

CLIENT ALERT

DOL Information Letter Opens Door for Private Equity Investments by Defined Contribution Plan Participants

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In an [Information Letter](#) issued on June 3, 2020 (the “**Letter**”), the Department of Labor (the “**DOL**”) concluded that a professionally-managed asset allocation fund with a private equity component can be a prudent investment alternative to include in the investment lineup for individual account plans subject to the Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), such as 401(k) and other defined contribution plans (“**DC Plans**”). By issuing the Letter, the DOL has provided clarity on certain ERISA fiduciary issues that have historically impeded the inclusion of private equity investments in DC Plan investment lineups and potentially created a significant new source of capital for the private equity industry.

Eugene Scalia, the U.S. Secretary of Labor, has been quoted as saying “The Letter helps level the playing field for ordinary investors and is another step by the [DOL] to ensure that ordinary people investing for retirement have the opportunities they need for a secure retirement.” Jay Clayton, the Chairman of the Securities and Exchange Commission (the “**SEC**”), said the Letter “will provide our long-term Main Street investors with a choice of professionally managed funds that more closely match the diversified public and private market asset allocation strategies pursued by many well-managed pension funds as well as the benefit of selection and monitoring by ERISA fiduciaries.”

The Letter contemplates that private equity investments would be offered to participants in a DC Plan as part of a professionally-managed custom target date, target risk or balanced fund in which there is a sufficient pool of assets to diversify the exposure of plan participants to the private equity investments with other investments in a range of asset

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classes with different risk and return characteristics and investment horizons. This could be accomplished in several ways, including as a pre-packaged fund-of-funds structured as a collective investment trust or other pooled vehicle, or as a separately managed account with investment responsibilities delegated to a qualified investment manager. The Letter does not address fiduciary issues involved with a DC Plan allowing individual participants to invest their accounts directly in private equity funds, although the Letter explains that such investments raise distinct legal and operational issues for plan fiduciaries.

The Letter does not absolve a plan fiduciary of its duty to prudently select and monitor any designated investment alternatives under the plan or shield them from liability for failure to satisfy this duty. As a result, plan fiduciaries will still need to engage in an objective, thorough, and analytical process that considers all relevant facts and circumstances in evaluating any particular asset allocation fund for inclusion in the DC Plan's investment lineup (a "**prudent process**"). However, the Letter identifies the following factors that plan fiduciaries should consider in evaluating whether to include a particular asset allocation fund with a private equity component as a designated investment alternative:

- whether adding the particular asset allocation fund would offer plan participants the opportunity to invest their accounts among more diversified investment options within an appropriate range of expected returns (net of fees) and diversification of risks over a multi-year period;
- whether the asset allocation fund is overseen by investment professionals who have the capabilities, experience and stability to manage such fund, given the nature, size and complexity of private equity activity;
- whether the asset allocation fund limits the allocation to private equity investments in a manner that will permit the fund to provide liquidity for participants to take benefits and direct exchanges among the plan's investment lineup consistent with the plan's terms, with the DOL suggesting that plan fiduciaries consider the SEC rules that include a 15% limit on illiquid investments applicable to registered open-end investment companies as a guide;
- whether the private equity investments of the asset allocation fund are independently valued in accordance with existing accounting standards and whether the fund is able to provide the additional disclosure necessary to meet the plan's ERISA obligations to report information about the current value of the plan's investments (e.g., a daily "NAV" or net asset value);
- whether the asset allocation fund will meet the needs of the plan's participants, taking into account the plan participant population (including ages, normal retirement age, anticipated employee turnover and contribution/withdrawal patterns) and the fund's investment allocation and strategy, fees and other expenses, the nature and duration of any liquidity restrictions, the participants' ability to access funds in their accounts for plan loans and distributions, and the ability to change investment selections on a frequent basis; and

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- the adequacy of information that will be made available to plan participants to enable them to make an informed assessment regarding making or continuing an investment in such asset allocation fund.

In the Letter, the DOL concludes that “[t]here may be many reasons why a fiduciary may properly select an asset allocation fund with a private equity component as a designated investment alternative for a participant directed individual account plan” and the selection of such a fund for inclusion in a DC Plan’s lineup following engagement in a “prudent process” will not result in a breach by a plan fiduciary of its ERISA fiduciary duties. As Jeanne Klinefelter Wilson, the Employee Benefits Security Administration Acting Assistant Secretary, put it: “this [L]etter should assure defined contribution plan fiduciaries that private equity may be part of a prudent investment mix and a way to enhance retirement savings and investment security for American workers.”

While the Letter does not require DC Plan fiduciaries to include an asset allocation fund with a private equity component in its investment lineup, we expect that many DC Plan fiduciaries will start evaluating the merits of including investment alternatives that will provide plan participants with exposure to private equity investments. As DC Plan fiduciaries conclude that an asset allocation fund with a private equity component should be included in the plan’s investment lineup, many plan participants will be able to gain exposure to private equity investments that were not previously available to them. It could also provide the private equity industry with access to a significant new source of capital and likely foster the creation of many new custom target date, target risk and balanced funds that include a private equity component.

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