IX. Pension Funds and Private Equity

A. Introduction

Pension funds are the source of retirement payments for many of the United States public servants.[1] Beneficiaries of these funds are promised steady payments regardless of market conditions or underfunding.[2] Unfortunately, many United States public pension funds are underfunded and faced with the dilemma of how to make up for their lack of funds.[3] Many pension funds have turned to private equity investments as a strategy to solve this dilemma.[4] Investing in private equity gives pension funds exposure to private companies and to the private equity industry's reputation for high returns.[5] However, many critics think that private equity's promise of high reward comes with too big of a risk for public pension funds.[6] These critics object to private equity's high management fees and lack of transparency, and argue that private equity returns are more likely to be, at most, average.[7]

This article will discuss the problems that public pension funds face when they invest in private equity. Section B will provide an overview of the rise of private equity as a pension fund investment strategy. Sections C and D will discuss the State Teachers Retirement System of Ohio and the Pennsylvania Public School Employees Retirement System, two pension funds that are currently receiving criticism for their private equity investments and their lackluster

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[1] Adam Lewis, *Pensions under fire after PE underperforms*, PITCHBOOK (June 13, 2021), https://pitchbook.com/news/articles/pensions-under-fire-after-pe-underperforms [https://perma.cc/BJ9U-72L6].

[2] Jamal Hagler, *Pension Funds and Private Equity*, AM. INV. COUNCIL 1 (2019), https://www.investmentcouncil.org/wp-content/uploads/pension-funds-and-private-equity.pdf.

[3] *Id.*

[4] THE PEW CHARITABLE TR.S AND LAURA AND JOHN ARNOLD FOUND., STATE PUBLIC PENSION INVESTMENTS SHIFT OVER THE PAST 30 YEARS, (2014) (on file with author)[hereinafter PEW CHARITABLE].

[5] Hagler, *supra* note 2, at 1.

[6] Marc Joffe, *Examining Private Equity in Public Pension Investments*, REASON FOUND. (Jan. 2021), https://reason.org/wp-content/uploads/examining-private-equity-public-pension-investments.pdf.

[7] See Id.; Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns & The Billionaire Factory*, (The University of Oxford, Said Business School, Working Paper), https://ssrn.com/abstract=3623820.

performance. Section E will assess the benefits of pension funds investing in private equity. Finally, Section F will assess the disadvantages and potential risks that pensions funds incur when they invest in private equity.

B. Background

Public pension funds provide retirement savings and payments for many individuals who work in the public sector.[8] Typically, employees and employers contribute capital to the fund throughout an employee's career knowing that, when the employee retires, the fund will distribute pension payments to them.[9] Beneficiaries are guaranteed steady payments, regardless of the market conditions.[10] However, many pension funds in the United States are significantly underfunded.[11] In 2018, a report found that the average United States pension fund was only 66% funded.[12] Beneficiaries of these funds are guaranteed payments; thus, if the fund does not have enough capital, it is up to the taxpayers in their respective states to make up for the gap.[13]

Beginning in the 1980s, pension funds began relying more heavily on stock to boost their investment returns and fix their problem of being underfunded.[14] However, in the past decade, they have diverted more of their resources to alternative investments, such as private equity, to achieve higher returns.[15] Private equity funds invest in private companies that are undervalued, and work to transform the company over time to create value.[16] Pension fund managers are eager to invest in private equity because it gives them exposure to private companies

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[8] Lewis, *supra* note 1.
[9] *Pension Fund,* CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/other/pension-fund/ [https://perma.cc/S694-MHKS].
[10] Hagler, *supra* note 2, at 1.
[11] *Id.*
[12] *Id.*
[13] Lewis, *supra* note 1.
[14] PEW CHARITABLE , *supra* note 4.
[15] *Id.*
[16] Gretchen Morgenson, *Private equity and hedge fund firms invested pension cash for retired Ohio teachers. Here's what happened.*, NBC NEWS (June 9, 2021, 6:00 AM), https://www.nbcnews.com/business/personal-finance/private-equity-hedge-fund-firms-invested-pension-cash-retired-ohio-n1269885 [https://perma.cc/M7AW-XHRT].

and the private equity industry's reputation for high returns.[17] Pension fund managers use private equity investments as a way to maximize their long-term returns and diversify their portfolios.[18]

The pension fund trend towards private equity investments has not slowed in recent years.[19] Recently, CalPERS, the nation's largest pension fund, closed its $4 billion hedge fund portfolio.[20] Instead, it is reallocating its capital towards a private equity strategy.[21] In 2020, U.S. pension funds allocated 9% of their assets to private equity.[22] However, many critics think that private equity's promise of high returns comes with too big of a risk for public pension funds.[23] These critics point to private equity's high fees, lack of transparency, and volatile returns as reasons that pensions funds should decrease their allocation in private equity.[24]

C. State Teachers Retirement System of Ohio (STRS)

The State Teachers Retirement System of Ohio is one of the largest pension funds in the United States and has approximately $88 billion in investment assets.[25] The fund provides retirement benefits to public school employees in Ohio and has over 500,000 beneficiaries.[26] However, the fund is currently underfunded with only 77% of its liabilities covered.[27] The fund has taken various measures to make up for this problem.[28] In 2017, STRS eliminated its annual cost-of-living increase on payments to beneficiaries even though prices in the United

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[17] PEW CHARITABLE , *supra* note 4.
[18] *Id.*
[19] Liam Hunt, *Why Pension Funds Now Favor Private Equity Investing*, SOPHISTICATED INVESTOR (Jan 13, 2020) https://sophisticatedinvestor.com/pension-funds-now-favor-private-equity-investing/ [https://perma.cc/N7Y2-L9RC].
[20] *Id.*
[21] *Id.*
[22] AM. INV. COUNCIL, PRIVATE EQUITY DELIVERS THE STRONGEST RETURNS FOR RETIREES ACROSS AMERICA: 2021 PUBLIC PENSION STUDY 2 (2021) (on file with author).
[23] Joffe *supra* note 6, at 1.
[24] *Id.*
[25] Morgenson, *supra* note 16.
[26] *Id.*
[27] *Id.*
[28] *Id*

States continue to rise.[29] Additionally, the fund has allotted over 18% of its portfolio to more risky alternative investments.[30]

1. STRS Private Equity Investments

STRS allocates 10.6% of its resources to private equity.[31] While this may not seem like a large number, CalPERS, the country's largest private equity fund, only allocates 7.7% of its investment assets to the same asset class.[32] To put things into perspective, STRS invests "with about 140 money managers. . .", two of which are giant private equity firms: Apollo Global Management and the Carlyle Group.[33] While this allocation was made in hopes of achieving high returns, it has not been successful.[34] In the past five years, STRS' private equity investments returned an average of 6.7%, significantly below the fund's goal of 10%.[35] In addition to these poor returns, STRS pays very high fees to the private equity firms that it relies on.[36] In the past decade, the fund has paid over $4.1 billion in fees to private equity and hedge funds.[37]

2. Public Criticism

Many critics have taken issue with STRS' willingness to pay high management fees in light of the fund's decision to end cost-of-living increase to its beneficiaries.[38] Critics point out that the $4.1 billion in fees paid to private money managers over the last decade would have more than covered the cost-of-living increase.[39] Former Ohio teachers recently tried to sue the fund in federal court over the elimination of the cost-of-living adjustments.[40] They argued that the change "interferes

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[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id*
[35] *Id.*
[36] Lewis, *supra* note 1.
[37] *Id.*
[38] Morgenson, *supra* note 16.
[39] *Id.*
[40] Jacklyn Wille, *Challenge to Ohio Teacher Pension Cuts Booted from Federal Court,* BLOOMBERG L. (Aug. 18, 2021),

with their vested pension benefits and violates Ohio law providing that the board 'shall annually increase' these payments."[41] However, the case was dismissed because the Ohio State Teachers Retirement Board "operates as an arm of the state …" and is entitled to immunity from federal litigation under the Eleventh Amendment.[42]

3. *Criticism from the Ohio Retired Teachers Association (ORTA)*

This year, the Ohio Retired Teachers Association, which consists of thousands of stakeholders, contacted Benchmark Financial Services to conduct a forensic investigation of STRS.[43] ORTA raised $75,000 in order to commission the audit, which is being conducted by a former SEC attorney, Edward Siedle.[44] The report was commissioned due to poor investment decisions, poor performance, and lack of transparency.[45] One specific instance that sparked concern with the ORTA was that in March 2021, STRS lost over $525 million in its investment with Panda Power Funds, a private equity firm.[46] The executive director of ORTA believes that the loss from this investment, and other investments that indirectly went to Panda Power Funds, could be as high as $1.5 billion.[47] The report's preliminary findings showed that:

> STRS has long abandoned transparency; legislative oversight of the pension has utterly failed; Wall Street has been permitted to pocket lavish fees without scrutiny; investment costs and performance may have been misrepresented; and failure to monitor conflicts may have undermined the integrity of the investment process,

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https://www.bloomberglaw.com/bloomberglawnews/class-action/XCT6V7OK000000?bna_news_filter=class-action#jcite.

[41] *Id.*

[42] *Id.*

[43] BENCHMARK FIN. SERV., THE HIGH COST OF SECRECY, (2021) (on file with author).

[44] Micheal Katz, *Ohio Retired Teachers Association Sues Ohio STRS for Transparency,* CHIEF INV. OFFICER (May 6, 2021) https://www.ai-cio.com/news/ohio-retired-teachers-association-sues-ohio-strs-for-transparency/ [perma.cc/A9PL-PRAZ].

[45] BENCHMARK, *supra* note 38.

[46] Katz, *supra* note 39.

[47] *Id.*

> as billions that could have been used to pay the retirement benefits promised to teachers have been squandered.[48]

Almost immediately after these findings were released, STRS responded by attacking the report's legitimacy and trying to rebut its conclusion and content.[49] The fund claims that it is committed to transparency, it implements effective oversight, the investment fees that it pays are at most average, it monitors conflicts, and it has not misrepresented its costs and performance.[50] However, STRS's response has been publicly criticized by Edward Siedle, who pointed out that even though the fund issued a response, in the June 2021 Board meeting the majority of the board declined to discuss the report because the board members had not read the report yet.[51] This signals the board's lack of concern about the issue.

Further, ORTA is suing STRS to force it to turn over public financial information that it has failed to make public and that is necessary for the ongoing audit.[52] Back in February 2021, a public records request was submitted to STRS requesting records "related to the pension's investment managers, investment consultants, performance compliance auditor, investment cost monitor, financial auditor, custodians, board, and staff."[53] While STRS has provided 140 documents pursuant to the request, it has refused to disclose key documents about the fund's private equity investments.[54] ORTA maintains that these records are essential to understanding the value of the fund's investments but are being kept private at the request of money managers, despite the fact that Ohio law requires the records to be public on request.[55] This lack of disclosure is harmful to the fund's

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[48] BENCHMARK, *supra* note 38.
[49] STATE TCHR. RET. SYS. OF OHIO, STRS OHIO RESPONSE TO BENCHMARK FINANCIAL SERVICES (BFS) REPORT, (2021) https://www.strsoh.org/_pdfs/board/BFS-response-08-19-2021.pdf.
[50] *Id.*
[51] Edward Siedle, *Forensic Investigation of Ohio Teachers' Pension Reveals Widespread Failures and Mismanagement,* FORBES (June 29, 2021), https://www.forbes.com/sites/edwardsiedle/2021/06/29/forensic-investigation-of-ohio-teachers-pension-reveals-widespread-failures-and-mismanagement/?sh=14303b82eb67 [https://perma.cc/3DCY-U2VL].
[52] Katz, *supra* note 39.
[53] *Id.*
[54] *Id.*
[55] *Id.*

beneficiaries because beneficiaries deserve to know how their money is being allocated.

D. Pennsylvania Public School Employees Retirement System (PSERS)

The Pennsylvania Public School Employees Retirement System fund oversees the pensions of about 250,000 retired teachers and other public-school workers, as well as an equal number of working teachers.[56] The fund is run by a 15-member board, comprised of public officials, that manages approximately $64 billion dollars.[57] However, while retired Pennsylvania public school workers depend on the stability of the fund for steady payments, it has been severely underfunded since the early 2000s.[58] In the early 2000s, the state government increased pension benefits without setting aside money to pay for them.[59] This decision led to a deficit of $40 billion, and the burden has fallen on taxpayers to make up the difference.[60] In 2020, taxpayers put almost $5 billion into the fund while school employees invested a mere $1.1 billion.[61]

1. PSER's Private Equity Investments

In 2008, PSERS began its alternative investment strategy to make up for the growing deficit.[62] The fund's managers began aggressively investing in private equity, in recent years putting more than half of its assets into alternative investments.[63] However, this

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[56] Joseph DiStefano & Craig McCoy, *PSERS and its troubles: A guide to the woes facing Pa.'s biggest pension plan*, THE PHILA. INQUIRER (Apr. 11, 2021), https://www.inquirer.com/business/psers-sers-pension-fbi-scandal-investigaton-teachers-20210411.html.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] Joseph DiStefano, *Why PSERS investment strategy has failed to pay off for Pa. taxpayers and school employees*, THE PHILA. INQUIRER (Aug 8,2021), https://www.inquirer.com/business/psers-returns-oil-land-florida-alternative-investments-20210808.html.
[62] *Id.*
[63] *Id.*

aggressive tactic has not paid off.[64] A recent study showed that PSERS's return over the last 10 years is only 7.7%, which was the fifth worst of the 24 funds considered in the study.[65]

Current private equity investments undertaken by the fund include morally questionable ventures. PSERS's investment staff recently recommended allocating more money to a big trailer-park venture led by Stockbridge Capital, despite public concerns that trailer parks are becoming too expensive for their target market.[66] PSERS has also put the fund's money "into a provider of calling systems for inmates" led by Platinum Equity, a private equity firm known for being a "prison profiteer."[67]

2. Recent Criticism

PSERS has received recent criticism for its poor financial performance, payment of high management fees, and lack of transparency.[68] Six of the members on the board of PSERS called for the resignation of the fund's executive director and CIO.[69] These members cited the fund's poor investment performance and its payment of management fees totaling more than $4.3 billion over the last four years.[70] Critics argue that PSERS would be better off using a strategy that favors U.S. stocks and bonds instead of the complicated, illiquid alternative investment strategy that is currently in place.[71] Further, they believe that the fund's current investment portfolio, favoring alternative

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64 Richard M. Ennis, *Cost, Performance, and Benchmark Bias of Public Pension Funds in the United States: An Unflattering Portrait*, J. OF PORTFOLIO MGMT., https://www.documentcloud.org/documents/21031602-richard-ennis-study.
65 *Id.*
66 Mary Walsh, *F.B.I. Asking Questions After a Pension Fund Aimed High and Fell Short*, N.Y. TIMES (May 11, 2021), https://www.nytimes.com/2021/05/11/business/dealbook/psers-pennsylvania-fund-fbi.html?partner=bloomberg [https://perma.cc/D2JH-J5VK].
67 *Id.*
68 Lewis, *supra* note 1.
69 *Id.*
70 *Id.*
71 Joseph Distefano & Craig McCoy, *PSERS board freezes private investments, but move to oust bosses fizzles*, THE PHILA. INQUIRER (June 11,2021), https://www.inquirer.com/business/psers-pension-board-firing-staff-hedge-fund-alternative-investments-20210611.html.

investments, is "too complicated, too illiquid, and too opaque …"[72] However, proponents of the strategy, and most of the Board, argue that the high fees are worth the risk because alternative investments have "the potential to pay off big for the plan."[73]

3. Botched Financial Calculation

In 2010, Pennsylvania adopted a "risk sharing" mandate that stated that public school employees hired after 2011 would have to increase their pension payments if PSERS underperformed.[74] The mandate set a threshold of 6.36% on the fund's investment returns.[75] Further, it required that the fund's average rate of return meet the threshold between the years of 2011 and 2020.[76] The consequence of this goal not being met would be the increase of pension payments by public school employees hired after 2011. [77] In December of 2020, the board endorsed a figure of 6.38% as the average return over the last nine years.[78] However, critics called the figure into question because it was so close to the threshold.[79] In March 2021, the board admitted that it had mistakenly endorsed an inflated figure for its return on investment and stated that the actual figure was below 6.36%.[80] As a consequence of missing the target, public school employees hired after 2011 now have to pay more into the fund.[81]

The calculation error was narrowed down to a small clerical mistake, which arose after incorrect data was input in April 2015.[82] The error falsely increased the fund's performance by about a third of a percentage point over one financial quarter.[83] Critics believe the Board

[72] *Id.*
[73] *Id.*
[74] DiStefano & McCoy, *supra* note 51.
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] Joseph N. Distefano, Craig McCoy, & Angela Couloumbis, *Internal PSERS documents show how Pa's biggest pension fund got key financial calculation wrong,* THE PHILA. INQUIRER (May 30, 2021), https://www.inquirer.com/business/psers-pension-error-mistake-teachers-fbi-20210530.html.
[83] *Id.*

may have allowed it to happen.[84] While the Board was warned that it should avoid using unaudited numbers, it rejected that advice and instead used untested figures that made the results inflated.[85] Further, the Board limited the scope of review for the outside consultant group that it hired to check calculations, only allowing consultants to analyze certain months.[86]

4. *FBI and SEC Investigations*

Three weeks after the mistake was revealed, PSERS disclosed that its investment practices were being investigated by the FBI.[87] The investigation is focused on uncovering evidence of kickbacks or bribery to explain the plan's endorsement of an inflated investment return figure.[88] The FBI is also looking into the fund's 2019 decision to invest $5 million in real estate in Pennsylvania.[89] While the fund has stated that it is cooperating with the government and an internal inquiry on these matters, the investigations could be bad news for the fund and its beneficiaries.[90]

E. Benefits of Investing in Private Equity

Institutional investors often favor private equity because it gives them access to private deals and promises high returns.[91] Proponents of private equity commonly cite access to assets not traded on the public market, high returns, and minimal regulatory oversight as key benefits of private equity investments.[92]

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[84] *Id*
[85] *Id.*
[86] *Id.*
[87] DiStefano & McCoy, *supra* note 51.
[88] Angela Columoumbis, Joseph DIStefanno, & Craig McCoy, *FBI probe of massive Pa. pension fund seeks evidence of kickbacks or bribery,* SPOTLIGHT PA (May 16, 2021), https://www.spotlightpa.org/news/2021/05/pa-fbi-pension-psers-investigation-subpoenas-properties-real-estate-harrisburg/ [https://perma.cc/3NQU-LTH3].
[89] Walsh, *supra* note 60.
[90] *See id.*
[91] Paul Sullivan, *The Allure, and Burden, of Private Equity,* N.Y. TIMES (March 8, 2019), https://www.nytimes.com/2019/03/08/your-money/private-equity-investing.html [https://perma.cc/NQS5-GCWT].
[92] *Id.*

1. *Private Equity is a "Best Performing Asset Class"*

Many investors are drawn to private equity due to its reputation for yielding high returns and being a "best performing asset class."[93] Private equity has continually beat the public market performance in long term returns.[94] Historically, U.S. private equity buyout funds have outperformed the S&P 500 "by a fairly wide margin."[95] Using historical data, professors Gregory Brown and Steven Kaplan showed that in 2019, private equity long-term returns continue to outperform the S&P 500 by 2 to 3 percent.[96] Proponents of this argument claim that these results are consistent whether the analysis is conducted using internal rate of return or the public market equivalent.[97]

Looking more specifically at pension fund performance in private equity, Cliffwater LLC, an investment advisory firm, showed that over a 16-year period, private equity investments by public pension funds outperformed the pension funds' public equity investments by 4%.[98] Further, the American Investment Council found that "private equity is the best returning asset class in a public pension portfolio."[99] The study showed that in 2020, the median annualized return for public pension funds' private equity portfolios was 12.3% over a ten year period.[100] It also highlighted the Illinois State Board of Investment as the pension with the best performing private equity portfolio with a 10-year annualized return of 16.10%.[101]

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93 Private Equity FAQs, AM. INV. COUNSEL, https://www.investmentcouncil.org/private-equity-faqs/ (last visited Oct. 29, 2021).
94 *Id.*
95 Gregory Brown & Steven Kaplan, HAVE PRIVATE EQUITY RETURNS REALLY DECLINED?, FRANK HAWKINS KENAN INST. OF PRIV. ENTER. REP. (April 2019) (on file with author).
96 *Id.*
97 Hagler, *supra* note 2.
98 AN EXAMINATION OF PRIVATE EQUITY PERFORMANCE AMONG STATE PENSION FUNDS, CLIFFWATER LLC (May 2018) (on file with author).
99 AM. INV. COUNCIL, *supra* note 20.
100 *Id.*
101 *Id.*

2. *Diversification*

Pension funds also value private equity investments to diversify their portfolios.[102] Diversification is fundamental to creating a successful investment portfolio and mitigating risk.[103] Diversification is even more important for pension funds because they are obligated to pay beneficiaries despite the conditions of the market.[104] According to the American Investment Council, approximately 85% of public pensions have some exposure to private equity.[105] Further, pension funds are typically significantly underfunded.[106] Pension funds need to diversify their portfolios in order to reduce their funding gaps, so they should "invest in asset classes that provide exposure to areas where they can achieve returns beyond public market indexes."[107] Thus, alternative investments in private equity give Pension Funds access to opportunities they would not be able to get on the public markets.[108]

F. Disadvantages of Investing in Private Equity

Opponents of public pension funds investing in private equity believe that it is too risky for funds that are meant to support retirees who rely on the funds' returns for financial security.[109] Critics often cite private equity's high fees, lack of transparency, and lack of liquidity as key disadvantages to the asset class.[110]

1. *High Fees Charged by Private Equity Firms*

The main critique of public pension funds investing in private equity relates to the high fees that private equity firms charge. Critics believe that putting public money into private investments could be "dangerous" because the extent of the fees is frequently misunderstood.[111] Private equity firms typically charge management

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[102] *Id.*
[103] *Id.*
[104] Hagler, *supra* note 2, at 1.
[105] AM. INV. COUNCIL, *supra* note 20.
[106] Hagler, *supra* note 2, at 2.
[107] *Id.*
[108] *Id.*
[109] Phalippou, *supra* note 7, at 4.
[110] *Id.*
[111] Walsh, *supra* note 60.

fees of 1 to 2 percent and about 20% of portfolio gains.[112] However, there are even more fees that are undisclosed to the investor — including, but not limited to, "transaction fees, legal costs, taxes, monitoring or oversight fees, and other expenses."[113] A 2009 paper authored by Ludovic Phalippou, a professor of financial economics at the University of Oxford, found that the typical private equity buyout fund charged more than 7% in fees each year, a figure that is bound to effect the total return that an investor receives.[114] The fees paid by pension funds to private equity firms vary on a case-by-case basis.[115] A recent report found that "some pensions consistently pay higher fees ex-post than others in their fund."[116]

But how much are pension funds actually paying in fees? Over the last four years, PSERS has paid at least $4.3 billion in fees, and fund beneficiaries have received lackluster returns.[117] Ohio's STRS has paid at least $4.1 billion in fees to private equity in the last decade.[118] Critics point out that the expectation when paying these high fees is receiving a high return.[119] However, the two pension funds above have not recognized this tradeoff.[120]

2. Lack of Transparency

Another problem that critics of pension fund investment in private equity have identified is lack of transparency.[121] A key issue associated with lack of transparency surrounds valuations.[122] Private equity valuations are subject to error and possible bias because the value of their shares can only be estimated, as these funds are not traded on

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[112] Gretchen Morgenson, *Pension Funds Can Only Guess at Private Equity's Cost,* N.Y. TIMES (May 1, 2015), https://www.nytimes.com/2015/05/03/business/pension-funds-can-only-guess-at-private-equitys-cost.html [https://perma.cc/TK67-95S8].
[113] *Id.*
[114] Phalippou, *supra* note 7.
[115] Juliane Begenau and Emil Siriwardane, *How do private equity fees vary across public pensions?*, (STAN. UNIV. AND HARV. BUS. SCH.), https://ssrn.com/abstract=3526469.
[116] *Id.*
[117] Lewis, *supra* note 1.
[118] *Id.*
[119] DiStefano & McCoy, *supra* note 64.
[120] *Id.*
[121] Joffe, *supra* note 6, at 5.
[122] *Id*. at 25.

the public market.[123] Thus, private equity firms must estimate what their holdings are worth, and when they are trying to make their returns look attractive, it is more likely that they overestimate their value.[124] This creates a problem when pension funds are deciding whether or not to invest in private equity. A board member of PSERS recently stated that "[p]rivate valuations are very susceptible to manipulation," shedding light on the problem that pension funds are facing.[125] However, not all pension fund board members share this skepticism.[126] Some pension officials are attracted to the "fuzzy" valuations of private equity holdings because it may make their private investments seem less volatile than stocks.[127]

Additionally, many investors critique the lack of transparency when it comes to the fee structures associated with private equity investments.[128] In the pension fund context, beneficiaries are particularly frustrated by this factor.[129] A beneficiary from Ohio's STRS pointed out that the fund is not allowed to tell its beneficiaries details on the fee structures and costs associated with their private investments.[130] This no doubt causes concern, as the beneficiaries of pension funds rely on the funds' returns.

3. Volatile Returns

While private equity is known for its promise of high returns, some scholars are beginning to question this reputation. In 2020, a study found that public and private equity performance has been roughly the same since 2006.[131] Another study showed that U.S. pension funds reported a median 13.88% annualized return on their private equity investments compared to a 14.35% return on U.S. stocks over a ten-year period.[132] Further, data currently suggests that private equity underperformed against public equity in 2020, and many critics do not think the asset class will bounce back.[133] This data begs the question: if

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[123] *Id.* at 26.
[124] *Id.*
[125] Walsh, *supra* note 60.
[126] *Id.*
[127] *Id.*
[128] Morgenson, *supra* note 16.
[129] *Id.*
[130] *Id.*
[131] Phalippou, *supra* note 7.
[132] Joffe, *supra* note 6, at 16.
[133] *See id.* at 17.

private equity's promise of high returns is fraudulent, is the investment worth the high fees and lack of liquidity that comes with it?

G. Conclusion

Despite the many downfalls of private equity, pension funds have continued to use the asset class as a strategy to make up for their underfunding.[134] Private equity promises high returns, but also presents high risk, as seen in the lackluster performances by private equity investments made by STRS and PSERS.[135] While many critics would be happy if pension funds steered clear of private equity, instead allocating the public funds to more stable investments like index funds, this proposition may be unwise.[136] The majority of pension funds in the United States are severely underfunded, and fund managers are going to have to take risks in order to take some of the pressure off tax-payers to make up the difference.[137] Further, many pension funds have proven to be successful in their private equity strategies.[138] Illinois State Board of Investment is just one of many examples of this success.[139] Pension funds should take some risks in their search for high returns, but they must be smart about where their money is going if they want to realize the reward.

Morgan Sciumbato[140]

[134] PEW CHARITABLE , *supra* note 4.
[135] Morgenson, *supra* note 16.
[136] Walsh, *supra* note 60.
[137] Hagler, s*upra* note 2.
[138] AM. INV. COUNCIL, *supra* note 20.
[139] *Id.*
[140] Student, Boston University School of Law (J.D. 2023).