U.S. Department of Labor
Office of Inspector General
Office of Audit

BRIEFLY…

Highlights of Report Number 09-13-001-12-121, issued to the Assistant Secretary for Employee Benefits Security.

WHY READ THE REPORT

About 150 million Americans currently have approximately $6.5 trillion invested in retirement accounts. How plans invested these funds has a direct – and sometimes harmful – effect on the retirement security of plan participants. The Employee Retirement Income Security Act of 1974 (ERISA) governs the investment of assets in private sector employee benefit plans, which include both retirement and health and welfare plans. The Employee Benefit Security Administration (EBSA) oversees private sector management of employee benefit plans.

ERISA places responsibility on plan administrators to accurately report the fair value of plan assets. An accurate valuation of plan assets plays a critical role in determining plan funding levels and payments to participants and beneficiaries because the assets in a plan determine its ability to pay beneficiaries.

EBSA faces challenges in meeting its mission because some plans have increasingly shifted assets from traditional investments, such as stocks and bonds, to complex alternative investments, such as limited partnerships, common collective trusts, and hedge funds. As of 2010, employee benefit plans had amassed almost $3 trillion in alternative investments, of which EBSA estimated between $800 billion and $1.1 trillion were hard-to-value. In 2010, the Internal Revenue Service (IRS) Emerging Issues Task Force reported to EBSA that significant assets invested by plans in alternative investments may be a serious problem.

WHY OIG CONDUCTED THE AUDIT

Concerns by various parties, such as the Internal Revenue Service, General Accountability Office, and American Institute of Certified Public Accountants (AICPA) over plan assets invested into alternative and hard-to-value investments prompted the OIG to conduct an audit to determine if EBSA is providing adequate oversight of employee benefit plans that hold alternative investments.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to:

http://www.oig.dol.gov/public/reports/oa/2013/09-13-001-12-121.pdf

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EBSA NEEDS TO PROVIDE ADDITIONAL GUIDANCE AND OVERSIGHT TO ERISA PLANS HOLDING HARD-TO-VALUE ALTERNATIVE INVESTMENTS

WHAT OIG FOUND

EBSA has made efforts to improve its oversight of plans that hold hard-to-value alternative investments. Despite these efforts, however, EBSA must take further action to increase protections for participants and beneficiaries of plans investing in these types of investments. We found EBSA had not formalized into regulatory guidance a requirement that plan administrators identify and adequately support the fair value of hard-to-value investments nor implemented the 2006, 2008, and 2011 ERISA council recommendations on the same. As a result, plans are using poor practices in valuing these investments. Almost no plan administrator in our samples obtained an independent valuation or demonstrated an analytical process to determine the fair value of all their hard-to-value assets.

Plans can and have invested in unaudited alternative investments that self-report their asset values. This provides no independent opinion of asset values, and effectively no assurance that the assets in question even exist. Additionally, even audited fund values reported by alternative investment entities may not always translate into fair value for the plans invested because of complex factors such as illiquidity of ownership interests and other considerations. Compounding this problem is the fact that plan administrators have increasingly used limited scope audits, in which plan auditors do not test for existence or valuation of plan assets in certain cases. In 2010, approximately $3 trillion in assets received only a limited scope audit.

Lastly, we found EBSA could improve procedures in enforcement reviews and Form 5500 reporting, data collection, and targeting for plans with hard-to-value alternative investments. EBSA has previously stated that in light of the challenges facing retirement plan fiduciaries and investors, such as Ponzi schemes and hard-to-value assets, participants need protection from potential losses.

WHAT OIG RECOMMENDED

We recommended the Assistant Secretary for Employee Benefits Security take the following actions for plans holding hard-to-value alternative investments: (1) propose and formalize guidance and evaluate the ERISA Council recommendations, (2) improve procedures in enforcement reviews, and (3) improve Form 5500 data collection, analysis, and targeting.

In response, EBSA stated that it did not believe the trillions of dollars of plan assets invested in alternative investments and hard-to-value assets pose significant valuation concerns, that ERISA already provided sufficient guidance, that its investigative procedures were sufficient, and that the Form 5500 already focuses on asset valuation. EBSA agreed to further consider the OIG recommendations, but did not provide any explicit corrective actions.