

MEMO# 32506

June 3, 2020

DOL Guidance on Private Equity Investments within 401(k) and Other Defined Contribution Plans

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June 3, 2020 TO: ICI Members
Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension RE: DOL Guidance on Private Equity Investments within 401(k) and Other Defined Contribution Plans

On June 3, 2020, the Department of Labor (the “Department”) issued an Information Letter to Groom Law Group providing its views on the use of private equity investments within 401(k) and other defined contribution (DC) plans.[\[1\]](#) The Information Letter, issued to Groom on behalf of two of its clients, makes clear that 401(k) fiduciaries can prudently include private equity as a component of an ERISA plan’s diversified investment option, such as a target date fund. In doing so, the letter provides a framework of relevant factors for plan fiduciaries to consider if they choose to explore private equity as a component of a larger diversified, managed fund.

The guidance is similar to previous pronouncements by the Department in laying out investment considerations for novel types of investments such as derivatives, liability-driven investment strategies and annuities. The Information Letter confirms that ERISA does not prohibit plan fiduciaries from making available an allocation to private equity as part of a DC plan investment option so long as it is done “. . . in a manner consistent with the requirements of Title I of ERISA.” The Department acknowledges 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.”

The Department further explains that the plan investment option might be a custom target date fund, target risk fund, or a balanced fund that would provide participants with exposure to a range of asset classes. Additionally, the Department states that this type of fund could be structured in multiple ways, including as a separately managed account managed by a plan investment committee or managed by an investment manager exercising delegated investment responsibility, or as a pre-packaged fund-of-funds structured as a collective investment trust or other pooled vehicle. The Department clarified, however, that the guidance does not address vehicles that would allow a

participant to investment in private equity directly, and that such investments present distinct legal and operations issues.

The Information Letter identifies the following considerations as important in analyzing a private equity allocation by DC plan fiduciaries:

- The impact of the private equity allocation on the plan investment option in terms of diversification and expected return net of fees, including management and performance fees, on a long-term basis;
- Whether the plan fiduciaries overseeing the asset allocation fund have the requisite skills to evaluate and monitor private equity investments or should use an investment consultant or delegate investment selection authority to an investment manager;
- The percentage of the investment option to be invested in the private equity component. In this respect, the Department noted that the Securities Exchange Commission had adopted a regulation that sets forth a 15 percent limitation on investment in illiquid assets for registered open-end investment companies;
- Whether the investment option will include features regarding liquidity and valuation that allow participants to take benefit distributions and exchange into other plan investment options in a manner consistent with plan terms. In this respect, the Department noted that Groom's clients--Pantheon Ventures (US) L.P. (Pantheon) and Partners Group (USA), Inc.-- have developed private equity investment products containing a liquidity component to manage participant directed deposits and withdrawals. The Department also suggested that fiduciaries confirm that private equity investments will be valued according to accounting standards and that private equity fund investments be subject to an annual audit.
- Whether the long-term nature of private equity investments and any potential liquidity restrictions align with the plan participant population, in terms of how participant age, employee turnover, contribution and withdrawal patterns may affect the ability of participants to take distributions or change investment options with the frequency they would desire; and
- The adequacy of disclosures to be provided to participants regarding the character and risks of the plan investment option that includes a private equity component, so as to allow participants to make an informed assessment as to whether to invest in the investment option.

Finally, the Department clarifies that the Information Letter did not address whether the structure, investments, or fees involved in a private equity allocation could raise issues under the prohibited transaction rules of ERISA.

David M. Abbey
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endnotes

[\[1\]](#) A copy of the Information Letter is *available at*

<https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020>. The Department's press release regarding the Information Letter is available at <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200603-0>.

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