

---

**MICHELLE RAPPA**

Managing Director, Retirement Client Advisor

## Private Equity in Defined Contribution Plans

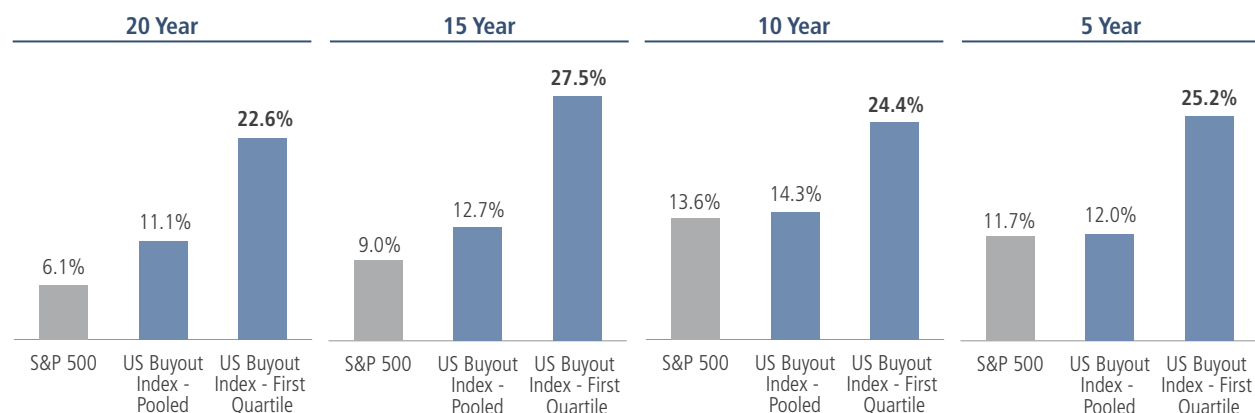
A recent information letter from the DOL may facilitate greater access to private equity for plan participants.

Private equity has long been the subject of interest—if not action—from defined contribution plan sponsors. The asset class' strong performance and low correlation to traditional assets have given it appeal as a source of potential diversified return for defined benefit plans. However, its complexity, valuation uncertainty, fee structures and illiquidity have created challenges within the DC framework. Plan sponsors have also worried that these issues could open them up to liability as fiduciaries. Undeterred, the industry has continued to look for ways to introduce private equity in DC plans where it makes sense in managed asset allocation plan options.

Recently, those efforts received an important shot in the arm from the U.S. Department of Labor in the form of an information letter. Without approving a particular fund or product, the DOL said that, in certain circumstances, it would be open to the inclusion of private equity investments in "designated investment alternatives" such as custom target date, target risk and balanced funds. In the scenario addressed by the letter, a multi-class vehicle would cap its weighting in private equity, with the rest of its assets held in public securities and other liquid investments to manage risk and liquidity needs.

In our view, this is a positive development that is likely to reinforce the perceived benefits of private equity to DC sponsors. A quick review is worthwhile, showing that the asset class has outperformed public equities across multiple timeframes (see display).

## PERFORMANCE COMPARISON: U.S. PRIVATE VS. PUBLIC EQUITY



For illustrative purposes only. The benchmark performance is presented for illustrative purposes only to show general trends in the market for the relevant periods shown. The investment objectives and strategies of the benchmarks may be different than the investment objectives and strategies of a particular private fund, and may have different risk and reward profiles. A variety of factors may cause this comparison to be an inaccurate benchmark for any particular type of fund and the benchmarks do not necessarily represent the actual investment strategy of a fund. It should not be assumed that any correlations to the benchmark based on historical returns would persist in the future. Indexes are unmanaged and are not available for direct investment. Source: Cambridge Associates. Represents pooled horizon IRR and first quartile return for the Global All Private Equity Index from Cambridge Associates as of December 2019, which is the latest data available. **Past performance is not indicative of future results.** Please see the Important Valuation and Other Financial Analyses Risk Considerations for details concerning, among other things, COVID-19, including its impact on valuations and other financial analyses.

In our opinion, these figures reflect characteristics inherent to the asset class, including the following:

**Information and control.** [Private Equity] managers generally have deeper access to information, and more direct and transparent governance control, and thus have the ability to create value through strategic and operational improvements.

**Timing.** [Private equity] managers often spend months sourcing and completing investments, and can choose a variety of methods to exit their positions, providing them with great flexibility as to the timing of their investments.

**Distinct opportunities.** Private companies generally avoid the quarterly reporting burden of public companies, and thus may be better able to take on opportunities that may take time to reach fruition.

The latter point is particularly important today, as the pandemic challenges so many sectors and companies. We believe that private equity managers' ability to provide needed capital, and their ability to wait out temporary stresses, could prove particularly beneficial as the global economy moves toward recovery.

## A Difference in DC

Even if asset class statistics appear more favorable in general, a key question is whether private equity can make a difference in the context of a target-date fund. Here, the answer appears to be yes. In a 2019 study<sup>1</sup> sponsored by Neuberger Berman, the Defined Contribution Alternatives Foundation and the Institute for Private Capital analyzed a comprehensive sample of 2,515 U.S. private equity funds to create hypothetical simulated portfolios for 1987 – 2017 that invested part of their overall equity allocation in the funds. They found that including the private investments increased average portfolio returns and Sharpe ratios. The results remained robust when accounting for higher fees, as well as randomly selecting a few private funds from each vintage year.

This is not to say that adding private equity to a target-date fund is an automatic decision. As the DOL letter emphasized, private equity introduces a range of additional issues around analysis and oversight, and requires that plan fiduciaries and their portfolio managers have sufficient "capabilities, experience and stability" to effectively run a fund that includes private assets. Creating this exposure has potential benefits, but responsibilities as well.

<sup>1</sup> "Why Defined Contribution Plans Need Private Investments," Defined Contribution Alternatives Foundation and Institute for Private Capital, October 2019.

**FOR INVESTMENT PROFESSIONAL, BROKER-DEALER AND INSTITUTIONAL USE ONLY. NOT FOR USE BY OR DISTRIBUTION TO THE GENERAL PUBLIC.**

This material is provided for informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. Any views or opinions expressed may not reflect those of the firm as a whole. Information presented may include estimates, outlooks, projections and other "forward-looking statements." Due to a variety of factors, actual events may differ significantly from those presented. Neuberger Berman products and services may not be available in all jurisdictions or to all client types. This material is informational and educational in nature, is not individualized and is not intended to service as the primary or sole basis for any investment or tax-planning decision. Diversification does not guarantee profit or protect against loss in declining markets. Investing entails risks, including possible loss of principal. Indexes are unmanaged and are not available for direct investment. **Past performance is no guarantee of future results.**

This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Neuberger Berman is not providing this material in a fiduciary capacity and has a financial interest in the sale of its products and services. Investment decisions and the appropriateness of this material should be made based on an investor's individual objectives and circumstances and in consultation with his or her advisors. This material may not be used for any investment decision in respect of any U.S. private sector retirement account unless the recipient is a fiduciary that is a U.S. registered investment adviser, a U.S. registered broker-dealer, a bank regulated by the United States or any state, an insurance company licensed by more than one state to manage the assets of employee benefit plans subject to ERISA, or, if subject to Title I of ERISA, a fiduciary with at least \$50 million of client assets under management and control, and in all cases financially sophisticated, capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies. This means that "retail" retirement investors are expected to engage the services of an advisor in evaluating this material for any investment decision. If your understanding is different, we ask that you inform us immediately.

Neuberger Berman Investment Advisers LLC is a registered investment adviser. The "Neuberger Berman" name and logo are registered service marks of Neuberger Berman Group LLC.

NEUBERGER	BERMAN
-----------	--------

**Neuberger Berman**

1290 Avenue of the Americas  
New York, NY 10104-0001

**[www.nb.com](http://www.nb.com)**