Lifting the Curtain on Private Equity:  
A Guide for Institutional Investors and Policymakers

As pension funds and institutional investors have increased investments in private equity, the latest report of the AFT and Americans for Financial Reform evaluates the returns from these investments and examines the risks associated with private equity. Our report offers fiduciaries and policymakers a road map to increase the transparency of private equity practices and performance and mitigate the risks of these investments.

In just a dozen years, the global investment landscape has experienced two of the most severe shocks in modern history: the 2008 financial crisis and the COVID-19 pandemic. These crises, and the local and state budgetary pressures they induced, have placed acute stress on institutional investors like pension funds. In this context, institutional investors have increasingly turned to private equity buyout funds promising to beat the returns of traditional investments like stocks and bonds. In the decade following the financial crisis, pension funds' allocations to the alternative investment asset class that includes private equity doubled. But a trove of recent scholarship suggests that private equity might not be the deal investors were expecting.

The AFT-AFR report demonstrates that private equity performance, as a whole, has never been as impressive as the industry has claimed, and that it has worsened in recent years. Moreover, key indicators suggest that private equity performance will deteriorate further in coming years. Our report also sheds light on the significant risks associated with achieving even these mediocre returns, including risks directly related to the investment management relationship as well as indirect risks resulting from private equity business practices and structural trends in the investment landscape.

The direct risks include extremely high fees, a lack of transparency, discrimination toward smaller investors, illiquidity, and the waiving of fiduciary duty by investors. Indirect risks include reputational risks associated with the impact of destructive private equity practices on workers, consumers, the environment and local communities. Further risks include private equity's agenda of privatization, its tax avoidance, and the increased economic inequality created by its practices; taken together, these pose significant threats to state and local budgets, which in turn affects public sector employment and pension funds. As public pension fund fiduciaries are accountable, above all, to public employees and retirees who are fund beneficiaries, investments that threaten public employee jobs and retiree benefits are of great risk.

Fiduciaries and elected officials can take steps to increase transparency in private equity practices and performance and to mitigate the risks associated with investment in this asset class.
**Steps fiduciaries can take include:**

- Develop appropriate benchmarks to ensure clear and accurate reporting of fund performance, and mandate that private equity firms consistently report thorough quarterly fee and cost data.
- Require that private equity firms provide information related to portfolio companies and investment targets to assess any adverse consequences for employees, consumers and other stakeholders that can create reputational risks for investors.
- Adopt investment policies requiring private equity firms to refrain from eliminating public sector jobs and privatizing public assets as part of their business model, and adopt Responsible Contractor Policies that mitigate risk and provide for robust labor due diligence.
- Consider supporting federal legislation, such as the Stop Wall Street Looting Act, that would mitigate some of the investment risks associated with private equity.

**Steps policymakers can take include:**

- Pass legislation requiring private equity firms to share responsibility for all liabilities of companies under their control and ending private equity firm immunity for violations of law by portfolio companies.
- Pass legislation requiring private equity firms to prioritize worker pay and worker retention in the bankruptcy process and requiring them to retain risks related to debt arrangement to disincentivize the use of bankruptcy as a strategic exit.
- Pass legislation that bans dividends for two years after a portfolio company is acquired and limits monitoring and transaction fees to disincentivize asset stripping and encourage value-generating management and investment.
- Implement regulations that ensure that private equity firms are held accountable when they charge pension funds improper or illegal fees and expenses.
- Implement regulations that require private equity firms to disclose all fees and returns to provide investors with a comprehensive picture of investment performance and to disclose results from SEC compliance exams.