

# DOL Issues Guidance on Private Equity Investments in 401(k) Plans

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The Department of Labor (DOL) recently issued guidance in the form of an Information Letter describing the process that plan fiduciaries should undertake in determining whether an investment fund having a private equity component satisfies ERISA fiduciary standards. Specifically, the DOL emphasized that there are factors unique to such investment funds that should be considered as part of a prudent process.

## Description of the Fund

The fund at issue was structured as a professionally managed asset allocation fund to be offered as a designated investment alternative under a participant-directed plan. The fund's overall exposure to private equity investments was limited to a target allocation, with the remainder of the fund's portfolio invested in publicly traded securities or other liquid investments with readily ascertainable market values. The fund was to be offered as a custom target date fund, target risk fund or balanced fund, and could be structured as a pooled investment vehicle – such as a collective trust fund – or a separately managed account.

Note: The DOL guidance only addressed the decision to offer a managed asset allocation fund that had a private equity component; it did not address the selection of private equity investments offered directly as investment options to participants.

## Prudent Process

The DOL acknowledged that in evaluating investments to be offered as designated investment alternatives, plan fiduciaries must engage in an objective, thorough and analytical process that considers all of the relevant facts and circumstances. The DOL pointed out that, as applied to the fund at issue, certain factors unique to private equity investments should be considered, including the following:

- Oversight: Is the proposed fund overseen by plan fiduciaries (using third-party investment experts as necessary) or is it managed by investment professionals with the experience,

capability and stability to manage these types of investments?

- **Liquidity:** Does the proposed fund provide sufficient liquidity for participants to receive benefits and make direct exchanges among the plan's other investment options? The DOL noted that to address this issue, a plan fiduciary could require that private equity investments by the fund be limited to a specific percentage.
- **Valuation:** Does the proposed fund appropriately value the private equity investment, for example, according to independent valuation procedures such as the Financial Accounting Standards Board Accounting Standards Codification (ASC) 820?
- **Alignment with Plan's Characteristics:** Does the proposed fund align with the characteristics and needs of the participants, taking into account the fund's allocation and strategy, fees/expenses, liquidity restrictions and the ability of participants to access their funds (e.g., to obtain plan loans and distributions) and/or change their investment selections?
- **Diversification.** Does offering the proposed fund provide participants with more diversified investment options within an appropriate range of expected returns (net of fees) and risks over a multi-year period?
- **Adequacy of Information:** Does the proposed fund provide adequate information regarding its character and risks to enable participants to make an informed decision regarding an investment in the fund? The DOL stressed that disclosure of this information would be especially important for fiduciaries who claim limited fiduciary liability under the ERISA section 404(c) safe harbor to establish that participants had investment control over their plan accounts.
- **Seek Expert Assistance if Needed:** Do the plan fiduciaries have the skill, knowledge and experience to make the required determinations about the proposed fund? If not, the DOL pointed out that the plan fiduciaries should consider seeking advice from a qualified investment adviser or other investment professional.

Plan fiduciaries that are considering a managed asset allocation fund with a private equity component as a designated investment alternative to be offered under the plan should follow the guidelines set forth above in determining whether the fund is a prudent investment option.

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