

ALERTS

DOL Confirms Private Equity Can Be Small Components of Defined Contribution Plan Investments

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Earlier this month, the U.S. Department of Labor (“DOL”) issued an Information Letter confirming the widely held view that private equity can be small components of professionally managed diversified investment portfolios, such as target date funds and balanced funds, offered to participants in 401(k) plans and other defined contribution plans. The Information Letter identifies a number of specific factors that a plan fiduciary of a defined contribution plan, who is evaluating the addition of an investment portfolio using private equity, must consider to meet its fiduciary obligations under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

While ERISA does not expressly restrict private equity as an investment in defined contribution plans, the inherent qualities of private equity restrict it from being offered directly as an investment alternative in a participant-directed plan. Accordingly, investments in private equity are more commonly utilized by defined benefit pension plans. In compliance with the general fiduciary principles imposed by ERISA, however, various defined contribution plans have also offered managed investment portfolios with private equity components (as well as other private investment fund components).

Noting the important differences between private equity funds and publicly traded investments (e.g., more complex organizational structures, investment strategies, fee structures and longer time horizons), the Information Letter describes a number of considerations that, in the view

of the DOL, plan fiduciaries of defined contribution plans must evaluate when contemplating an investment portfolio using private equity. The DOL does not, however, clarify in the Information Letter what weight plan fiduciaries should assign to each of these considerations. None of the considerations and issues noted by the DOL are unexpected and likely would otherwise have been a necessary part of a fiduciary's analysis to meet ERISA's obligations.

Among the reasons for the DOL's issuance of the Information Letter is "to address uncertainties regarding ERISA that may be impeding plan fiduciaries from considering private equity investment opportunities." Importantly however, the DOL also cautioned that the Information Letter:

"Does not address any fiduciary or other ERISA issues that would be involved in a defined contribution 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 ERISA-covered individual account plans."

Such legal and operational issues primarily refer to federal securities laws and the lack of liquidity inherent to private equity and generally inapposite to the tax law-required design of defined contribution pension plans. Accordingly, it is unlikely that the Information Letter will result in a surge of private equity investments by defined contribution plans.

Authored by Ronald E. Richman, David M. Cohen, Ian L. Levin, Susan E. Bernstein and Melissa J. Sandak.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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Related People



**Ronald
Richman**

Partner
New York



**David
Cohen**

Partner
New York



**Ian
Levin**

Partner
New York



**Susan
Niver**

Special Counsel
New York

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