

Goodwin Alerts

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DOL Release May Increase ERISA Defined Contribution Plan Interest in Private Equity Investments

by Patrick S. Menasco

On June 3, 2020, the U.S. Department of Labor issued an information letter concluding that a plan fiduciary would not violate ERISA's fiduciary duties 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, such as a 401(k) plan.^[1] The letter also offers a roadmap for plan fiduciaries considering such an investment option. The letter was released with uncommon fanfare, including a press release quoting both the Secretary of Labor and Chairman of the Securities and Exchange Commission, indicating that it was of particular interest to the current administration. The release is available [here](#).

Historically, some individual account plan fiduciaries have been wary of investment products that include private equity components due to the complex organizational structures, complex fees, valuation issues and lack of liquidity often associated with such strategies. While the selection of such products remains subject to ERISA's fact-intensive fiduciary duties, the letter may remove a perceived chill on the consideration of longer-term, complex assets that may otherwise form part of a prudent investment strategy for individual account plans. Thus, the letter may result in an increased interest in asset allocation options with private equity components, including widely-used "target date", "target risk" or "balanced" fund options.

The extent to which the letter will result in significant changes in plan or market practices is unclear, however. Some individual account plans already include options with private equity components, while others will continue to view the relatively high fees and complexities associated with private equity to be prohibitively risky relative to index funds and other mainstream options. Further, while the letter is helpful in reviewing the lengthy list of relevant prudential considerations (and opportunities for mistakes), it offers no legal protection, including from suits by private plaintiffs. As informal guidance, the letter lacks the force and effect of law and is generally entitled to no deference by the courts, other than to the extent of its power to persuade.^[2] Still, informal guidance that is well reasoned and stands the test of time tends to be respected by the regulator, as well as plan fiduciaries and other regulated entities. Also, the letter represents the views of the current administration, which is responsible for the enforcement of ERISA (although such views may change with administrations).

A fiduciary of an ERISA-covered individual account plan is required to prudently select and monitor designated investment alternatives, considering all relevant facts and circumstances. In selecting an asset allocation option that includes a private equity component, the Department explains in the letter that "the fiduciary must engage in an objective, thorough, and analytical process that compares the asset allocation fund with appropriate alternative funds that do not include a private equity component, anticipated opportunities for investment diversification and enhanced investment returns, as well as the complexities associated with the private equity component." A private equity component injects special concerns into this process, including the potential for: (i) complex organizational structures and strategies, relatively long time horizons, higher fees and unique valuation methodologies, (ii) investment concentrations, (iii) the application of "operating company" exemptions from ERISA coverage, (iv) restricted liquidity for participant withdrawals, and (v) misalignment with plan characteristics and participant needs.

The letter specifically excludes the offering of direct investments in private equity funds to plan participants. It is unlikely that the Department would find such offerings to be prudent, given its view that many plan participants might not be able to understand such investments on their own. Even as to plan fiduciaries, the Department

cautions that, “as with any designated investment alternative, the plan fiduciary must consider whether it has the skills, knowledge, and experience to make the required determinations or whether the plan fiduciary needs to seek assistance from a qualified investment adviser or other investment professional.” Further, direct investing would raise significant issues under the securities laws.

The letter is available [here](#).

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Goodwin has served as legal counsel to plan fiduciaries and private fund managers on a wide range of ERISA investment matters for over four decades. Please contact [Patrick Menasco](#), Co-Chair of Goodwin’s [ERISA & Executive Compensation](#) practice, or any other member of the Goodwin ERISA practice for further information.

^[1] While the letter specifically addressed private equity, its reasoning may be extended to other complex, high fee investments, such as direct real estate and venture capital.

^[2] *Christensen v. Harris County*, 529 U.S. 576 (2000) (Department of Labor opinion letter insufficiently persuasive and therefore unworthy of deference).

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