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401(K) PLANS

Issues Involving Securities Lending in Plan Investments

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Highlights

Highlights of GAO-11-359T, a testimony before the Special Committee on Aging, U.S. Senate

Why GAO Did This Study

Securities lending can be a relatively straightforward way for plan sponsors and participants to increase their return on 401(k) investments. However, securities lending can also present a number of challenges to plan participants and plan sponsors. GAO was asked to explain how securities lending with cash collateral reinvestment works in relation to 401(k) plan investments, who bears the risks, and what are some of the challenges plan participants and plan sponsors face in understanding securities lending with cash collateral reinvestment.

In this testimony, GAO discusses its recent work regarding securities lending with cash collateral reinvestment. GAO is making no new recommendations in this statement but continues to believe that the Department of Labor (Labor) can take action to help plan sponsors of 401(k) plans and plan participants to understand the role, risk, and benefits of securities lending with cash collateral reinvestment in relation to 401(k) plan investments. Specifically, GAO recommended that Labor provide more guidance to plan sponsors about fees and returns when plan assets are utilized in securities lending with cash collateral reinvestment, amend its participant disclosure regulation to include provisions specific to securities lending with cash collateral reinvestment information, and make cash collateral reinvestment a prohibited transaction unless the gains and losses for participants are more symmetrical.

View GAO-11-359Tor key components.
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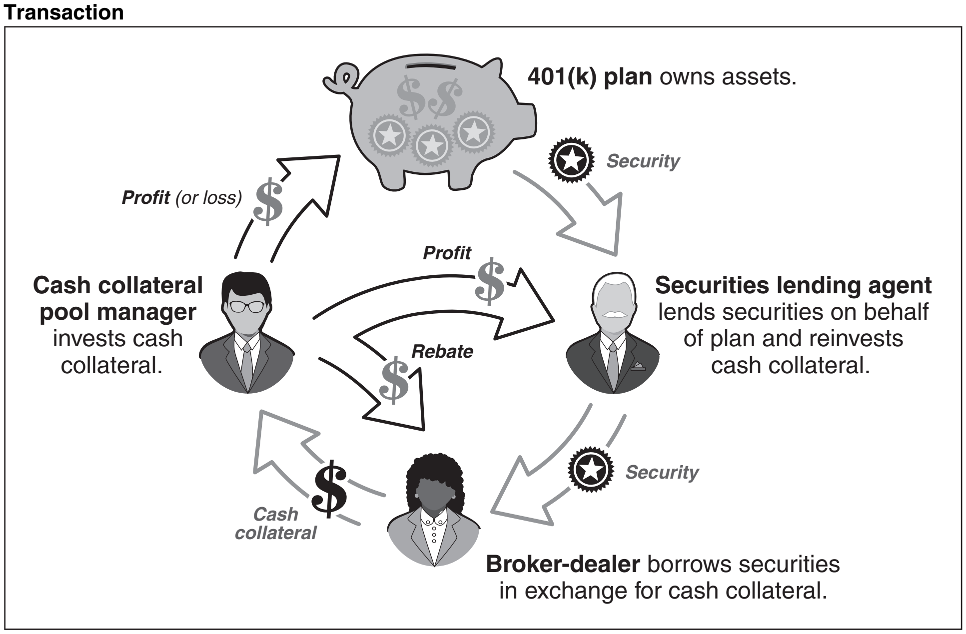
What GAO Found

Some 401(k) investment options that hold assets on behalf of plan participants lend out those assets for a period of time to a third party in exchange for collateral. In the United States, cash is the primary form of collateral taken in these securities lending transactions. When cash is received it is typically reinvested in a cash collateral pool to earn a greater return for participants. Many investment options offered by 401(k) plans engage in securities lending with cash collateral reinvestment, and the structure of the investment options offered by the plan affects the type of securities lending the plan engages in—direct or indirect securities lending—and the way the gains and losses are allocated to plan participants.

401(k) plan participants share any gains but fully bear any losses from cash collateral pool investments in the case of securities lending with cash collateral reinvestment. As shown in the figure below, 401(k) plan participants only receive a portion of the return when the reinvested cash collateral earns more than the amounts owed to others engaged in the transaction. In the past few years, risky assets in the cash collateral pool, which lost value and were difficult to trade, caused realized and unrealized losses to 401(k) plan participants.

Participants and some plan sponsors are often unaware that 401(k) plan investment options are engaged in securities lending with cash collateral reinvestment and that these arrangements can pose risks to plan participants. Current disclosures on these transactions are often not transparent, although certain government and private sector entities are taking steps to make these arrangements more transparent and less risky. GAO recommended that Labor also take action to assist plan sponsors in understanding, among other things, the potential gains and losses associated with the cash collateral pools, and to provide better guidance to plan sponsors and participants.

Example of a Separate Account Securities Lending with Cash Collateral Reinvestment Transaction



Source: GAO interviews and analysis of the practice of securities lending with cash collateral reinvestment.