

DOL Provides its View on Private Equity Investment Exposure in Defined Contribution Plans

Alert

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In a [new information letter](#), the U.S. Department of Labor (DOL) concludes offering professionally managed asset allocation funds, which include a private equity component as an investment option in an individual account plan (e.g., a 401(k) plan), is not a *per se* violation of ERISA. Plan fiduciaries commonly invest defined benefit pension plan assets in private equity in order to take advantage of the increased diversification and enhanced returns offered by private equity investments relative to publicly traded securities. In contrast, due to questions surrounding the ERISA fiduciary liabilities associated with having private equity investment exposure in an individual account plan, such plans have not offered participants investment options that include private equity exposure. As a result of the DOL's position in the information letter, this dichotomy may change soon. However, before plan fiduciaries jump to offer private equity investment exposure to plan participants, fiduciaries must consider that the information letter outlines a robust process to follow when determining whether to offer a professionally managed asset allocation fund with a private equity component in the plan's investment line-up.

THE SCOPE OF DOL'S CONCLUSION

In the June 3, 2020 information letter, the DOL concludes that a "plan fiduciary would not, in the view of the Department, violate the fiduciary's duties under section 403 and 404 [ERISA's fiduciary duty provisions] of ERISA solely because the fiduciary offers a professionally managed asset allocation fund with a private equity component as a designated investment alternative for an ERISA covered individual account plan." This conclusion does not, however, open the door to a plan fiduciary allowing plan participants to invest in any type of private equity arrangement.

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First, the DOL only considered the type of investment vehicle proposed by the private equity investment group requesting the letter, and therefore, the scope of the letter is limited to such investment vehicles. The proposed professionally managed asset allocation funds with a private equity component would be structured as a custom target date, target risk, or balanced fund, permitting only a certain portion of the fund's assets to be exposed to private equity. The remainder of the fund's assets would be invested in publicly traded securities or other liquid investments with established market values.

Second, the information letter's conclusion only applies to private equity investments that are components of larger, diversified multi-asset investment vehicles. The information letter does not address situations in which individual account plan participants are able to invest directly in private equity.

FACTORS THE PLAN FIDUCIARY MUST CONSIDER

In addition to concluding the inclusion of asset allocation funds with private equity components in a plan's investment line-up is not a *per se* violation of a plan fiduciary's duties under ERISA, the information letter describes the factors that a plan fiduciary must consider before deciding to include such an investment vehicle in the plan's investment line-up. The plan fiduciary must determine if it has the skills, knowledge, and experience necessary to understand the private equity component of the investment vehicle and to make the required determinations. If the plan fiduciary lacks these traits, it must engage a qualified investment adviser or professional to help it determine whether including an asset allocation fund with a private equity component in the plan's investment line-up is appropriate and, if so, assist in selecting a suitable asset allocation fund.

With respect to selecting a particular asset allocation fund with a private equity component, the plan fiduciary must follow a thorough, objective and analytical process that considers all relevant facts and compare the asset allocation fund with appropriate alternatives that do not include a private equity component. According to the DOL, during such a process a plan fiduciary must consider the following:

- Whether the fund's characteristics match the characteristics of the plan and the needs of its participants and beneficiaries (e.g., in light of the participants' ages, contribution and withdrawal patterns, employment turnover, etc., if the nature and duration of the fund's liquidity restrictions are appropriate)
- Whether the addition of the fund would allow participants to diversify investment risk while still earning an appropriate return (net of fees) over a multiple year period
- Whether the party controlling the fund has the requisite capabilities, experience, and stability to manage an investment with a private equity component, given the complexity of private equity activity
- Whether the private equity component of the fund has been appropriately limited in size (e.g., no more than 15% of the fund's assets are held in the private equity component)

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- Whether the fund has features to ensure it maintains sufficient liquidity to allow participants to receive benefit distributions and change their plan investment options as permitted by the plan's terms
- How the fund will value the private equity investments
- Whether plan participants will be given sufficient and adequate information regarding the fund to understand the risks associated with investing in a fund that includes a private equity component

Should a plan fiduciary decide to include an asset allocation fund with a private equity component in a plan's investment line-up, the DOL stresses that the plan fiduciary must continuously monitor such a fund to ensure that keeping it in the plan's investment line-up remains prudent.

For more information regarding the DOL information letter of ERISA fiduciary duties related to investment of plan assets, please contact [Sam Butler](#), [Elizabeth Delagardelle](#), [Tom Dowling](#), [Phil McKnight](#), [Lisa Rippey](#) or the Stinson LLP contact with whom you regularly work.

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