

As Private Equity Firms Work to Access 401(k) Market, Plaintiff Lawyers Gear Up to Sue

Seeing a green light from the Department of Labor, private equity firms are developing new investment products they hope will achieve their longtime goal of accessing the lucrative \$7 trillion 401(k) market, industry experts tell *The Capitol Forum*.

Private equity funds have historically been shut out of 401(k) plans due to their high fees, high risk and liquidity issues. But years of lobbying came to fruition in 2020 when the Trump administration blessed the inclusion of PE funds in 401(k) portfolios. The Biden White House, despite issuing warnings, has not reversed that move.

Private equity firms are staying quiet about their plans, but industry members who have consulted with them confirm the firms are actively developing investment models they hope will grant PE funds access to defined contribution retirement plans without triggering enforcement from regulators.

The ability for PE funds to receive money from 401(k) plans would be a transformational shift in the US retirement industry, both massively expanding the reach of 401(k) plans to private markets and introducing unprecedented risk to the retirement savings of everyday workers. But it won't happen without a fight. Top Employment Retirement Income Security Act (ERISA) lawyers say they are ready and waiting for the first sign of PE intermingling with 401(k)s.

“I will tell you this, as soon as I see a platform that has private equity or a hedge fund or Bitcoin or any of that type of alternative asset, I will sue in a second,” said Paul Secunda, former chairman of the ERISA Advisory Council under President Obama and one of the most active class-action ERISA attorneys in the country.

Secunda said he has consulted with PE companies who are “working hard” to get access to both 401(k) plans and multi-employer plans. He said his research into consumer behavior as a professor and first-hand experience as a class action lawyer left him with no doubt that the average retiree does not have sophisticated knowledge of issues like fees, risk and carried interest that come with private equity.

“The odds that you as an individual retiree are going to beat the market through some kind of actively-managed fund are pretty slim,” said Secunda. “To add additional risk... I think is playing with fire. Most people who go down that path are just going to get burned.”

Accessing 401(k) funds would be an enormous new spigot of capital for PE firms, which have mostly tapped pension funds and private wealth funds. But many see those firms as fundamentally incompatible with the 401(k) policy goals of providing a safe, transparent savings vehicle to everyday workers at cost.

“Retirees have historically not had access to private equity funds for good reason, which is that private equity investments are opaque, they are risky, and they might not even be that good for the ordinary investor,” said Brendan Ballou, author of the new book *Plunder: Private Equity’s Plan to Pillage America*.

“Even if it is a good investment, it’s going to drive up purchase prices for companies, which means that the companies that they buy are going to have ever more debt, which means they’re going to have to take on ever riskier schemes,” said Ballou.

Major PE firms like Blackstone Inc. and The Carlyle Group lobbied for many years to access 401(k) plans. “In life, you have to have a dream,” Blackstone CEO Steve Schwarzman said during a 2017 conference call. “And one of the dreams is our desire and the market’s need to have more access at retail to alternative asset products.” He theorized the Trump administration may break down those barriers, which he said were denying people a better retirement.

His prediction proved correct. In 2020 Trump’s Labor Secretary Eugene Scalia handed PE a major victory when he issued an information letter saying PE funds can be responsibly included in retirement plans as long as managers considered fees and risks.

Since coming into power, the Biden administration has largely punted on the issue. In late 2021 the Department of Labor issued an updated information [letter](#) that derided the Trump-era guidance—saying it presented industry talking points about the upside of PE that was not balanced with counterpoints – but did not repeal it. The letter narrowed acceptance to plan managers who have experience with PE investments. This closed the door for some small, individual account plans but not the major financial services players, who can claim experience investing in PE with defined benefit plans.

Even with federal regulators signing off on the issue of risk, the threat of lawsuits and/or federal enforcement has so far prevented 401(k) managers from allowing PE onto their platforms. PE firms are trying to develop investment vehicles that will win over plan managers but have three main hurdles to overcome. First, PE funds charge comparatively enormous fees, and 401(k) managers who invest in high-fee funds are regularly sued. Second, PE funds are illiquid, as investments are locked in for up to a decade. Third, 401(k) plans provide asset values on a daily basis while PE investments are tied to target dates years in the future with no clear way to mark to market.

The industry's proposed solutions seem to hinge on diversification, said Thomas Clark of the Wagner Law Group, who has also talked to PE firms trying to crack into the market. Clark said he does see a place for PE in the defined contribution world and sympathizes with the argument that everyday Americans are disadvantaged by being limited to public markets. The key, he said, is limiting the higher risk.

He listed potential solutions such as limiting PE to only one tranche of any individual's 401(k) plan, ensuring those PE funds are exposed to hundreds of companies rather than just a few, and requiring a professional investment manager with a fiduciary duty to plan members to shoulder some of the risk.

"Is it cool to expose plan participants, even in small increments, to those kinds of markets? It could be. It could be if a professional investment fiduciary is managing it and knows what to look for and could protect participants if something happens," said Clark.

The next domino to fall will be when PE firms begin to successfully pitch retirement plan managers to include their products as an investment offering in their portfolio. Recently the Supreme Court ruled that plan fiduciaries have a duty under ERISA to continually monitor their menu of investment options and remove any that are imprudent.

That case was brought by Jerry Schlichter of Schlichter, Bogard & Denton, who pioneered suing over excessive fees in 401(k) plans and is one of the lawyers waiting for PE's next move. He said including high-priced, illiquid, long-term assets in these funds is like putting a square peg in a round hole. PE firms may come up with some formula for putting out daily valuations, he said, but sophisticated investors will know those cannot be relied upon while the average investor may not.

"I don't know how they're going to be able to provide daily valuation," said Schlichter. "The inherent structure is a long-term, illiquid structure."

On the broader issue of private equity, the Department of Labor appears to be taking a wait-and-see approach.

Politicians so far seem content to leave the private equity issue to the courts. Sens. Elizabeth Warren and Patty Murray and the Congressional Progressive Caucus, all loud voices in Congress for preserving ESG funds, did not respond to requests for comment about the Department of Labor's private equity guidance.