size, and complexity of those investments.

A. Restrictions on Public Fund Investments in and with Affiliated Private Funds

Two further restrictions under the 1940 Act could limit the potential benefits to retail investors of investing in private equity through public closed-end funds. These are the restrictions on public funds investing in: (1) private funds that share a common manager with the public fund ("**affiliated private funds**"), and (2) portfolio company deals originated by the manager of an affiliated private fund.[193]

These restrictions are intended to mitigate potential conflicts of interest concerns that could arise when the manager of a public fund causes the fund to invest in another fund or portfolio company from which the manager may receive fees. However, the 1940 Act authorizes the SEC to exempt public funds from these restrictions if the SEC finds that the terms of the investment are "reasonable and fair" and "do not involve overreaching on the part of any person concerned."[194]

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[192] Represents estimated operating fees and expenses of the Investment Funds in which the iDirect fund invests. Some or all of the Investment Funds in which the fund invests charge carried interest, incentive fees, or allocations based on the Investment Funds' performance. The Investment Funds in which the fund invests generally charge a management fee of 1.00% to 2.00% annually on committed or net invested capital, and approximately 20% of net profits as a carried interest allocation. The 0.38% shown as "Acquired Fund Fees and Expenses" reflects operating expenses of the Investment Funds (e.g., management fees, administration fees, and professional and other direct, fixed fees and expenses of the Investment Funds) after refunds, excluding any performance-based fees or allocations paid by the Investment Funds that are paid solely on the realization and/or distribution of gains, or on the sum of such gains and unrealized appreciation of assets distributed in-kind, as such fees and allocations for a particular period may be unrelated to the cost of investing in the Investment Funds.

[193] 15 U.S.C. § 80a–17 ("Transactions of certain affiliated persons and underwriters").

[194] *Id*. at § 80a–17(b)(1).

Because investment fund managers commonly offer both public and private funds, these restrictions could significantly narrow the range of investment options available to a public closed-end fund that invests in private equity or private credit. Furthermore, investing in affiliated private funds and co-investing with affiliated private funds can provide economies of scale by reducing search costs, as multiple funds can share in a single investment opportunity that the funds' common manager identifies. The private funds available to institutions and qualified purchasers are not subject to these restrictions, and their greater flexibility to invest in and alongside affiliated funds is a contributing factor to the superior returns and diversification benefits outlined in Part II. If public funds cannot benefit from the same flexibility and range of investment opportunities, they may underperform the funds available to institutional investors and qualified purchasers. We therefore recommend that the SEC use its authority to grant such exemptions on a fund-by-fund basis where the SEC finds that the terms of the proposed investment arrangement are reasonable and fair. We also recommend that the SEC seek to simplify the process for obtaining relief from the co-investment restriction, which currently involves often complicated and potentially burdensome conditions.[195]

6. Application of our closed-end fund recommendation to individual retirement accounts

Individual retirement accounts ("**IRA**s") are a type of retirement account that provides beneficiaries with complete control over how their savings are invested, such that beneficiaries can choose from the full selection of investments that are available through a brokerage account, including closed-end funds. However, the criteria for "accredited investor" and "qualified purchaser" status apply directly to the beneficiary of the IRA. Thus, an IRA beneficiary may invest in private equity through his or her IRA only if the beneficiary meets the wealth and income requirements necessary for direct investment in private equity as described above.[196] As a result, the exclusion of most U.S. households from private equity investments also applies to investments made through IRA accounts, which are significant and growing rapidly: Figure 8 illustrates the substantial growth in IRA account values over the past 2 decades. At the first quarter of 2025, U.S. households held \$16.7 trillion in assets through IRAs, up from \$3.3 trillion in 2004.[197]

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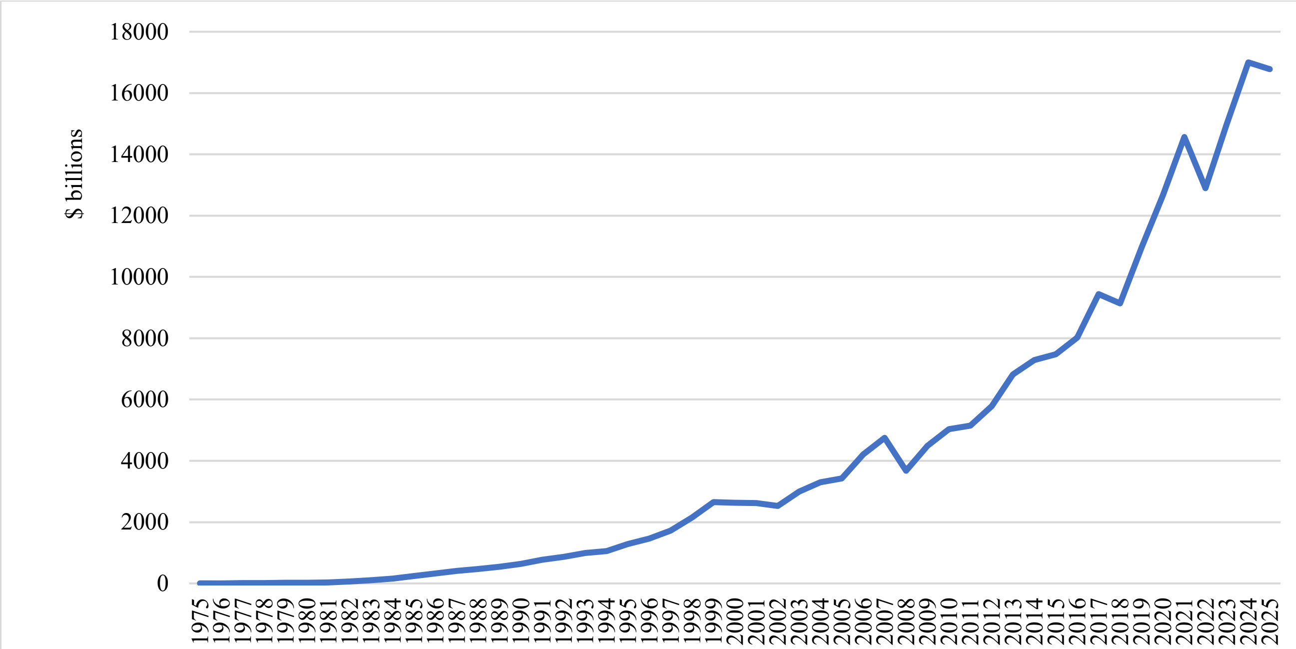
[195] *See, e.g.*, SEC*, In the Matter of FS Credit Opportunities Corp., et al., Application for an Order Pursuant to Sections 17(d) and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 under the Investment Company Act of 1940 Permitting Certain Joint Transactions Otherwise Prohibited by Sections 17(d) and 57(a)(4) of and Rule 17d-1 Under the Investment Company Act of 1940, SEC Accession No. 0001193125-25-030936* (Feb. 20, 2025), https://www.sec.gov/Archives/edgar/data/1568194/000119312525030936/d909521d40app.htm.

[196] An IRA is accredited under Reg D only if its owner is an accredited investor. *See* 17 C.F.R. § 230.501(a)(8); SEC, *Compliance and Disclosure Interpretation 255.22* (Nov. 6, 2017), https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm; SEC, *Manual of Publicly Available Telephone Interpretations* at E.8 & E.9 (Mar. 4, 2017), https://www.sec.gov/interps/telephone/cftelinterps_regd701.pdf Similarly, the SEC looks through an IRA to its owner when determining if an IRA is a qualified purchaser. See AMERICAN BAR ASSOCIATION, *SEC No-Action Letter Ref No. 1999* at 14 (Apr. 22, 1999).

[197] INVESTMENT COMPANY INSTITUTE, *Quarterly Retirement Market Data (Q1 2025),* https://www.ici.org/research/stats/retirement.

Figure 8: Total IRA Accounts Value Held by U.S. Households



Our recommendation that public funds be enabled to increase their exposure to private equity thus applies with respect to investments made through IRAs. Indeed, the inherently long-term nature of retirement account investments underscores their compatibility with the long-term investment strategies that underlie private equity investments.

Part IV: Expanding Access to Private Equity Through Retirement Accounts

Part IV recommends that U.S. policymakers expand access to private equity by facilitating the provision of private equity investment options by 401(k) plan sponsors.

We begin by showing how U.S. investors' retirement savings – which constitute the most significant part of U.S. households' financial assets – are shifting from defined benefit plans, which invest in private equity, to defined contribution plans, most commonly the 401(k) plan, which do not. We review the empirical evidence showing that the absence of private equity investments in 401(k) plans has caused them to underperform defined benefit plans, with detrimental effects on U.S. households' retirement savings.

We then review in detail the structure of 401(k) plans and the risks that deter plan sponsors from offering private equity investment options to their participants. We summarize recent, incomplete steps toward expanding access to private equity through 401(k) accounts. Finally, we describe how the DOL could rescind the 2021 Supplemental Letter and enact an ERISA safe harbor that would address these risks and enable 401(k) plan sponsors to provide private equity, private credit, and other alternative investment options.

1. Overview of defined benefit and defined contribution plans

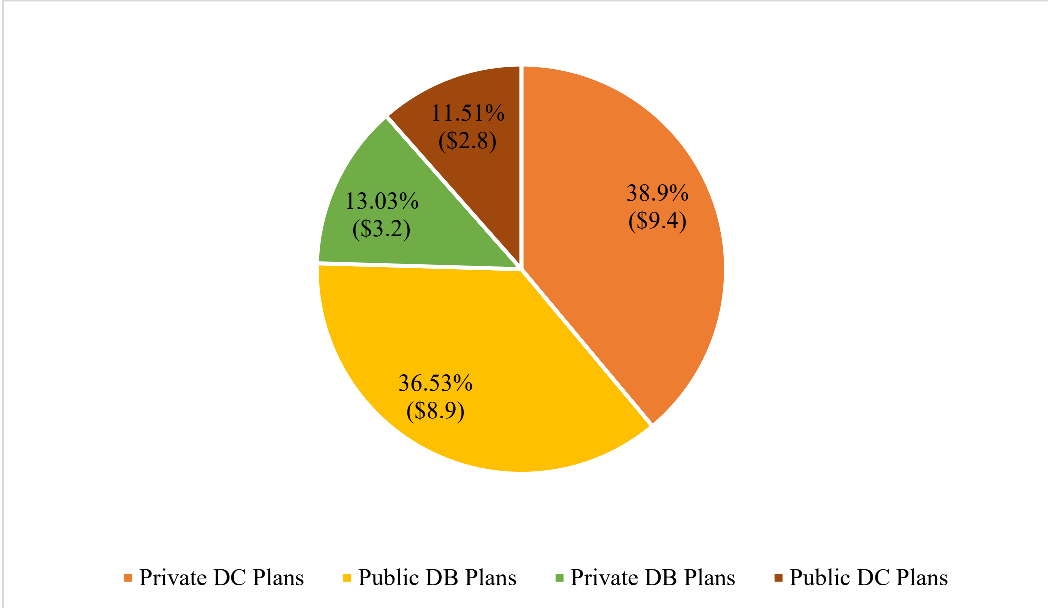
As noted in Part I, the most recent data indicate that retirement accounts make up 36% of U.S. households' financial assets and thus constitute the largest source of financial wealth for U.S. households.[198] Retirement accounts can be broadly categorized into IRAs and employer-sponsored plans. Our recommendations with respect to IRAs are explained in Part III. In Part IV, we focus solely on employer-sponsored plans.

In the case of employer-sponsored plans, the employer selects the investments that are available to beneficiaries. ERISA imposes fiduciary duties on employer sponsors with respect to their administration of the plan and the investment of plan assets. The DOL is responsible for the administration and enforcement of ERISA requirements.

Figure 9 breaks down employer-sponsored retirement plans into assets held by government (public) and private defined benefit and defined contribution plans as of Q1 2025.[199] Our primary focus in this report is on 401(k) plans, the largest subtype of private defined contribution plans. 401(k) plans had $8.7 trillion in AUM as of Q1 2025 and thus accounted for over 92% of total private defined contribution plan assets.[200]

[198] Data derived from the BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *supra* note 15.
[199] Data extrapolated from INVESTMENT COMPANY INSTITUTE, *Report: The US Retirement Market, First Quarter 2025* (Jun. 18, 2025), https://www.ici.org/research/stats/retirement.
[200] *Id.*

Figure 9: Breakdown of U.S. Employer-Sponsored Retirement Plan Assets ($ trillions) [201]



An employer sponsoring a defined benefit plan promises to pay participants in the plan a certain amount of benefits upon retirement, regardless of the performance of the investments that the plan holds.[202] These plans typically determine the amount of benefits that a participant is entitled to receive based on the participant's years of service, age, and salary.[203] Participants generally receive a fixed amount per month after retirement for the remainder of their lives.[204] Typically, an internal investment committee and one or more external asset managers manage the assets of a defined benefit plan.[205] The managers of a defined benefit plan pool assets together for all participants and invest them to earn a return that is then used to help meet the obligations owed to plan participants.[206]

Unlike defined benefit plans, the amount that a participant in a defined contribution plan is entitled to receive in retirement depends on the value of an account established for the participant under

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[201] *Id.*

[202] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *The Nation's Retirement System: A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security* at 12 (Oct. 18, 2017), https://www.gao.gov/products/gao-18-111sp.

[203] *See id.* at 9-11.

[204] *Id.*

[205] According to a recent Towers Watson survey, 33% of defined benefit plan sponsors outsource at least one aspect of their investment services, such as manager selection or implementation. *See* WILLIS TOWERS WATSON, *Evolving Risks, Structure and Strategies in Retirement Plan Governance: Highlights from the 2016 Willis Towers Watson U.S. Retirement Plan Governance Survey* at 2-3 (2016), https://ab-d.com/wp-content/uploads/2016/07/Towers-July-6-2016-Survey.pdf.

[206] *See id. See also* Kathryn L. Moore, *An Overview of the U.S. Retirement Income Security System and the Principles and Values It Reflects*, 33(1) COMPARATIVE LABOR LAW & POLICY JOURNAL 5 at 20 (2011), https://uknowledge.uky.edu/law_facpub/269/.

the plan.[207] The value of the account is determined by four factors: (1) the amount of contributions; (2) the expenses incurred by the plan; (3) the asset allocation decisions made by the participant among the investment options available in the plan; and (4) the performance of the investments in the account over time.[208] Participants in defined contribution plans typically make contributions to their plan account as part of their regular payroll, and employers often contribute a certain additional amount—for example, by "matching" the amount contributed by each participant.[209]

2. The shift from defined benefit to defined contribution retirement plans

Private employer-sponsored retirement accounts have shifted dramatically over the past decades, away from defined benefit plans and toward defined contribution plans. We focus on *private* plans because government employers still predominantly offer defined benefit plans.[210]

Figures 10 through 12 below present historical data on private employer-sponsored retirement plans from the DOL's 2024 report on retirement plan assets. The DOL publishes these data bi-annually, such that 2022 is the most recent year for which data are available.

Figure 10 shows that in 1975—the year after ERISA was passed—the number of U.S. workers with access to private defined benefit plans was twice the number of U.S. workers with access to private defined contribution plans.[211] However, as of 2022, the number of U.S. workers with access to private defined contribution plans was four times the number of U.S. workers with access to private defined benefit plans: 121.3 million participants with access to private defined contribution plans, as compared to just 30.2 million with access to private defined benefit plans.[212]

[207] *See* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 202 at 12.
[208] *See id*.
[209] *See* Moore, *supra* note 206 at 20.
[210] *See* U.S. BUREAU OF LABOR STATISTICS, *National Compensation Survey: Employee Benefits in the U.S.* at 379 (Mar. 2017), https://www.bls.gov/ncs/ebs/benefits/2017/ebbl0061.pdf (noting that 86% of state and local government workers have access to a defined benefit plan; Federal workers also generally have access to a defined benefit plan.) *See* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 202 at 9, n.13.
[211] U.S. DEPARTMENT. OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, *Private Pension Plan Bulletin Historical Tables and Graphs 1975-2022* at 5 (Sept. 2024), https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/pension-plan-historical-tables.pdf.
[212] *Id*.

Figure 10: Participants with Access to Private Employer-Sponsored Retirement Plans[213]

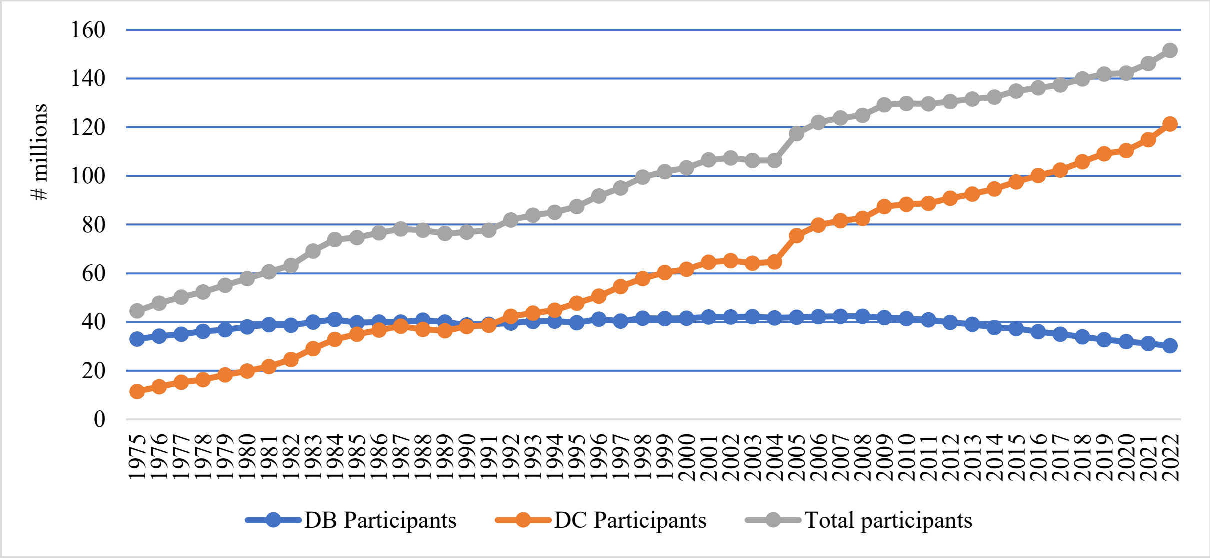
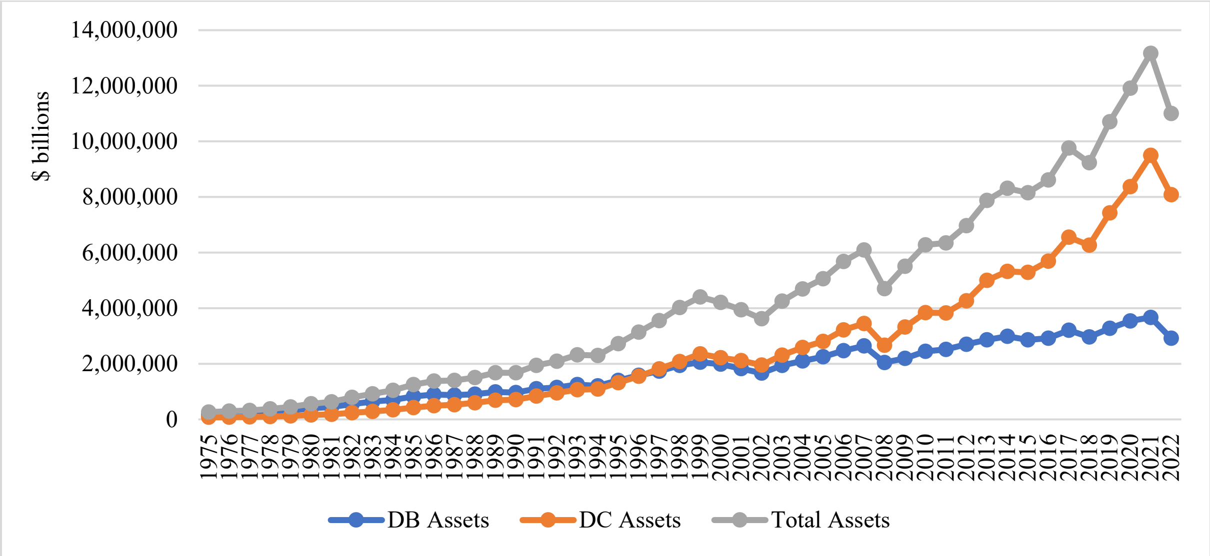


Figure 11 shows the total assets of private employer-sponsored retirement plans for each year from 1975 through 2022. As the figure shows, private defined contribution plans have grown substantially in recent decades. As of 2022, the total assets held by private defined contribution plans were over $8 trillion, almost three times the total assets held by private defined benefit plans.[214]

Figure 11: Private Employer-Sponsored Retirement Plans Assets[215]



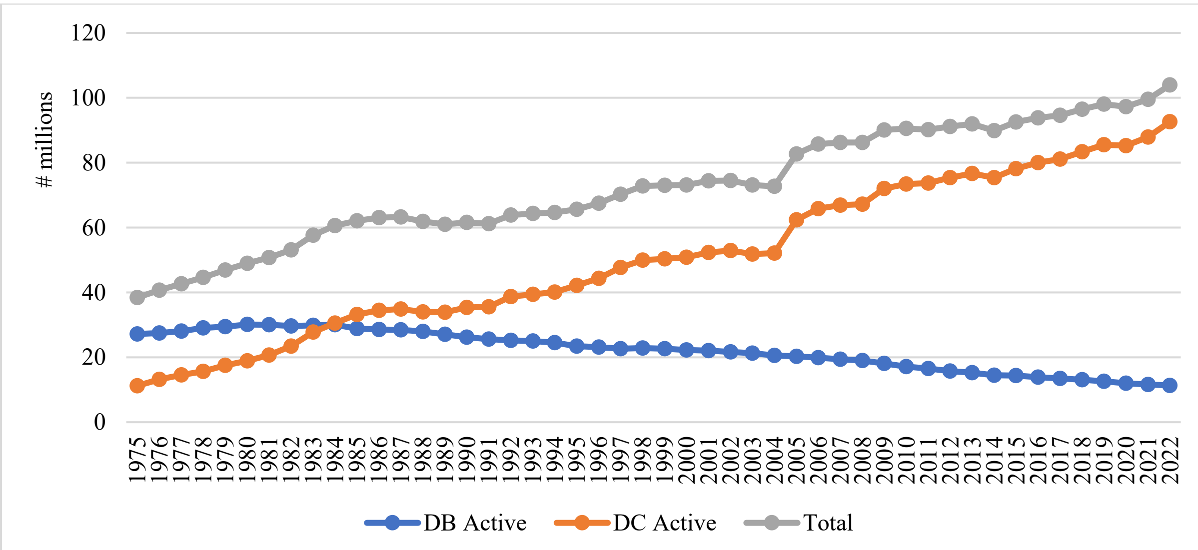
[213] *Id.*

[214] *Id.* at 13.

[215] *Id.* at 14.

The number of active participants with access to employer-sponsored retirement plans—workers who can still earn or retain credited service under a plan—is a forward-looking indicator of future trends in retirement plan assets. Figure 12 shows that recent trends are likely to accelerate. As of 2022, the number of active participants with access to private defined contribution plans was 92.6 million, which is nearly **nine times** the 11.3 million active participants with access to private defined benefit plans.[216]

Figure 12: Active Participants with Access to Private Employer-Sponsored Retirement Plans[217]



Several factors are driving the rise of defined contribution plans. These include growing life expectancy combined with increasing funding requirements for defined benefit plans, both of which increase the cost of providing defined benefit plans and incentivizes employers to provide defined contribution plans instead.[218] In addition, defined benefit plans can have unpredictable impacts on an employer's balance sheet, which results in a reporting burden for public companies. This is because the value of the employer's future liabilities to plan beneficiaries is fixed, whereas the value of the assets that the employer holds to fund those future liabilities varies with the market, which can cause significant swings in the value of the employer's equity for each reporting period.[219] For example, an employer may have defined benefit plan assets and liabilities that each equal $1 billion at one reporting period, but if the value of the plan assets depreciates to $900 million in the next quarter and the value of the liabilities remains constant, the employer will show

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216 *Id*. at 9.

217 *Id*. at 10.

218 James Poterba, Joshua Rauh, Steven Venti & David Wise, *Defined Contribution Plans, Defined Benefit Plans, and the Accumulation of Retirement Wealth*, 91(10) JOURNAL OF PUBLIC ECONOMICS 2062 (2007), https://doi.org/10.1016/j.jpubeco.2007.08.004.

219 PACIFIC LIFE, *Reduce the Impact of Pension Volatility on the Balance Sheet*, https://www.in.pacificlife.com/products/for-employers/blog/reduce-the-impact-of-pension-volatility-on-the-balance-sheet.

a loss of $100 million in equity. By contrast, an employer's liabilities under a defined contribution plan are always equal to the value of the assets that employees hold in their accounts, and thus these plans do not result in such balance sheet impacts. Further factors include (1) the increasing frequency of job changes, meaning that an employee-controlled defined contribution plan that follows the employee across employers is more practical than an employer-controlled defined benefit plan,[220] (2) increased use of auto-enrollment features in defined contribution plans,[221] and (3) tax reforms that increased companies' post-tax earnings, encouraging many employers to increase their 401(k) contributions.[222]

3. Lack of access to private equity in 401(k) plans results in underperformance

Studies documenting the performance of defined benefit plans and 401(k) plans show that defined benefit plans outperform 401(k) plans. The evidence also indicates that defined benefit plans' private equity investments are a significant factor in driving this outperformance. Therefore, the unavailability of private equity investments in 401(k) plans negatively affects retirees, and the shift away from private defined benefit plans and toward 401(k) plans amplifies this effect.

We review here several important examples of this research.

A. Defined benefit plans outperform 401(k) plans

A 2015 study by the Boston College Center for Retirement Research found that private defined benefit plans outperformed private defined contribution plans by 90 basis points annually from 1990-2012 (7.9% average annual returns for defined benefit plans versus 7.0% average annual returns for defined contribution plans).[223] The outperformance of private defined benefit plans over private defined contribution plans is even greater for larger retirement funds. From 2003-2012, private defined benefit plans with more than $100 million in assets outperformed similarly sized private defined contribution plans by 1.50% annually.[224] A more recent 2023 Georgetown University analysis found that defined benefit plans continued to outperform defined contribution

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[220] Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends*, EBRI ISSUE BRIEF NO. 405 (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2515930.

[221] *See* Paula Aven Gladych, *Employers Adding 401(k) Auto-Enrollment in Record Numbers*, EMPLOYEE BENEFIT NEWS (Feb. 27, 2018), https://www.benefitnews.com/news/employers-adding-401-k-auto-enrollment-in-record-numbers.

[222] *See* WILLIS TOWERS WATSON, *Tax Law Fueling Changes to Employer Benefits and Compensation Programs* (Jan. 25, 2018), https://www.globenewswire.com/news-release/2018/01/25/1305044/0/en/Tax-law-fueling-changes-to-employer-benefits-and-compensation-programs-Willis-Towers-Watson-survey-finds.html. *See also* Anne Tergesen, *With Tax Savings, Some Employers Will Boost 401(k) Contributions*, THE WALL STREET JOURNAL (Jan. 18, 2018), https://www.wsj.com/articles/with-tax-savings-some-employers-will-boost-401-k-contributions-1516302593.

[223] Alicia H. Munnell, Jean-Pierre Aubry & Caroline V. Crawford, *Investment Returns: Defined Benefit vs. Defined Contribution Plans*, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE at 3 (Dec. 2015), https://crr.bc.edu/wp-content/uploads/2015/12/IB_15-211.pdf.

[224] *Id*.

plans by 1.80% annually from 1998 through 2005 and by 0.46% annually from 2007 through 2016.[225]

A critical difference between defined benefit plans and defined contribution plans is that defined benefit plans invest in private equity, among other alternative investments, whereas defined contribution plans generally do not.[226] As of 2023, U.S. public defined benefit plans allocated 14% of their total assets to private equity investments.[227] By contrast, fewer than 1% of 401(k) plan sponsors offer participants any exposure to private equity. In the subsection below, we review the evidence linking the outperformance of defined benefit plans to their greater ability to invest in private equity.

B. Private equity drives defined benefit plans' outperformance

Several empirical studies confirm that private equity fund investment is critical to defined benefit plans' strong performance and that including private equity in 401(k) plan portfolios would help to close this performance gap. These studies focus on public defined benefit plans, because these plans provide detailed disclosures as to the performance of their specific asset allocations. We believe that the performance of private equity in the portfolios of public defined benefit plans is likely representative of the performance of private equity in the portfolios of private defined benefit plans.

Figure 13 shows the average annual returns for public defined benefit plans across various asset classes from 2013 through 2023, based on data from a 2024 American Investment Council study.[228] The returns from private equity investments outperformed all other classes of investments — including public equity investments, by a significant margin.[229] This outperformance by private equity is consistent with our review of private equity returns in Part II.

[225] Angela M. Antonelli, *Has the Lack of Asset Diversification in DC Retirement Plans Been a Costly Missed Opportunity?*, CENTER FOR RETIREMENT INITIATIVES, GEORGETOWN UNIVERSITY (Jun. 2023), https://cri.georgetown.edu/wp-content/uploads/2023/06/GeorgetownCRI-CEm-Benchmarking_Lack-of-Asset-Diversification-CRI-paper.pdf.

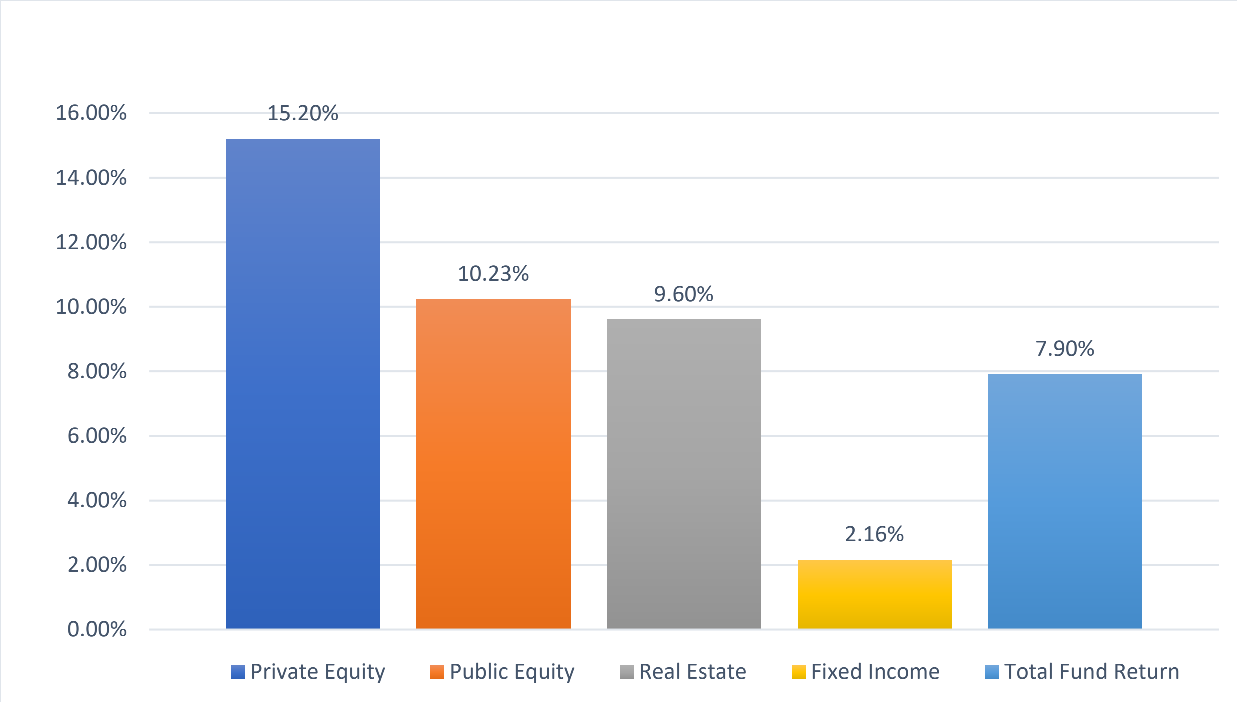
[226] Based on CCMR staff conversations with representatives from Preqin, a provider of data on the private equity industry. *See also*, Scott Higbee, *It's Time To Let 401(k) Holders Invest Like the Pros*, WALL STREET JOURNAL (Jan. 30, 2014), https://www.wsj.com/articles/it8217s-time-to-let-401k-holders-invest-like-the-pros-1391126566. ("[401(k)] plans generally don't provide investors with the opportunity to add a range of alternative assets to the mix."); Frances Denmark, *Private Equity Tries to Break the 401(k) Barrier*, INSTITUTIONAL INVESTOR (Apr. 19, 2017), https://www.institutionalinvestor.com/article/2bsvybqv0isoqvyvamfwg/portfolio/private-equity-tries-to-break-the-401k-barrier ("DC gatekeepers — retirement plan sponsors and their investment consultants — continue to keep [private equity funds] off 401(k) plans.").

[227] AMERICAN INVESTMENT COUNCIL, *2024 Public Pension Study: Private Equity Delivers the Strongest Returns for Retirees Across America* at 2 (Jul 18., 2024), https://www.investmentcouncil.org/wp-content/uploads/2024/07/2024-AIC-Pensions-Report_final.pdf.

[228] *Id*. at 7.

[229] *Id*.

Figure 13: Public Defined Benefit Plan Median Annual Net Returns by Asset Class (2013-2023) [230]



A 2022 study by the Boston College Center for Retirement Research similarly concluded that private equity had a positive impact on returns for public defined benefit plans over the 2001-2022 period and outperformed all other asset classes in the plans' portfolios, including public equity.[231] A 2024 analysis of the portfolios of 19 public defined benefit plans over the 2020-2023 period reached the same conclusion: private equity investments have consistently been the strongest-performing asset class in the plans' portfolios and have substantially enhanced the return on plan assets relative to the return that the plans would have obtained by investing the same assets in public equity.[232] Specifically, the analysis found that the plans' private equity investments produced an 11% annual return, as compared to 6.2% for public equity.

A 2025 analysis of recent public pension fund performance by the National Association of State Retirement Administrators attributes the continued outperformance of public pension funds' returns relative to inflation over the past few years to public pension funds' "increased allocations to alternative assets, such as private equities … which have a higher expected return than those of public equities and fixed income securities."[233]

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[230] *Id.*
[231] Aubry, *supra* note 67.
[232] Stephen L. Nesbitt, *Long-Term Private Equity Performance: 2000 to 2023* (Apr. 23, 2024), CAIA ASSOCIATION, https://caia.org/blog/2024/04/23/long-term-private-equity-performance-2000-2023.
[233] NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS, *Public Pension Plan Investment Return Assumptions* (Jun. 2025), https://www.nasra.org/files/Issue%20Briefs/NASRAInvReturnAssumptBrief.pdf.

While private equity investments have provided significant boosts to the overall returns of public defined benefit plans, an important question remains whether the risk exposure of public defined benefit plans has increased as well. However, the 2022 Boston College study finds that, based on the sample of public defined benefit plan returns from 2001 through 2022, increasing allocations into private equity investments did not have a statistically significant effect on the volatility of returns.[234] Therefore, while private equity investments serve to increase the overall returns of public defined benefit plans, there is not a corresponding increase in overall risk. Moreover, the Voya study reviewed in Part II shows a *reduction* in overall risk to a portfolio from investments in private equity funds.[235]

C. Adding Private Equity Investments to 401(k) Portfolios Would Help to Close the Performance Gap

A series of studies by Professor Gregory Brown and his co-authors has specifically analyzed whether reallocating a portion of 401(k) plan portfolios to private equity funds would improve the performance of those portfolios. Each analysis indicates that 401(k) plans could improve their performance and reduce their risk by allocating a portion of their assets to private equity funds. As in the case of the studies discussed in Part II above, performance is calculated on a net basis (i.e., after deducting management and performance fees received by fund managers).

Brown et al. (2019) analyzed the performance of a sample of 2,515 U.S. private equity funds for the years 1987-2017 and used the performance metrics to simulate the effect of adding private equity to a 401(k) plan portfolio. The analysis found that the reallocation of 20% of a portfolio consisting entirely of public equity to buyout funds increased average annual returns from 8.05% to 8.69% and reduced the standard deviation of returns from 9.89% to 8.50%.[236]

Brown et al. (2022) reviewed the empirical literature addressing the potential benefits of including private equity investments in 401(k) portfolios.[237] The review found that there is substantial evidence that the inclusion of private equity investments offers the potential for higher returns and improved diversification, as well as a relatively safe method for accessing investments previously only available to institutions and the high-net-worth investors.

Several similar studies produced consistent results. For example, Cosic et al. (2021)[238] estimated the effect of reallocating a portion of 401(k) portfolios to private equity. The results showed that the private equity allocation would significantly increase the average rates of return of 401(k)

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[234] *Id.*

[235] *See supra* notes 58-59 and accompanying text.

[236] Gregory W. Brown, Wendy Hu & Bert-Klemens Kuhn, *Why Defined Contribution Plans Need Private Investments*, DCALTA/IPC RESEARCH PAPER (Oct. 2019), https://www.northerntrust.com/content/dam/northerntrust/pws/nt/documents/asset-servicing/why-defined-contribution-plans-need-private-investments.pdf.

[237] Gregory W. Brown, Keith Crouch, Andra C. Ghent, Robert S. Harris, Yael V. Hochberg, Tim Jenkinson, Steven N. Kaplan, Richard Maxwell & David T. Robinson, *Should Defined Contribution Plans Include Private Equity Investments?*, KENAN INSTITUTE OF PRIVATE ENTERPRISE RESEARCH PAPER NO. 20-14 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3747684.

[238] Cosic et al., *supra* note 65.

participants' assets. Specifically, the availability of a private equity investment option in defined contribution retirement plans would increase the average 401(k) participant's account balance at age 65 by $27,600, or 6.6 percent.

A 2023 study by the Georgetown Center for Retirement Initiatives that evaluated the impact of adding alternative investments to defined contribution plan portfolios via target date funds produced similar results to the analyses above.[239] A target date fund is an investment vehicle with a portfolio of assets that changes over time, becoming more conservative as an investor approaches retirement age. The analysis found that reallocating 10% of the defined contribution plans' assets from public stocks to private equity would have increased the annual return by 0.22% over the 2011-2020 period. Reallocating 10% of defined contribution plans' assets from public stock to a mix of private equity and a mix of other private assets would have increased the annual return by 0.15%. The analysis then estimates that a 0.15% increase in investment performance would have resulted in $35 billion per year in additional savings across all defined contribution plan assets. This equates to a 5% increase in annual spending power for an individual plan participant. The study also found that, in the case of some of the worst market outcomes (the fifth percentile of results), such a private equity allocation still improves retirement income by 12% compared to the baseline.[240]

Thus, substantial empirical evidence indicates that access to private equity investments would improve the performance of 401(k) plans.

[239] Antonelli, *supra* note 225.
[240] *Id*.

4. How to expand access to private equity through 401(k) plans

As explained above, 401(k) plans are private employer-sponsored retirement plans that account for over 90% of all defined contribution plan assets. They are structured to enable employees (or "**plan participants**") to invest part of their wages for retirement on a tax-advantaged basis. In order to maintain tax-advantaged status, there are significant limitations on participants' ability to make withdrawals from their 401(k) plan accounts. A 401(k) plan must generally not allow for distributions unless: (i) the participant dies or becomes disabled; (ii) the plan terminates and no successor plan is established; or (iii) the participant reaches age 59½ or incurs a financial hardship.[241] If a distribution before the age of 59½ is allowed by the employer because the employer determines that one of the other requirements has been satisfied, then the distribution is often subject to a 10% tax in addition to ordinary income tax.[242]

Despite the restrictions on participant withdrawals from 401(k) accounts, a majority of 401(k) plans allow participants to take out loans of up to $50,000 against their retirement accounts in order to provide participants with liquidity.[243] As of 2024, approximately 18% of eligible 401(k) participants had such loans outstanding.[244] These loans are generally not considered taxable distributions. Additionally, when a plan participant's employment with a specific employer ends before the age of 59½, he or she has the opportunity to liquidate the full 401(k) account balance, subject to ordinary income taxes and the 10% additional tax.[245] Alternatively, a plan participant has the option to "roll over" their 401(k) account into a new employer's 401(k) or into an IRA.[246] These features make 401(k) plans more liquid than defined contribution plans in other countries. Indeed, Beshears et al. (2015) compared defined contribution systems internationally and found that the defined contribution systems in the United Kingdom, Canada, Australia, Singapore, and Germany were "overwhelmingly illiquid" as compared to 401(k) plans in the U.S.[247]

Approximately 95% of 401(k) plans are "employee-directed plans," and that is our focus in this report.[248] In an employee-directed 401(k) plan, an individual employee chooses to allocate his or her contributions among several investment options ("**Investment Options**") that are part of the 401(k) plan (together, the "**Investment Menu**"). The employer sponsoring the plan—often through an investment committee made up of finance and human resources employees—is

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241 *See* 26 U.S.C. § 401(k). *See also* 26 C.F.R. § 1.401(k)-1(d)(3) (regarding hardships). For a useful resource explaining 401(k) plans and how they operate, *see* Arris Murphy & Paul Hamburger, THE 401(K) HANDBOOK (2018).
242 *See* 26 U.S.C. § 72(t). *See also* Murphy & Hamburger, *supra* note 241 at ¶263.
243 Sarah Holden, Jack VanDerhei, Luis Alonso & Steven Bass, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2015*, 23(6) ICI RESEARCH PERSPECTIVE 1 at 47 (Aug. 2017), https://www.ici.org/pdf/per23-06.pdf. In 2015, approximately 53% of 401(k) plans offered a loan feature. However, loan features were much more prevalent—close to 90%—among the largest 401(k) plans. *Id.*
244 FIDELITY, *Q1 2024 Retirement Analysis*, https://www.fidelity.com/about-fidelity/Q1-2024-retirement-analysis.
245 *See* Murphy & Hamburger, *supra* note 241 at ¶262.
246 *See id*. at ¶263. *See also* 26 U.S.C. § 402(c).
247 *See generally* John Beshears, James J. Choi, Joshua Hurwitz, David Laibson & Brigitte C. Madrian, *Liquidity in Retirement Savings Systems: An International Comparison*, 105 (5) AMERICAN ECONOMIC REVIEW (May 2015), https://www.aeaweb.org/articles?id=10.1257/aer.p20151004.
248 *See* PLAN SPONSOR COUNCIL OF AMERICA, *67th Annual Survey of Profit Sharing and 401(k) Plans*, https://www.psca.org/industry-content/surveys/annual-401k-survey/.

generally responsible for determining the Investment Options that are included in the Investment Menu.[249] However, the employer sponsor can appoint an external asset manager to determine the Investment Options and Investment Menu.[250] The assets of a 401(k) plan are legally owned by a plan trustee, who is also appointed by the employer sponsor, and the plan trustee holds the 401(k) plan assets for the benefit of the participants.[251]

As demonstrated by Figure 14, each Investment Option holds a portfolio of assets (e.g. stocks and bonds) that are typically managed by a third-party asset manager within certain parameters.[252] Investment Options can be structured using a number of different investment vehicles or "wrappers," including mutual funds, collective investment trusts ("**CITs**"), and separate accounts. CITs are pooled investment vehicles that are organized as trusts and maintained by a bank or a trust company.[253] A separate account is an account managed with a distinct strategy for a 401(k) plan, but does not involve a separate legal entity, as is the case with a mutual fund or CIT.[254] Based on a 2024 Callan survey of 401(k) plan sponsors, 80% of respondents said they offered mutual funds in their Investment Menu, while 82% and 48% offered CITs and separate accounts, respectively.[255]

Critically, plan participants can shift their allocations among Investment Options without any tax or penalty, as also demonstrated by Figure 14. For example, if a plan participant has 100% of his or her 401(k) plan assets allocated to Investment Option One, he or she can move them, in part or entirely, into Investment Option Two. When this happens, the participant redeems his or her interests in Investment Option One, highly liquid assets in Investment Option One's portfolio are typically sold, and the funds from the redemption are moved to Investment Option Two, which typically uses the additional cash to purchase assets as determined by its asset allocation. Of course, the cash that a plan participant is entitled to shift to Investment Option Two is based on the net asset value of Investment Option One at the time of redemption.

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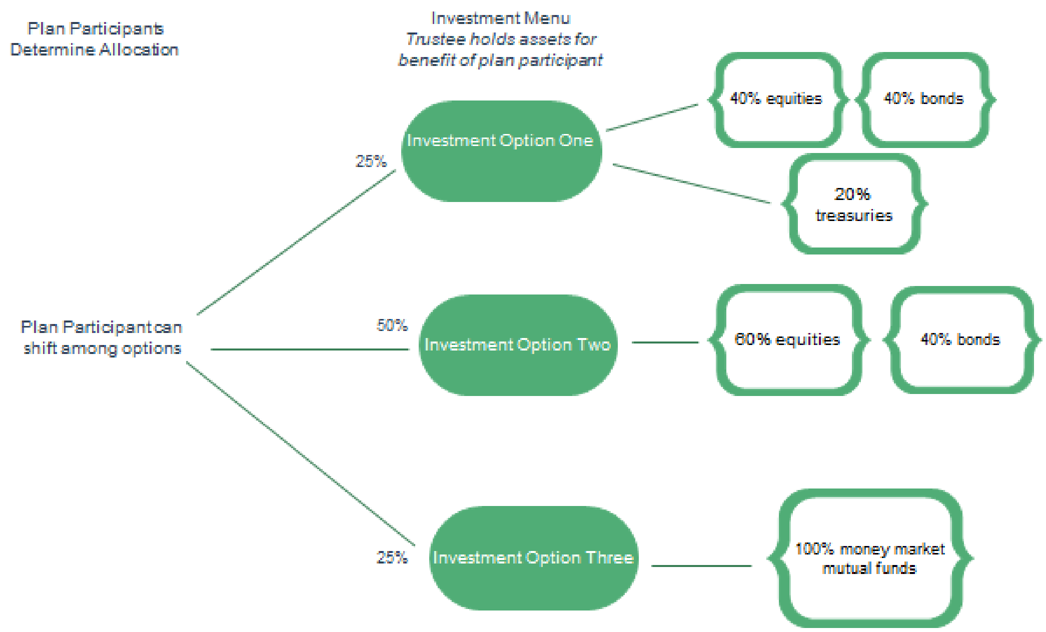
[249] *See generally* Murphy & Hamburger, *supra* note 241 at ¶¶ 410-411.
[250] 29 U.S.C. § 1102(c).
[251] *See* 29 U.S.C. § 1103.
[252] *See generally* DEFINED CONTRIBUTION INSTITUTIONAL INVESTMENT ASSOCIATION, *A Guide to Commonly Used DC Plan Investment Vehicles* (2017), https://cdn.ymaws.com/dciia.org/resource/collection/23D6FA15-31A6-4ABA-826B-A8718DC03E59/a_guide_to_commonly_used_investment_vehicles_final.pdf.
[253] *See* COALITION OF COLLECTIVE INVESTMENT TRUSTS, *Collective Investment Trusts* at 3 (2021), https://ntam.northerntrust.com/content/dam/northerntrust/investment-management/global/en/documents/solutions/collective-funds/collective-investment-trusts-white-paper.pdf. The bank acts as a fiduciary for the CIT and holds legal title to the CIT's assets for the benefit of CIT investors. CITs provide the advantages of not being subject to the restrictions on holding illiquid assets that otherwise apply to mutual funds registered under the 1940 Act.
[254] *See generally* DEFINED CONTRIBUTION INSTITUTIONAL INVESTMENT ASSOCIATION, *supra* note 252 at 6, 14. Separate accounts can be "unitized," where the holdings are divided into units that represent interests in the underlying assets of the account. *See* BLACKROCK, *Comment Letter to the Department of Labor* at 19, n.53 (Jul. 21, 2015), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00684.pdf.
[255] CALLAN INSTITUTE, *Callan 2024 Defined Contribution Trends Survey: Focus on Plan Governance, and Continued Efforts to Rein in Fees* (2024), https://www.callan.com/blog-archive/2024-dc-survey/.

Figure 14: Investment Menu



The majority of 401(k) plan participants allocate their savings to Investment Options that consist of target date funds.[256] A target date fund is an investment vehicle with a portfolio of assets that changes over time, becoming more conservative as an investor approaches retirement age. Target date funds, and Investment Options in general, can be "off-the-shelf" products, based on an existing investment strategy used by an asset manager,[257] or an asset manager can build a "custom" Investment Option based on a particular asset allocation chosen by the 401(k) plan sponsor. According to a survey by the Callan Institute, in 2023, 37% of defined contribution plans with more than $5 billion in assets provided custom target date funds.[258]

A. 401(k) Plans Can Legally Invest in Private Equity

401(k) plans with retail investors as participants can legally invest in private equity funds because the accredited investor standard and the qualified purchaser standard do not prohibit 401(k) plans from investing in private equity funds.

256 U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 202.
257 *See* DEFINED CONTRIBUTION INSTITUTIONAL INVESTMENT ASSOCIATION, *supra* note 252 at 16-17.
258 CALLAN INSTITUTE, *supra* note 255.

Under the 1940 Act, 401(k) plans are qualified purchasers, and under the Securities Act, 401(k) plans are also accredited investors.[259] However, if the accredited investor or qualified purchaser standard were to "look through" to the participants in the plan, then 401(k) plans with retail investors as participants could not invest in private equity funds.

Statute and regulations provide explicitly that the accredited investor standard does *not* "look-through" a 401(k) plan to its participants.[260] And SEC guidance clarifies that the qualified purchaser standard does *not* "look-through" a 401(k) plan to its participants, provided the plan adheres to certain criteria.[261] More specifically, the SEC's *Standish and H.E.B.* no-action letters clarify that 401(k) plans can invest in private funds without a look-through of the qualified purchaser standard, so long as several conditions are met.[262] First, the 401(k) plan must not have been formed for the specific purpose of acquiring the securities offered by a *specific* private fund.[263] Second, plan participants cannot choose the *specific* private fund to invest in, and no representations can be made to plan participants that investments will be made in any specific private fund.[264] And finally, at least 50% of the assets in an Investment Option must consist of securities or property other than the securities of a specific private fund.[265] If structured in accordance with these requirements, then 401(k) plans can invest in private equity funds without a look through of the qualified purchaser standard to plan participants.

Therefore, neither the accredited investor standard nor the qualified purchaser standard prohibits 401(k) plans with retail investors as beneficiaries from investing in private equity funds. However, for the reasons explained in the following section, the vast majority of 401(k) plan sponsors still do not currently provide Investment Options with exposure to private equity.

i. Legal Risks Deter Plan Sponsors from Offering Exposure to Private Equity Funds

401(k) plan sponsors and their appointees are subject to ERISA fiduciary duties. The vast majority of plan sponsors avoid including Investment Options with exposure to private equity funds, as a result of the risk that providing such options could lead to meritless allegations of fiduciary

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[259] Any person, acting for its own account, who in the aggregate owns and invests on a discretionary basis over $25 million in investments, is a qualified purchaser. *See* 15 U.S.C. § 80a-2(a)(51)(A). An employee benefit plan is an accredited investor so long as the plan's investment decisions are made by a plan fiduciary which is either a bank, savings and loan association, insurance company, or registered investment adviser, the plan has total assets in excess of $5,000,000, or, if a self-directed plan, and the plan's investment decisions are made solely by persons who are accredited investors. 17 C.F.R. § 230.501(a)(1).

[260] *See* 15 U.S.C. § 77b(a)(15)(i) and 17 C.F.R. § 230.501(a).

[261] We also note that the Advisers Act's restriction on performance fees does not preclude 401(k) plans from investing in Section 3(c)(7) private equity funds. *See supra* notes 127-129 and accompanying text.

[262] *See* STANDISH, AYER & WOOD, INC. STABLE VALUE GROUP TRUST, *SEC No-Action Letter Ref. No. 95-423-CC* (Dec. 27, 1995), https://www.sec.gov/divisions/investment/noaction/1995/stable-value-group-trust-122895.pdf; H.E.B. INVESTMENT AND RETIREMENT PLAN, *SEC No-Action Letter Ref. No. 20001171143* (May 18, 2001), https://www.sec.gov/divisions/investment/noaction/heb051801.htm. *See also* PANAGORA GROUP TRUST, *SEC No-Action Letter Ref. No. 93-212-CC* (Apr. 29, 1994), https://www.sec.gov/divisions/investment/noaction/1994/panagora042994.pdf.

[263] *See* H.E.B. INVESTMENT AND RETIREMENT PLAN, *supra* note 262.

[264] *Id.*

[265] *Id.*

violations (e.g., lack of due care or prudence) based on unique features of private equity investments (e.g., higher gross fees or relative illiquidity), even when the plan sponsor has prudently considered and accounted for those features in a manner consistent with ERISA's fiduciary duties. In practice, the risk of such allegations has discouraged plan sponsors and their appointees from including Investment Options with exposure to private equity funds in 401(k) plans.

B. ERISA's Fiduciary Duties

ERISA imposes fiduciary duties on any person that: (i) exercises any discretionary authority or control respecting management of a 401(k) plan or its assets; (ii) renders investment advice for a fee with respect to any assets of the plan; or (iii) has any discretionary authority or responsibility in the administration of the plan.[266] We refer to such persons as "**plan fiduciaries**." Plan fiduciaries can appoint others to carry out some of their responsibilities under the plan. However, a plan fiduciary who has appointed another plan fiduciary has the ongoing responsibility to monitor and review the performance of the appointee at reasonable intervals, including the regular review of the appointee's fees and expenses to ensure that they are reasonable.[267]

Of course, selecting Investment Options and an Investment Menu involves exercising discretionary authority and control respecting the management of plan assets. As a result, whoever constructs the Investment Options and Investment Menu is a plan fiduciary. In addition, anyone who appoints the person/group responsible for the Investment Options or Investment Menu is also responsible for monitoring their performance.[268] Thus, employers that sponsor 401(k) plans, plan trustees, and investment managers that help select the Investment Menu and Investment Options are all plan fiduciaries under ERISA.

ERISA establishes five basic duties for plan fiduciaries:

> (1) act solely in the interest of plan participants and their beneficiaries;
>
> (2) act for the exclusive purpose of providing benefits to plan participants and their beneficiaries and defraying reasonable expenses of administering the plan;
>
> (3) act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims;

[266] 29 U.S.C. § 1002(a)(21) ("[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.").

[267] *See* 29 C.F.R. § 2509.75-8.

[268] *Id*.

> (4) diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
>
> (5) act in accordance with the documents and instruments governing the plan, insofar as such documents and instruments are consistent with ERISA.[269]

Neither ERISA nor the DOL specifies the investments that plan fiduciaries may include in an Investment Option. As a result, plan participants can bring a claim alleging that offering certain investments in an Investment Option was imprudent based on the underperformance of an Investment Option. Plan participants can also bring claims alleging that certain Investment Options charged excessive fees. The cost and distraction from defending meritless actions of this type have been sufficient to discourage the vast majority of 401(k) plan sponsors from introducing an Investment Option with private equity funds into their Investment Menu.

Lawsuits against Intel's plan fiduciaries filed in 2015 and 2019 illustrate this risk. The suits were largely premised on the inclusion of Investment Options with exposure to private funds, including private equity funds.[270] Participants in Intel's 401(k) plan sued Intel's investment committee and other plan fiduciaries when Investment Options that allocated significant amounts to private funds allegedly underperformed.[271] The argument that Intel violated its fiduciary duties by offering plan participants exposure to private funds, like private equity funds, is weak, given that defined benefit plans—which are also subject to ERISA—routinely invest in these types of assets. Nonetheless, these plan participants argued that the defendants violated their fiduciary duties because the private fund investments were imprudently risky and subject to excessive fees.[272] Although the Ninth Circuit recently affirmed the district court's decision to grant the defendants' motion to dismiss the lawsuit, the risk of such suits remains.[273] Indeed, many other companies, including Boeing, AT&T, General Electric, and Verizon, have in recent years experienced lawsuits against plan fiduciaries that alleged excessive fees.[274] 401(k) plan lawsuits have typically numbered over 50 per year over the past five years.[275]

In our view, offering exposure to private equity funds is consistent with ERISA's fiduciary duties. As demonstrated in Part II, there is substantial evidence that the volatility of private equity returns has been lower than the volatility of returns in public markets, and incorporating private equity funds into an investment portfolio can *reduce* the overall risk and volatility of the portfolio.[276]

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[269] *See* 29 U.S.C. § 1104(a).
[270] *See, e.g.*, Complaint at ¶ 1, *Sulyma v. Intel Corp. Inv. Pol'y Comm*., 15-CV-04977 NC, 2017 WL 1217185, at *1 (N.D. Cal. Mar. 31, 2017)
[271] *Id.* at ¶ 14.
[272] *Id.* at ¶ 1.
[273] *Anderson v. Intel Corp. Inv. Pol'y Comm*., 137 F.4th 1015 (9th Cir. 2025)
[274] *See Spano v. Boeing Co.*, No. 3:06-CV-00743DRHDGW, 2008 WL 1774460 (S.D. Ill. Apr. 16, 2008); *Bugielski v. AT&T Servs., Inc.*, 76 F.4th 894 (9th Cir. 2023); *Haskins v. Gen. Elec. Co.*, No. 17-CV-1960-CAB-BLM, 2018 WL 692280 (S.D. Cal. Feb. 2, 2018); *Jacobs v. Verizon Commc'ns, Inc.*, No. 16 CIV. 1082 (PGG), 2017 WL 8809714 (S.D.N.Y. Sept. 28, 2017).
[275] Mallika Mitra, *Major 401(k) Litigators Are 'Back in Action,' with More Entering the Fray*, PLAN ADVISER (Aug. 1, 2024), https://www.planadviser.com/exclusives/major-401k-litigators-back-action-entering-fray/.
[276] *See supra* notes 62-65 and accompanying text.

Additionally, the data on private equity returns—which are *net of fees*—show that private equity funds have consistently outperformed public markets.[277] However, the *potential* for meritless lawsuits has been sufficient to discourage plan sponsors from offering Investment Options that include exposure to private equity funds. This is because there is no direct economic benefit to the sponsors from offering these investment choices. However, sponsors incur the costs associated with the litigation, while the attorneys that bring such suits are direct beneficiaries – in the form of lucrative fees for bringing the actions – of any settlement that derives from such litigation.

Gropper (2024) demonstrated empirically that a sponsor's risk of being subject to such a lawsuit results in the sponsor narrowing the Investment Options available to plan beneficiaries, which in turn has a negative effect on beneficiaries' retirement savings.[278] The author documented the Investment Options and investment returns for 35,000 defined contribution plans, encompassing more than $5 trillion in assets. The author then estimated each plan sponsor's relative litigation risk based on quantitative factors such as plan size that are associated with a greater risk of being subject to a lawsuit. The analysis showed that sponsors with higher litigation risk tend to offer a narrower array of Investment Options to plan beneficiaries, which results, on average, in a 3% reduction in the account values of beneficiaries of that plan.

C. ERISA's Broad Alternatives and Control Requirements

The vast majority of 401(k) plans are designed and operated to meet the requirements of ERISA's Section 404(c) safe harbor,[279] because Section 404(c) provides that no plan fiduciary is liable under ERISA for any losses that result from a plan participant's exercise of investment control.[280] DOL regulations provide that a 401(k) plan complies with Section 404(c) as long as the plan gives participants the opportunity to: (1) choose from a broad range of Investment Options (the "**Broad Alternatives Requirement**"); and (2) exercise control over the assets in their individual accounts (the "**Control Requirement**").[281] Although some plan fiduciaries have begun to incorporate Investment Options that include multi-asset funds with limited private asset allocations, plan fiduciaries lack DOL guidance as to the full extent to which an Investment Option could include exposure to private assets, particularly private equity buyout funds, while complying with these requirements. The resulting uncertainty presents an opportunity for a litigant to pursue a case against a plan fiduciary offering an Investment Option with more extensive exposure to private assets or private equity buyout funds that would survive procedural challenges and subject plan fiduciaries to extensive and costly discovery, even when such challenges would be likely to fail if pursued to conclusion on the merits. We briefly review the Broad Alternatives Requirement and Control Requirement below to illustrate their relevant complexities.

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[277] *See supra* notes 35-57 and accompanying text.

[278] Michael Gropper, *Lawyers Setting the Menu: The Effects of Litigation Risk on Employer-Sponsored Retirement Plans*, SSRN WORKING PAPER (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4393420.

[279] *See* CALLAN INSTITUTE, *supra* note 255 at 7.

[280] 29 U.S.C. § 1104(c).

[281] 29 C.F.R. § 2550.404c-1(b).

i. Broad Alternatives Requirement

To satisfy the Broad Alternatives Requirement, DOL regulations require that a 401(k) plan's Investment Menu provide the participant with a reasonable opportunity to: (a) materially affect the potential return and the degree of risk in his or her individual account; (b) choose from at least three diversified Investment Options, each of which has materially different risk and return characteristics (the "**Core Options**"); and (c) diversify the individual account so as to minimize the risk of large losses.[282] Each of the Core Options, when combined with the investments in the other Investment Options, must tend to minimize through diversification the overall risk of a participant's portfolio.[283] In addition, the Core Options must in the aggregate enable the participant to achieve a portfolio with aggregate risk and return characteristics at any point within the range "normally" appropriate for the participant.[284]

ii. Control Requirement

To satisfy the Control Requirement, DOL regulations require that a 401(k) plan give participants: (1) the opportunity to obtain sufficient information to make informed investment decisions; and (2) a reasonable opportunity to give investment instructions with respect to the available Investment Options.[285]

The DOL's Control Requirement also contains three specific mandates concerning the frequency with which participants must be allowed to shift their assets among Investment Options.[286] First, the regulation's "general volatility rule" requires that participants be given an opportunity to give investment instructions with a frequency "appropriate in light of the market volatility to which the investment may reasonably be expected to be subject."[287] Second, under the regulation's "3-month minimum rule," at least three of the Core Options must permit investment instructions at least once within any three-month period.[288] Third, the regulation's "volatile investment transferability rule" addresses transfers into the Core Options and effectively requires that a safe alternative be open to receive transfers from other Investment Options.[289]

Due in part to the general volatility rule, 401(k) plans typically provide participants with the ability to shift assets among Investment Options on a ***daily*** basis,[290] even though daily liquidity is not a

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[282] *See id*. at (b)(3).
[283] *See id*. at (b)(3)(i)(B)(4).
[284] *See id*. at (b)(3)(i)(B)(3).
[285] *See id*. at (b)(2)(i).
[286] *See id*. at (b)(2)(ii)(C).
[287] *Id*.
[288] *Id*. at (b)(2)(ii)(C)(1).
[289] *See id*. at (b)(2)(ii)(C)(2).
[290] *See* PARTNERS GROUP, *Adding Private Markets to DC Pension Plan Portfolios – a Case Study* at 11 (Jan. 2017), https://www.partnersgroup.com/fileadmin/user_upload/Documents/Research_PDF/20170123_Adding_private_markets_to_DC_pension_plan_portfolios.pdf ("DC plans typically require investment funds to meet certain eligibility criteria, such as . . . daily pricing, [and] daily subscriptions and redemptions at NAV . . . ."). *See also* John Manganaro, *DCIIA Says Illiquid Assets 'Manageable' in DC Plans*, PLAN SPONSOR (Sept. 16, 2015), https://www.plansponsor.com/dciia-says-illiquid-assets-manageable-in-dc-plans/ ("There is a perception that you have to have daily liquidity … in a DC plan.").

statutory or regulatory requirement. In the next section, we explain how a 401(k) plan can include an Investment Option with exposure to private equity funds while still offering plan participants the ability to shift assets among Investment Options on a daily basis.[291] We then set forth a recommendation for how the DOL could better clarify the Section 404(c) safe harbor so as to safely provide plan participants with enhanced returns on their retirement savings by facilitating expanded exposure to private equity fund strategies.

D. How to Offer Private Equity Fund Exposure While Maintaining Liquidity for Plan Participants

As noted above, some 401(k) plan sponsors have begun to offer Investment Options with exposure to private asset classes such as private credit and real estate that, like private equity, are less liquid than publicly traded assets.[292] In providing these Investment Options, plan sponsors maintain liquidity for plan participants by offering such exposure through multi-asset class investment vehicles that combine allocations to less liquid private asset classes with allocations to more liquid public asset classes.

Plan sponsors can apply an equivalent approach to maintain participant liquidity while providing Investment Options with exposure to private equity. More specifically, an Investment Option with exposure to private equity funds can also provide plan participants with the ability to switch into or out of the Investment Option on a daily basis, so long as the Investment Option holds sufficient liquid assets. For example, suppose a hypothetical 401(k) plan offers "Investment Option X," with $100 million in assets, 10% in cash, 80% in publicly traded stocks and bonds, and 10% in private equity funds. In order to provide plan participants with daily liquidity, the manager of Investment Option X could simply rely on the cash or sell the liquid stocks and bonds when participants switch out of the Investment Option.

However, this "liquidity buffer" approach has its limits. Suppose that on a given day, plan participants representing 20% of the assets (or $20 million) in Investment Option X decide to shift their allocation to Investment Option Y. Drawing down the cash and selling public stocks and bonds to generate the necessary liquidity would mean that the plan participants remaining in Investment Option X will have greater exposure to illiquid private equity assets and fewer liquid assets to meet future short-term redemptions.

In practice, this consideration is mitigated by the fact that plan participants very rarely exercise their right to shift assets among Investment Options. For example, according to Alight Solutions, a benefits administrator that tracks the 401(k) trading activity of over 2 million U.S. retirees with

[291] While we have not specifically recommended a safe harbor to allow plan sponsors to depart from daily liquidity (e.g., quarterly), we have reservations about whether daily liquidity is well-suited to the approximately 30-year investment horizon of 401(k) participants, particularly if they are simply provided the option of selecting less liquid investments. Moreover, capital investments that are committed for relatively long periods of time reduce the likelihood of participants selling at the wrong time when markets experience a steep decline.

[292] Anne Tergesen, *401(k) Giant to Allow Private Markets Investments in Its Retirement Portfolios*, THE WALL STREET JOURNAL (May 14, 2025), https://www.wsj.com/personal-finance/retirement/empower-401k-private-markets-retirement-accounts-fa74dd00; Antonelli, *supra* note 225 at Exhibit 1.

more than $200 billion in collective assets, total annual transfers represented only 1.24% of 401(k) balances in 2024 and only 0.82% of total balances in 2023.[293] Experience also shows that asset shifting in 401(k) accounts is subdued even when markets are tumultuous. According to a 2009 survey conducted by the Investment Company Institute, 401(k) participant activity during 2008 was in line with historical norms.[294] Thus, by keeping an Investment Option's allocation to private equity investments modest, plan fiduciaries can be highly confident that short-term flows into or out of an Investment Option will not result in excessive exposure to illiquid private equity funds.[295] Mutual funds have significantly more volatile investor inflows and outflows than 401(k) plans, yet they are still permitted by the SEC to invest up to 15% of their net assets in illiquid assets. This concern is also mitigated by the greater availability of the "perpetual" funds discussed above, which could provide a 401(k) plan with access to private equity while providing periodic liquidity rights that could assist the plan sponsor in managing any investor shifts between Investment Options.

Investment Options also typically provide plan participants with disclosures as to their target asset allocations and seek to stay within these parameters. Even with modest inflows and outflows, it is possible that an Investment Option with exposure to private equity funds (or other illiquid assets) could deviate from highly specific investment parameters. In practice, however, Investment Options are designed with flexible asset allocations to account for this possibility.[296] Therefore, a plan sponsor could design an Investment Option with a target asset allocation to private equity funds in the range of 20% to 30%, for example. That would give the manager of the Investment Option's portfolio leeway to manage flows into and out of the Investment Option on any given day, while planning future purchases and sales of private equity investments on a quarterly or bi-annual basis to bring the allocation to private equity funds back to the middle of the target range.

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[293] *See* ALIGHT, *Alight Solutions 401(k) Index: 2024 Observations*, https://www.alight.com/thought-leadership/alight-solutions-401k-index-full-year-2024. Based on the average monthly transfers, as reported by Alight in its monthly *Observations*.

[294] INVESTMENT COMPANY INSTITUTE, *ICI 401(k) Participant Activity Study Shows 2008 Activity in Line with Historical Data*, (Mar. 9, 2009), https://www.ici.org/401k/news/09_news_recordkeeping.

[295] In addition to a shift in participant investment allocations, another area of potential strain on liquidity is in-service withdrawals, loan activity and separation from service. According to a 2018 Vanguard study ("How America Saves"), however, these represent a relatively small amount of leakage, as during 2016, only 2% of aggregate plan assets were borrowed, only 3% of participants took in service withdrawals, and 82% of participants who separated from service either remained in their employer's plan or rolled over their savings to an IRA or new employer plan. In terms of assets, 97% of all plan assets available for distribution were preserved, and only 3% were taken in cash. Moreover, any potential liquidity issues, in any healthy company, are mitigated with new entrants that provide liquidity for the relatively small amount of leakage suggested by the Vanguard study. *See* VANGUARD, *How America Saves 2018* (2017), https://static1.squarespace.com/static/5c267f6cc258b4b91b7a2a7b/t/5cd815e8c830251ea832f7d2/1557665263304/How+America+Saves+2018%2C+Large+Market.pdf.

[296] *See, e.g.*, MASSMUTUAL RETIRESMART[SM] 2030 FUND, *Summary Prospectus* at S-3 (Apr. 1, 2014), https://www.sec.gov/Archives/edgar/data/916053/000119312514138843/d703915d497k.htm ("[The adviser to the Fund] periodically reviews the target asset allocation and underlying investment options and may, at any time, in its discretion, change the target asset allocation or deviate from the target asset allocation. Under normal circumstances, the Fund's asset allocation among equity, fixed income and certain other asset classes is generally expected to vary by no more than plus or minus ten percentage points from the target asset allocation at that time.").

Additionally, the lack of daily valuations for private equity funds should not present a problem. Although private equity funds typically report valuations on a quarterly basis,[297] an Investment Option with private equity exposure can still report a daily net asset value by simply relying on the most recent valuation information available for the private equity investment.[298]

Plan sponsors incorporating Investment Options with private equity exposure must also consider the mechanics of plan participants being able to switch *into* an Investment Option with private equity exposure on a daily basis. In particular, because private equity funds only take on new investors during defined periods of time, new cash shifted into an Investment Option with private equity exposure may not be immediately deployed into private equity funds. However, in a diversified investment fund, such amounts can be invested in other asset classes pending actual investment in the committed private equity fund. In addition, plan sponsors must consider that private equity funds often charge management fees on committed capital that has not yet been deployed. As a result, plan participants in an Investment Option with exposure to private equity funds could pay high fees before the private equity fund fully deploys its capital. However, plan fiduciaries can address both issues by purchasing interests in existing private equity funds (i.e., already deployed capital) in the secondary market. Secondary market trading in private equity fund interests has increased by more than a factor of ten over the past two decades, growing from an annual aggregate transaction volume of $8.5 billion in 2005 to $108 billion in 2022.[299]

401(k) plans can therefore offer plan participants an Investment Option with exposure to private equity funds while still providing plan participants with the ability to switch into and out of

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[297] *See* Stephen Holmes, *Limited Partner Financial Reporting*, THE INVESTOR RELATIONS MANUAL (2011) at 62-65.

[298] *See* PARTNERS GROUP, *supra* note 290 at 12. *See also* THE INVESTMENT ASSOCIATION, *Putting Investment at the Heart of DC Pensions* (Jun. 2018) at 12-13, https://www.theia.org/sites/default/files/2019-05/20180621-puttinginvestmentattheheartofdcpensions.pdf. We acknowledge that it can be relatively more difficult to precisely value private equity fund interests when the fund has not sold any of its portfolio assets. However, research has shown that private equity fund investors can independently apply valuation methodologies to verify and refine the valuations provided by the fund's sponsors. For example, Ercan et al. (2024) shows that investors can derive more precise current valuations of their private equity investments by analyzing the fund's historical valuation trends, including the historical frequency of write-downs of fund assets. *See* Ege Y. Ercan, Steven N. Kaplan & Ilya A. Strebulaev, *Interim Valuations, Predictability, and Outcomes in Private Equity* (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4833819. Furthermore, the safe harbor for private asset exposure in 401(k) plans that we propose below would require a 401(k) fiduciary to independently determine that adequate measures have been implemented to ensure that private equity assets will be fair valued according to standard accounting principles or by reference to third party transactions. The most robust way of obtaining such valuations would be to mandate secondary market transactions of subsets of the fund's portfolio, thus obtaining an objective indicator of the mark-to-market value of the fund's entire portfolio.

[299] COLLER CAPITAL, *The Private Equity Secondary Market* at 4 (2018), https://www.collercapital.com/sites/default/files/Coller%20Capital%20%E2%80%93%20the%20private%20equity%20secondary%20market_0.pdf.

Investment Options on a daily basis. In particular, plan fiduciaries can do so by creating a custom Investment Option with a modest target allocation to private equity funds.[300]

E. Policy developments since the 2018 Report

Since the 2018 Report, policymakers have taken limited steps toward facilitating 401(k) access to private equity. However, these steps have failed to broaden access. We summarize these steps here, before explaining how further action is needed.

i. Regulatory developments

In June 2020, the DOL issued an information letter (the "**DOL's 2020 Information Letter**") clarifying that "a plan fiduciary would not, in the view of the [DOL], violate the fiduciary's duties under… ERISA solely because the fiduciary offers a professionally managed asset allocation fund with a private equity component" as an Investment Option for an employee-directed 401(k) plan.[301]

The DOL then provided guidance as to how private equity should be included in an Investment Option, including that the allocation of investment in private equity is limited and the fund has "adopted features related to liquidity and valuation designed to permit… liquidity for participants to take benefits and direct exchanges among the plan's investment line-up consistent with the plan's terms."[302] Additionally, the DOL stated that the plan fiduciary must understand whether plan participants are being given sufficient information to make an informed investment decision, and noted that "[t]his factor would be especially important in the case of a plan or responsible plan fiduciary claiming limited fiduciary liability under ERISA section 404(c) for participants exercising control over their accounts . . . ."[303]

The 2018 Report called upon the DOL both to (1) clarify that including private equity funds in an Investment Option would satisfy the requirements of the Section 404(c) safe harbor for decisions made by plan participants, so long as there is sufficient liquidity at the Investment Option to provide for daily investment instruction; and (2) establish a new fiduciary safe harbor from class actions and other ERISA suits, for the inclusion of private equity in defined contribution plans. In line with the Committee's first recommendation, the DOL's 2020 Information Letter suggested that the Section 404(c) safe harbor could be available to plan fiduciaries who incorporate exposure to private equity funds into an Investment Option, and provided guidance on how to do so, including by taking steps relating to liquidity. The DOL's 2020 Information Letter did not address the Committee's second recommendation to establish a new safe harbor.

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[300] *See generally* DEFINED CONTRIBUTION INSTITUTIONAL INVESTMENT ASSOCIATION, *Considerations for Implementing a Custom Target Date Approach: A Guide for Defined Contribution Plan Sponsors* (2010), https://cdn.ymaws.com/dciia.org/resource/collection/AA7BF8DD-64D5-4DB5-B885-95404C4D1CBF/dciia_considerations_for_implementing_a_custom.pdf.

[301] U.S. DEPARTMENT OF LABOR, *Information Letter* (Jun. 3, 2020), https://www.dol.gov/sites/dolgov/files/ebsa/pdf_files/06-03-2020.pdf.

[302] *Id*. at 4.

[303] *Id*. at 5.

However, under subsequent leadership, in December 2021, the DOL issued a supplemental statement to the information letter (the "**2021 Supplemental Letter**").[304] While implicitly affirming the overall validity of the 2020 statement, the supplemental statement stressed that the DOL "did not endorse or recommend" including a private equity component in the Investment Options of individual account plans such as 401(k)s, and that the information letter should not be read to suggest that such investments are "generally appropriate for a typical 401(k) plan."[305] Moreover, in the supplement the DOL "caution[ed] against" applying the guidance in the information letter outside of the context of "plan fiduciaries who offer both defined benefit and defined contribution plans, and who may invest in [private equity] for their defined benefit plans," which the DOL stressed is a "minority of situations[] [for] plan-level fiduciaries of small, individual account plans."[306] Rather, the supplement stressed that "ERISA section 404(c) does not relieve a plan fiduciary of the prudence duties that apply to the selection and monitoring of designated investment alternatives," and expressed doubt that fiduciaries of smaller plans would be capable of evaluating the suitability of private equity investments.[307]

ii. Legislative developments

In September 2022, Patrick Toomey (R-PA), Timothy Scott (R-SC), and Cynthia Lummis (R-WY) introduced the "Retirement Savings Modernization Act" in the Senate. The bill was simultaneously introduced in the House by Peter Meijer (R-MI). The bill would have amended ERISA to clarify that fiduciaries of both defined benefit and defined contribution plans do not breach their fiduciary duties solely by investing in alternative asset classes, including private equity.[308] However, it would not have created a fiduciary safe harbor for private equity investments.[309]

As a result, the legal risks we outlined above continue to dissuade 401(k) plan sponsors from offering private equity Investment Options.[310] We therefore find that additional action, in the form of rescinding the DOL's 2021 Supplemental Letter and proposing a formal safe harbor, is still needed. We explain this recommendation in further detail below.

iii. Lessons Learned from the Principles-Based DOL Annuities Safe Harbor

The DOL's experience in establishing a safe harbor for the selection of annuities in defined contribution plans (the "**DOL Annuities Safe Harbor**") is relevant to developing a new safe harbor. In particular, the DOL Annuities Safe Harbor was a principles-based approach that did not provide detailed guidance to plan sponsors about what actions they could take to ensure that

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[304] U.S. DEPARTMENT OF LABOR, *Supplement Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives* (Dec. 21, 2021), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement.
[305] *Id.* at 1-2.
[306] *Id.* at 2-3
[307] *Id*. at 3.
[308] 117TH CONGRESS 2ND SESSION, *S.4973 – Amending the Employee Retirement Income Security Act of 1974* (Sept. 28, 2022), https://www.congress.gov/bill/117th-congress/senate-bill/4973/text.
[309] *Id*. *See* also Senator Pat Toomey & Senator Tim Scott, *Retirement Savings Modernization Act,* https://www.banking.senate.gov/imo/media/doc/retirement_savings_modernization_act1.pdf.
[310] *See* Gropper, *supra* note 278.

annuity-based investment options they selected were consistent with ERISA's fiduciary duties. As a result, it was not effective in providing enough comfort to plan sponsors to increase the inclusion of annuity offerings in DC plans, suggesting that the more detailed and specific methodology-based approach that we recommend is preferable. From a legal perspective, the DOL Annuities Safe Harbor and other regulatory safe harbors demonstrate that the DOL has the authority to promulgate a safe harbor for the selection of private equity investments in defined contribution plans. We discuss both points below.

Annuities are products offered by insurance companies that guarantee payments to participants for a period of time (often the rest of a participant's life).[311] In 2007, the DOL observed that given increased life expectancies, "[t]here is growing concern that … many retirees may outlive their retirement savings," and that, "annuities offer one means by which retirees may ensure a lifetime income."[312] However, the DOL noted that the potential for fiduciary liability under ERISA was discouraging plan sponsors from offering participants an annuity distribution option.[313] In 2005, an ERISA advisory council had found that plan sponsors' concerns stemmed from "ambiguity in the standard that applies to choosing an annuity provider."[314] At the time, plan sponsors were subject to a DOL interpretive bulletin which required them to limit the selection of annuities to the "safest available" option.[315] The advisory council found that this created an "outcome based" fiduciary standard, whereas the fulfilment of fiduciary duties usually involves following certain methodology.[316] Moreover, courts had criticized the DOL's standard, making it unclear what standard would be applied in litigation.[317] The advisory committee therefore recommended that the DOL "should undertake to clarify the prudent procedures for annuity selection."[318] The DOL thereafter proposed a safe harbor for the selection of annuity providers in defined contribution plans in an attempt to alleviate plan sponsors' fears of liability and encourage them to offer annuities options.[319]

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[311] *See* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *401(k) Plans: DOL Could Take Steps to Improve Retirement Income Options for Plan Participants* at 4 (Aug. 9, 2016), https://www.gao.gov/products/gao-16-433.
[312] *Id*.
[313] *See* U.S. DEPARTMENT OF LABOR, *Selection of Annuity Providers for Individual Account Plans*, 72 FED. REG. 52,021 at 52,023 (Sept. 12, 2007), https://www.federalregister.gov/documents/2007/09/12/E7-17743/selection-of-annuity-providers-for-individual-account-plans.
[314] *See* U.S. DEPARTMENT OF LABOR, *Advisory Council Report of the Working Group in Retirement Distributions and Options* (2005), https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council/2005-retirement-distributions-and-options.
[315] U.S. DEPARTMENT OF LABOR, *Advisory Opinion 2002-14A* (Dec. 18, 2022), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2002-14a.
[316] U.S. DEPARTMENT OF LABOR, *supra* note 314.
[317] *Id*.
[318] *Id*.
[319] U.S. DEPARTMENT OF LABOR, *supra* note 313 at 52,023.

In 2008, the DOL finalized the fiduciary safe harbor proposal for the selection of annuity providers under defined contribution plans.[320] However, to avail themselves of the safe harbor, plan sponsors were required to, among other things, "[a]ppropriately consider[] information sufficient to assess the ability of the annuity provider to make all future payments" and "[a]ppropriately conclude[] that, at the time of the selection, the annuity provider is financially able to make all future payments under the annuity contract."[321] The safe harbor did not provide greater specifics on how to satisfy these criteria, and a 2016 report by the Government Accountability Office ("GAO") found that plan sponsors lacked certainty as to what steps are necessary to assess "sufficient" information to "appropriately" conclude that the annuity provider will be financially able to make all future payments.[322] GAO thus found that concerns about legal risks were still deterring many plan sponsors from offering annuities.[323] Indeed, an annual survey report found that only 7% of 401(k) plans offered annuities. Although the goal of the DOL safe harbor had been to encourage more plans to offer an annuity option, its vague requirements precluded its intended effect. As a result, the GAO recommended that the DOL clarify the safe harbor by providing sufficiently detailed criteria to better enable plan sponsors to comply with the safe harbor requirements.[324]

While the DOL did not ultimately modify its rule, in 2019 Congress passed a new statutory safe harbor for the selection of annuity providers in the "Setting Every Community Up for Retirement Enhancement Act" (the "SECURE Act") which addressed the issues identified by the GAO report. While many of the obligations under the SECURE Act's safe harbor mirror those in the DOL Annuities Safe Harbor, the statute is more specific as to how a fiduciary can fulfill these obligations – in particular, by obtaining written representations from the annuity provider as to its fitness to provide guaranteed income products, including being properly licensed and undergoing periodic examination.[325]

While the subsequent uptake of annuities products in 401(k) Investment Options was not immediate, a prominent trade organization for the insurance industry recently noted that "[t]he SECURE Act removed some of the obstacles that had deterred plan sponsors from adopting [annuities] products and now we are beginning to see growth and momentum in this market."[326] Indeed, after the SECURE Act, "several financial services companies have introduced 401(k) plans and other defined contribution plans with integrated annuity products, including: Alliance,

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[320] *See* U.S. DEPARTMENT OF LABOR, *Selection of Annuity Providers – Safe Harbor for Individual Account Plans*, 73 FED. REG. 58,447 (Oct. 7, 2008), https://www.federalregister.gov/documents/2008/10/07/E8-23427/selection-of-annuity-providers-safe-harbor-for-individual-account-plans. The DOL later provided additional guidance on the annuity safe harbor. *See* U.S. DEPARTMENT OF LABOR, *Field Assistance Bulletin No. 2015-02* (Jul. 13, 2015), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2015-02.

[321] 29 C.F.R. § 2550.404a-4(b).

[322] *See* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 202 at 26-27.

[323] *Id*.

[324] *Id*. at 55.

[325] 29 U.S.C. § 1104(e).

[326] Ted Godbout, *In-Plan Annuities Gain Momentum, But Concerns Linger*, NATIONAL ASSOCIATION OF PLAN ADVISORS (Jun. 3, 2024), https://www.napa-net.org/news/2024/6/plan-annuities-gain-momentum-concerns-linger/.

Bernstein, BlackRock, Fidelity, Income America, Nuveen/TIAA, [and] State Street Global Advisors."[327]

Congress and the DOL's safe harbors for annuities show that policymakers understand that the risk of liability can reduce options for retirees and that safe harbors can address this risk for valuable retirement products. We believe that private equity funds are an asset class that warrants such treatment. Moreover, consistent with the GAO's recommendation in its 2016 report and the SECURE Act's more specific safe harbor criteria, we believe that a safe harbor that identifies in detail the specific review methodology that plan sponsors must follow to qualify for the safe harbor would be more readily usable by plan sponsors.

5. **Recommendation: Concurrently rescind the DOL's 2021 Supplemental Letter and propose a safe harbor for the selection of alternative asset investments in 401(k) plans.**

We recommend that the DOL rescind its 2021 Supplemental Letter, which will immediately reinstate the efficacy of the guidance provided in the DOL's 2020 Information Letter.[328] As part of the rescission, the DOL should expand the 2020 Information Letter to encompass private credit and other alternative asset classes. Concurrently with the rescission, the DOL should also propose a new safe harbor to enable the fiduciaries of defined contribution plans (including 401(k) plans) to satisfy their ERISA fiduciary duties when making available Investment Options that include exposure to private equity and private credit assets, as well as other alternative assets that policymakers should consider ("alternative assets") through an investment vehicle that includes such exposure within a multi-asset class portfolio (an "asset allocation fund"), so long as the fiduciaries apply a specified and detailed review methodology in connection with their decision to offer the Investment Option. This safe harbor would require the use of an asset allocation fund with exposure to a combination of alternative assets and more liquid assets so that beneficiaries retain the ability to move their account assets into and out of such Investment Options on a daily basis.

We believe that ERISA already permits plan sponsors to offer Investment Options that include exposure to private equity and private credit assets. However, rescission of the DOL's 2021 Supplemental Letter and the proposal of a clear safe harbor will reassure plan sponsors that they ought not to be exposed to meritless litigation on the basis of the unique liquidity and fee structures of such alternative assets that do not in fact affect whether offering an Investment Option with exposure to such funds is prudent.

As detailed in the sample safe harbor language below, a fiduciary should determine in good faith that the asset allocation fund's investment strategy, fees, and overall liquidity are consistent with the plan's characteristics and the needs of plan participants, and that the asset allocation fund would

[327] Miranda Marquit, *Should You Get an Annuity in Your 401(k) Plan?*, BRITANNICA MONEY (May 29, 2025), https://www.britannica.com/money/401k-plan-annuities.
[328] In May 2025, Partners Groups, the party that sought the guidance in the 2020 Information Letter, also called on the DOL to withdraw the 2021 Supplemental Letter. *See* GROOM LAW GROUP, *Letter to the Secretary of Labor and Deputy Secretary of Labor Re. Request for Withdrawal of Supplemental Statemen*t (May 29, 2025).

allow participants to invest their accounts among more diversified investment options within an appropriate range of targeted returns.

In making each of the required determinations, a fiduciary should be entitled to rely on written disclosures provided by the asset allocation fund about the fund's investment portfolio, valuation and liquidity practices, and managers. This approach recognizes that in practice fiduciaries must rely on information provided by the managers of an investment product when assessing its suitability as an Investment Option. In order for this approach to be feasible for fiduciaries, the compliance landscape must acknowledge this market reality. However, fiduciaries would remain responsible for applying their own judgment to assess the suitability of a potential Investment Option, even when they incorporate information provided by a manager into that assessment.[329]

Plan fiduciaries should be encouraged to base their assessment of the fees associated with the asset allocation fund on the targeted returns net of such fees, as well as the enhanced diversification provided by an allocation to private equity or credit assets.

In addition to the safe harbor, we also recommend that the DOL expand its Prohibited Transaction Exemption 77-4 ("PTE 77-4") to facilitate ERISA plans' and IRAs' investment in a broader class of affiliated funds. PTE 77-4 provides an exemption from certain prohibited transaction rules for plan and IRA investments in funds that are advised by an affiliate of a plan fiduciary subject to certain restrictions that are designed to protect participants from conflicts of interest.[330] In particular, the exemption requires an independent fiduciary to approve the purchase and sale (though the approval can be limited to the fees paid by the fund) and prohibits the payment of sales commissions and other specified fees. However, PTE 77-4 only applies if the affiliated fund is an open-end mutual fund or exchange-traded fund. Thus, plan fiduciaries currently are not exempt from ERISA's prohibited transaction provisions when they offer exposure to closed-end funds and other investment vehicles that are managed by affiliates, even if they abide by PTE 77-4's fee restrictions. As discussed above, alternative assets such as private equity and private credit are well-suited to closed-end funds. PTE 77-4 would thus better facilitate access to alternative asset classes though 401(k) accounts if it also applied to closed-end funds and other private fund vehicles. We therefore recommend that the DOL expand PTE 77-4 to encompass closed-end funds and other investment vehicles, while retaining the fee restrictions and the requirement of independent fiduciary review, which would continue to protect plan participants (or consider other exemptions that would yield a similar result).

The DOL has the authority to rescind its 2021 Supplemental Letter and to establish such a safe harbor under ERISA Section 505, which authorizes the Secretary of Labor to "prescribe such regulations as he finds necessary or appropriate to carry out the provisions" of ERISA Title I, which includes fiduciary duties.[331] For example, the DOL has relied on Section 505 authority to promulgate numerous ERISA safe harbors, both with respect to fiduciary duties and other aspects

[329] 29 U.S.C. § 1104(a); *see also Tibble vs. Edison Int'l*, 575 U.S. 523 (2015) (a fiduciary must monitor the performance of any plan service provider or other person to whom it has delegated fiduciary duties).
[330] Class Exemption for Certain Transactions Between Investment Companies and Employee Benefit Plans, 42 Fed. Reg. 18732 (Apr. 8, 1977).
[331] 29 U.S.C. § 1135.

of the statute, including the annuities safe harbor discussed above.[332] Furthermore, the DOL has the authority to amend PTE 77-4 under ERISA Section 408, which allows the DOL to exempt classes of transactions where doing so is in the interest of the plan's participants and is protective of their rights.[333]

Below, we present specific language for our recommended safe harbor.

[332] U.S. DEPARTMENT OF LABOR, *supra* note 320 (citing as authority 29 U.S.C. § 1135 (ERISA § 505)).
[333] 29 U.S.C. § 1108(a).

A. Proposed Safe Harbor for the Inclusion of Alternative Asset Investments in 401(k) Investment Options

§ 2550.404a-4 Inclusion of alternative assets within an asset allocation fund (including a target date fund or an advisor managed account) — safe harbor for individual account plans.

(a) Scope.

(1) This section adopts a safe harbor for satisfying the fiduciary duties under sections 404(a)(1)(A) and (B) of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1104-1114, regarding making available an asset allocation fund which includes investments in alternative assets for selection by participants as an investment option including as a qualified default investment alternative (QDIA), for participants under an individual account plan satisfying the requirements of Section 404(c) of ERISA. For purposes of this safe harbor, an asset allocation fund means a target date fund, an advisor managed account or any other investment vehicle which invests in a diversified pool of assets across multiple asset classes.

(2) This section provides an optional means for satisfying the fiduciary responsibilities under sections 404(a)(1)(A) and (B) of ERISA regarding making available an asset allocation fund which includes investments in alternative assets for selection by participants as an investment option for participants under an individual account plan satisfying the requirements of Section 404(c) of ERISA. This section does not establish minimum requirements or the exclusive means for satisfying these responsibilities.

(b) Safe harbor. The decision to offer an asset allocation fund which includes investments in alternative assets as an investment option for participants under an individual account plan, including as a QDIA, satisfies the requirements of sections 404(a)(1)(A) and (B) of ERISA if the fiduciaries of the plan in good faith:

(1) Determine that the investment characteristics of the asset allocation fund with the alternative asset component align with the plan's characteristics and needs of plan participants, taking into account (i) the plan's participant profile (including participant ages, normal retirement age, anticipated employee turnover, and contribution and withdrawal patterns); (ii) the asset allocation fund's investment allocation and strategy, fees and other expenses, and the nature and duration of any liquidity restrictions; and (iii) the participants' ability to access funds in their accounts (e.g., loans and distributions when employees separate from service with the sponsoring employer), and to change investment selections on a potentially frequent basis, taking into account the percentage of the asset allocation fund's assets invested in such alternative assets and the degree to which the other assets

of the asset allocation fund are reasonably expected to be available to address such liquidity needs within a reasonably short-period of time;

(2) Determine that permitting participants to invest a portion or all of their account balances in the asset allocation fund with an alternative asset component would offer such participants the opportunity to invest their accounts among more diversified investment options within an appropriate range of targeted returns, based on (i) an evaluation of the targeted returns of such alternative assets, net of reasonably anticipated fees and expenses (including management fees, performance compensation, or other fees or costs that would impact the returns received) related to such investment options over the reasonably anticipated investment period for such assets and (ii) the anticipated benefits of increased diversification of investments over a multi-year period, including with regard to risk mitigation and reduced investment volatility;

(3) Determine that the asset allocation fund and the alternative assets are managed by qualified investment professionals, taking into account the historical performance of the applicable class of alternative assets generally and specifically of the manager responsible for the investment decisions related to the alternative assets and the capabilities, proportionate scale, experience, and stability of the manager of the alternative assets to manage effectively alternative asset investments, given the nature, size, and complexity of the class or classes of such alternative assets;

(4) Determine that the asset allocation fund has limited the allocation of investments to alternative assets in a way that is designed to address the unique characteristics associated with such investments, including cost, complexity, disclosures, and liquidity, and has adopted features related to liquidity and valuation designed to permit the asset allocation fund to provide liquidity for participants to take benefits and direct exchanges among the plan's investment options consistent with the plan's terms;

(5) Determine that adequate and appropriate measures have been implemented to ensure that the applicable alternative assets either will be fair valued under Financial Accounting Standards Board Accounting Standards Codification (ASC) 820, "Fair Value Measurements and Disclosures," or any successor provision thereto, or valued by reference to third party transactions or pricing;

(6) Where the asset allocation fund is designated as a QDIA, determine that such fund qualifies to be selected as a QDIA under regulations promulgated under Section 404(c)(5) of ERISA (or any successor section thereto), and that the plan sponsor, plan administrator or other representative of the plan shall have established a process to satisfy the notice requirements applicable

to any such QDIA under such regulations and to provide the information required to be provided to plan participants under this safe harbor;

(7) Adopt reasonable procedures to assess whether any person providing advice to the fiduciary has any potential conflicts of interest that might affect its advice, and assess the impact any such potential conflict has on the ability to rely on such advice;

(8) Provide plan participants with information regarding the character and risks of including alternative assets in the asset allocation fund to enable them to make an informed assessment regarding making or continuing an investment in the fund; and

(9) Periodically review, not less frequently than annually, the determinations made as a condition to reliance on this safe harbor.

(c) In making any of the determinations required under subparagraph (b), a plan fiduciary that does not have the knowledge or experience necessary to make any such determination may rely on the recommendations of and/or information provided by an independent adviser that is knowledgeable about the risks, costs, targeted returns and expected duration of the alternative assets included within the asset allocation fund.

(d) In determining the appropriateness of the fees and expenses associated with an asset allocation fund made available for investment by plan participants, a plan fiduciary may properly base its determination on (i) the targeted returns net of the expected effect of such fees and expenses (without focusing exclusively or primarily on the gross fees payable), and (ii) the enhanced diversification provided by an allocation to alternative assets.

(e) In making the determinations required under this safe harbor, the plan fiduciaries and their advisors may rely on written disclosures provided by the asset allocation fund with respect to:

(1) the return characteristics of the asset allocation fund,

(2) the anticipated fees and expenses (including management fees and performance compensation) with respect to investing in the asset allocation fund,

(3) the qualification and experience of the investment professionals responsible for the investment of the asset allocation fund and the alternative assets, including the capabilities, proportionate scale, experience, and stability of the manager(s) of any class of alternative assets to manage effectively such alternative asset investments, given the nature, size, and complexity of such class of alternative assets;

(4) the diversification and volatility characteristics of the asset allocation fund;

(5) the nature and duration of any liquidity restrictions pertaining to the asset allocation fund;

(6) the historical performance of each class of alternative assets included in the asset allocation fund generally and specifically of the manager(s) responsible for the investment decisions related to each such class of alternative assets;

(7) measures undertaken by the asset allocation fund to ensure that the applicable alternative assets either will be valued (x) under Financial Accounting Standards Board Accounting Standards Codification (ASC) 820, "Fair Value Measurements and Disclosures," or any successor provision thereto, or (y) by reference to third party transactions or pricing; and

(8) the current value of the plan's investment and the character and risks of including alternative assets in the asset allocation fund.

(f) An asset allocation fund shall be presumed to provide adequate liquidity to address a participant's needs if the asset allocation fund has adopted investment policies or guidelines that provide that (i) the percentage of the asset allocation fund's assets invested in such alternative assets may not exceed one-third (33.3%) of the assets of such asset allocation fund except in unanticipated circumstances; and (ii) at least a majority of the assets of the asset allocation fund must be of a type reasonably expected to be available to address plan liquidity needs within a reasonably short period of time, generally not to exceed 90 days.

(g) For purposes of this safe harbor, alternative assets means:

(1) private market investments, including direct or indirect interests in the equity and/or debt of companies that do not offer their stock for investment to the public;

(2) direct and indirect interests in real estate, including debt instruments secured by direct or indirect interests in real estate;

(3) direct or indirect interests in the equity and/or debt of public and/or private companies, where the managers of such investments seek to take an active role in the management of such companies;

(4) investments in actively managed investment vehicles investing in cryptocurrency or precious metals; and

(5) direct or indirect interests in projects financing infrastructure investment.

Conclusion

In this report, we have revisited the case for expanding investor access to private equity investments and found that doing so continues to be both desirable and achievable.

First, the SEC should allow retail investors to invest in public closed-end funds that invest more than 15% of their assets in private equity funds. We note that public closed-end funds are required to provide retail investors with disclosures as to their principal risk factors, allocations to specific private equity funds, and the fees that investors will be charged.

Second, the DOL should rescind the 2021 Supplemental Letter and concurrently propose a rule creating a formal safe harbor that would allow 401(k) plan sponsors to offer investment options with exposure to private equity funds, providing reassurances to fiduciaries who adhere to a specified review methodology to determine that the investment option is suitable for the plan and its participants. This methodology is consistent with the methodologies that plan fiduciaries currently apply and which seek to ensure a robust process for selecting investment options that comply with their fiduciary duties to plan participants. The DOL should also exempt plan fiduciaries from ERISA's prohibited transaction provisions when they invest in closed-end funds and other investment vehicles that are managed by affiliates, when they abide by the same or similar requirements of the existing exemption available for investments in affiliated open-end mutual funds and exchange-traded funds.

We note that each of our proposals would only provide access to private equity funds, and the private companies in which they invest, through a financial professional with a fiduciary duty to the retail investor: in the case of public closed-end funds, the registered investment adviser to the fund, and in the case of 401(k) plans, the plan sponsor. Furthermore, we also recommend that policymakers apply additional regulatory standards to private equity funds that are available to retail investors through public closed-end funds and 401(k) plans that would further protect such investors. These include a requirement that the investment committee determines whether the private equity fund's manager possesses proportionate scale, experience, and stability to manage the fund's investments effectively, given the nature, size, and complexity of those investments.

Finally, the SEC and the DOL could implement each of our other recommendations through regulatory reforms. We encourage them to do so on a timely basis, as retail investors are missing out on the returns and risk-mitigation that private equity funds, and the private companies in which they invest, can offer through a well-balanced portfolio.

134 Mount Auburn Street, Cambridge, MA 02138

www.capmktsreg.org