Committee On Finance
Max Baucus, Chairman

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BAUCUS, GRASSLEY QUESTION HEDGE FUND INVESTMENTS FOR AMERICAN WORKERS' PENSION PLANS

Senators ask GAO to report on returns, risk for employees' financial futures

Washington, DC – U.S. Senators Max Baucus (D-Mont.) and Chuck Grassley (R-Iowa) want to know more about American pension plans' investments in hedge funds, and whether those investments pose risks for workers' retirement security. In a letter to U.S. Comptroller General David Walker today, the Chairman and Ranking Republican on the Senate Finance Committee asked the Government Accountability Office (GAO) to investigate the scope of public and private pension plan investments in hedge funds, and what returns and risks are likely for workers' retirement funds.

"If the folks running retirement plans don't have the facts about hedge funds, we'll end up with the blind leading the broke," said Baucus. **"Now is the time for a careful, impartial assessment of just how many retirement dollars are going into hedge funds, and whether retirees can expect decent dollars to come back out. We need to know whether hedge funds are real asset builders or just risky business for retirement."**

"A secure pension needs reliable investments," Grassley said. "We don't know enough about hedge funds to know whether they make a pension plan more secure or more unsound. Pension security and PBGC solvency require getting a handle on hedge funds."

The text of the Senators' letter follows here:

March 1, 2007

The Honorable David M. Walker
Comptroller General of the United States
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Walker:

Defined benefit pensions are a vital source of post-employment income for millions of retired Americans. According to the Department of Labor, America's pension and retirement savings system includes over 735,000 plans with assets totaling over $7.5 trillion and covering roughly 125 million participants. Pressures for sufficient pension funding and adequate retirement savings have led pension plan sponsors to seek new and innovative ways to ensure that adequate resources exist to meet future pension obligations. One way that some employers have sought to increase returns on pension plan investments is to invest in hedge funds.

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Although there is no universal definition, hedge funds are generally private investment funds or pools that trade and invest in various asset classes such as securities, commodities, currency, and derivatives on behalf of clients. A hedge fund can engage in a wide variety of investment strategies other than hedging, such as taking both long and short positions, using arbitrage, buying and selling undervalued securities, trading options or bonds, and investing in almost any opportunity in any market where it foresees impressive gains at reduced risk. Historically, these funds have primarily served wealthy individual investors and are viewed by many experts as offering the potential for above-market returns in exchange for greater risk. Also, hedge fund investments are generally subject to less regulatory oversight than traditional investments.

Since the returns on hedge fund investments are often uncorrelated with returns on equity investments, pension funds can, in principle, reduce their overall risk exposure through the purchase of hedge funds. However if pension funds lack the expertise to evaluate the complex investment strategies that hedge funds employ, greater risks and losses could result. Sponsors may then be forced to cover these losses through higher contributions. Until recently, hedge funds were limited in how much pension plan equity they could receive, but the Pension Protection Act effectively eliminated such restrictions with regard to governmental pension assets, raising the prospect of even greater pension asset investment in such funds.

Little is known about the extent to which public and private sector pension systems are investing in these vehicles or the role of regulators in overseeing such investments. Of particular concern to the committee is the extent to which under-funded plans sponsored by financially weak employers may be investing in hedge funds in an attempt to quickly build plan assets, thereby exposing the plan, plan participants, and potentially PBGC and the taxpayer, to greater financial risk. Given the committee's interest in a sound U.S. retirement system, we ask that the GAO conduct a review of the extent to which both public and private pension plan sponsors are investing in hedge funds and the potential implications of these investments on the U.S. pension system. Specifically, we ask that you examine:

- What is known about the extent to which both public and private sector pension plan sponsors invest in hedge funds?
- How do pension plan sponsors evaluate which hedge fund to invest in (e.g., use of investment consultants)?
- What mechanisms exist to monitor pension fund asset allocation to ensure their investment in hedge funds is prudent?
- How do pension funds' hedge fund investment returns (net of fees) compare to the pension funds' net returns in other types of investments (e.g., stocks, bonds and index funds)?
- What benefits and risks do hedge fund investments pose to pension funds and their participants?
- What roles do the Department of Labor and other federal agencies play in regulating and monitoring public and private sector pension plans' use of hedge fund investments?

If you have any questions, please contact Judy Miller or Dean Zerbe at (202) 224-4515. Thank you for your assistance.

Sincerely yours,

Max Baucus Chairman	Charles E. Grassley Ranking Member

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