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Private equity funds eye DC market

New Offering aims to address 401(k) plan restrictions, find a place in TDFs

By Michael Paterakis

Pension assets have been the lifeblood of private equity funds for decades. Yet one corner of the retirement market remains stubbornly elusive to them: U.S. defined contribution (DC) plans.

This might change soon as various private equity firms are making a stronger push for the approximately $7 trillion in aggregate assets that, as of last December, were held in various 401(k), 403(b) and other corporate, public and non-profit types of employer-sponsored retirement savings funds, according to the Investment Company Institute.

Last month, two private equity behemoths made their intentions clear. London-based Pantheon first unveiled a new pricing option to make its strategies more attractive to DC plans. A few days later, Blackstone disclosed its intention to acquire Aon Hewitt's recordkeeping business, which, according to various research firms, is among the top-five largest in the U.S.

Pantheon's move signals the first serious effort from a private equity firm to tackle restrictions and other difficulties that render DC assets inaccessible to the industry.

One of the biggest challenges for private equity has been the lofty fees such strategies command. As lawsuits targeting employers who have neglected to keep prices for their participants low have multiplied in recent years, DC sponsors have relied heavily upon index funds and managers like Vanguard for their investment options (*MMR*, 4/10/15).

Pantheon hopes to differentiate itself by offering a performance-based investment fee that will be levied only when the performance of the private equity assets in the portfolio beats its index, the S&P 500. The firm contends that this pricing structure beats even traditional asset managers who receive a fixed base fee even when their strategies underperform.

"That doesn't guarantee that you won't be sued," said **Kevin Albert**, a partner and managing director at Pantheon. "With our pricing, we say, 'try it, you only pay for private equity investments if they work.'"

Liquidity is another key concern. Contrary to defined benefit plans that can award mandates in strategies that will effectively lock their assets for long periods of time, DC plans are required to provide participants with easy access to their monies. Given these restrictions, Pantheon's approach includes a liquid reserve, in addition to a daily calculation of the strategy's net asset value (NAV) just like mutual funds—the preferred investment vehicle in DC plans—provide.

To manage the irregularity of capital inflows from DC plans and maximize their efficient deployment, Pantheon is working with several general partners like KKR. "The more firms you have involved in this with multiple strategies, the more flexibility you have," said Michael Gaviser, a managing director at the New York-based firm. "We are excited to partner with Pantheon on being the first to offer the opportunity to invest in private

Kevin Albert
partner and managing director at Pantheon

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equity to the DC space."

Although not as direct, Blackstone's involvement in the space through the acquisition of Aon's recordkeeping book of business also serves as a reminder that private equity firms are willing to explore all available avenues to tap the DC market. Blackstone, specifically, has long signaled its intention to go retail. The firm's first step toward that direction came in early 2013, when it teamed up with State Street to launch an exchange-traded fund (ETF), the SPDR Blackstone/GSO Senior Loan ETF.

In the acquisition of a major recordkeeper, Blackstone followed the footsteps of Genstar Capital and Aquiline Capital Partners, the pair of private equity managers that in late 2015 jointly bought Ascensus. A Blackstone representative declined a request to comment on the story. An Aon representative declined to comment before the closure of the transaction.

PE as allocation in target-date funds

While the U.S. undoubtedly has one of the most developed DC markets globally, it is the only one, so far, in which private equity allocations are almost non-existent. U.S. Securities and Exchange Commission filings reveal that a rare example of an S&P 500 company with a private equity option in its 401(k) plan is food manufacturer General Mills. But even in this plan, the private equity component is within a multi-asset class fund.

"When you make it a standalone option, it can be intimidating to people," Pantheon's Albert explained.

With that in mind, Pantheon anticipates embedding its strategies into target-date funds (TDFs)—initially in custom funds, where liquidity requirements can also be better accommodated.

The use of TDFs allowed another illiquid strategy, real estate, to break into the DC world. Taking advantage of exchange-traded vehicles like real estate investment trusts (REITs), investment firms specializing in the space, have managed to set an outpost in DC. At the end of 2016, 7.3% of target-date fund series included an allocation to real estate, Callan Associates estimated. "Real estate still has a long way to go, but it is further along the way dealing with defined contribution's operation issues," James Veneruso, a consultant with Callan, said.

"Also, on the education side, real estate is easier to understand," Veneruso added. "Real estate is your house."

Private equity's pitch is high returns that have carried pension plans for over forty years. Pantheon calculated that a TDF with 7.1% of its portfolio allocated to private equity over a 45-year time span would increase a participant's savings by 8.7%. To put that into perspective, if the participant saved $6,424 annually, then they would have $172,794 in savings at the fund's target date.

It remains to be seen whether this, along with the structure Pantheon provides, will be enough to convince DC plan sponsors. "We have half a dozen people quite interested in it," Albert said. "You can't just do that overnight. If we build a revenue stream within five years, we will be positively surprised."

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