Published on *The National Law Review* https://natlawreview.com

Private Equity Investments In 401(K) Plans – The DOL Says Not So Fast

Article By:

Adam B. Cantor

Hot button ERISA fiduciary issues remain a focus for investment committees of 401(k) plans in 2022. From "excessive" fee litigation – including litigation over the duty to monitor the fees charged by various mutual funds made available to plan participants (the U.S. Supreme Court reaffirmed this duty in January 2022) – to the U.S. Department of Labor's (the "DOL's") evolution in its position on investments in environmental, social, and governance ("ESG") funds – making pecuniary gain one factor, but not the sole factor, relevant to ERISA fiduciaries in deciding whether to invest in ESG funds – to the DOL's issuance of a "supplemental statement" noting its concerns with including private equity ("PE") investments in designated investment alternatives offered under defined contribution plans, the 401(k) plan investment landscape has become significantly more challenging for ERISA fiduciaries to navigate.

The DOL's recent guidance on private equity investments is a case in point. On June 3, 2020, the DOL issued an Information Letter regarding PE investments in designated investment alternatives made available to participants and beneficiaries in defined contribution plans. In the Information Letter, the DOL took the position that PE investments are more complex, illiquid and difficult to value than more traditional investments and, therefore, that ERISA fiduciaries seeking to add or maintain as a plan investment option an asset allocation fund (e.g., a target date, target risk, or balanced fund) that includes such investments must exercise a heightened level of review and diligence in their investment decision making.

To satisfy this heightened level of review and diligence, not only would ERISA fiduciaries need to undertake several DOL-prescribed steps to evaluate the PE investments thoroughly, but they also would need to ensure adequate disclosure of investment objectives and risks to plan participants and beneficiaries and "consider whether [they (the ERISA fiduciaries) have] . . . the skills, knowledge, and experience to make the required determinations or whether [they (the ERISA fiduciaries)] . . . need to seek assistance from a qualified investment adviser or other investment professional."

In short, the DOL put ERISA fiduciaries on notice that the bar for including PE investments in the funds offered under the plan is a high one. However, the DOL concluded that ERISA fiduciaries would not violate ERISA's fiduciary standards solely because they offer a professionally managed asset allocation fund with a PE component as a designated investment alternative under a defined contribution plan, provided that the requirements of the Information Letter are satisfied.

Fast forward to December 21, 2021. In a Supplemental Statement, the DOL, focusing on a Securities and Exchange Commission ("SEC") "Risk Alert" issued shortly after issuing the Information Letter – in which the SEC raised compliance concerns (conflicts of interest, fees, and policies regarding the use of material non-public information) for investment advisors managing PE funds and hedge funds – and concerns raised by various stakeholders regarding the Information Letter, "concluded that it should supplement the Information Letter to ensure that plan fiduciaries do not expose plan participants and beneficiaries to unwarranted risks by misreading the letter as saying that PE – as a component of a designated investment alternative – is generally appropriate for a typical 401(k) plan."

The DOL clarified that the Information Letter is to be construed as applying only to its limited facts – i.e., that PE investments may be appropriate for a defined contribution plan if a plan-level fiduciary who has experience in evaluating PE investments in a defined benefit pension plan enlists the assistance of an investment advisor in evaluating such investments for the defined contribution plan: "Except in this minority of situations, plan-level fiduciaries of small, individual account plans are not likely suited to evaluate the use of PE investments in designated investment alternatives in individual account plans."

Investment committees of 401(k) plans should take heed of the DOL's concerns raised in the Information Letter and the Supplemental Statement. The key takeaways regarding adding or maintaining an asset allocation fund including PE investments are:

- Ensure adequate disclosure of the fund's investment objectives and risks to plan participants and beneficiaries.
- Review and analyze, with respect to any PE investments, the investment valuations, the extent of investment illiquidity and fees, conflicts of interest, and other SEC-raised concerns.
- Enlist the assistance of a registered investment advisor to evaluate the PE investments and the fund as a whole.
- Carefully consider whether members of the committee have experience in evaluating PE investments in a defined benefit pension plan, which appears to be a *de facto* requirement of the Supplemental Statement.

National Law Review, Volume XII, Number 35