

DOL OUTLINES PATH FOR 401(K) PLANS TO INVEST IN PRIVATE EQUITY

The Department of Labor (“DOL”) issued an [Information Letter](#) on June 3, 2020 outlining its views on how 401(k) plans may include private equity investments in designated investment alternatives. The DOL indicated that a plan fiduciary of a 401(k) plan may offer an asset allocation fund with a private equity component in a manner consistent with the requirements of Title I of the Employee Retirement Income Security Act of 1974 (“ERISA”).

Under Title I of ERISA, plan fiduciaries have duties to prudently select and monitor any designated investment alternative under the plan, and liability for losses resulting from a failure to satisfy those duties. In evaluating a particular investment alternative for consideration as a designated investment alternative, the fiduciary must engage in an objective, thorough, and analytical process that considers all relevant facts and circumstances and then act accordingly. Without ERISA Title I guidance, plan sponsors were concerned that they may have fiduciary liability even when they believe that providing prudently selected and monitored exposure to private equity investments is in the best interest of the plan participants

In the DOL’s view, a plan fiduciary would not violate its fiduciary’s duties under Title I of ERISA solely because the fiduciary offers a professionally managed asset allocation fund with a private equity component as a designated investment alternative for a 401(k) plan in the manner described in the Information Letter. The DOL indicated that there 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 401(k) plan. In making such a selection for a 401(k) plan, 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.

In evaluating whether to include a particular investment vehicle with an allocation of private equity as a designated investment alternative, the responsible plan fiduciary must evaluate the risks and benefits associated with the investment alternative. In making this determination, the fiduciary should consider (i) whether adding the particular asset allocation fund with a private equity component 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 (including management fees, performance compensation, or other fees or costs that would impact the returns received) and diversification of risks over a multi-year period; (ii) whether the asset allocation fund is overseen by plan fiduciaries (using third-party investment experts as necessary) or managed by investment professionals that have the capabilities, experience, and stability to manage an asset allocation fund that includes private equity investments effectively given the nature, size, and complexity of the private equity activity; and (iii) whether the asset

allocation fund has limited the allocation of investments to private equity in a way that is designed to address the unique characteristics associated with such an investment, including cost, complexity, disclosures, and liquidity, and has adopted features related to liquidity and valuation designed to permit the asset allocation fund to provide liquidity for participants to take benefits and direct exchanges among the plan's investment line-up consistent with the plan's terms.

The Information Letter does not address any fiduciary or other ERISA issues that would be involved in a 401(k) plan allowing individual participants to invest their accounts directly in private equity investments. Such direct investments in private equity investments present distinct legal and operational issues for fiduciaries of 401(k) plans.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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