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DOL Statement on Private Equity Investment Emphasizes Fiduciary Responsibility

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On December 21, 2021, the Department of Labor (the "DOL") published a Supplemental Statement (the "Supplemental Statement") to its June 3, 2020 Information Letter (the "2020 Letter") addressing fiduciary considerations for including private equity within an investment option under an ERISA-covered defined contribution plan (*e.g.*, a 401(k) or 403(b) plan). In response to questions and reactions that the DOL received from a "range of stakeholders" regarding the 2020 Letter, as well as a "Risk Alert" that the SEC issued in June 2020 regarding compliance issues for managers of private equity and hedge funds, the Supplemental Statement advised that the 2020 Letter should not be "misread[] . . . as saying that PE – as a component of a designated investment alternative – is generally appropriate for a typical 401(k) plan."

So how did we get here, and what does this mean?

Many investment options under defined contribution plans include exposure to private equity, and plan fiduciaries often consider adding new asset classes to plan lineups, or to investments within plan lineups, for diversification and potential upside. For a long time, stakeholders have craved clarity on how ERISA's fiduciary rules apply to these investments; and challenges to the prudence of alternative investment strategies are actively being litigated.

The 2020 Letter was welcomed by many because the DOL stated affirmatively that an investment option under a defined contribution plan could have an allocation to private equity—albeit "limited," which the DOL suggested meant not more than 15%. However, the 2020 Letter also had many caveats, including a statement that it did not address private equity being offered as a standalone investment option (noting that direct investments in private equity present "distinct legal and operational issues"), and highlighting a range of considerations for plan fiduciaries to address, with no safe harbor. Still, its positive tone generated increased interest from plan fiduciaries and asset managers.

The Supplemental Statement is more cautionary, emphasizing that the DOL "did not endorse or recommend" offering designated investment alternatives with private equity components, and that it wanted "to ensure that plan fiduciaries do not expose plan participants and beneficiaries to unwarranted risks by misreading" the 2020 Letter as saying that these investments are "generally appropriate for a typical 401(k) plan."

The Supplemental Statement highlights the following key points:

- The DOL agrees with some stakeholders that representations in the 2020 Letter about the benefits of private equity investments were void of counter-arguments and research data from independent sources outside of the private equity industry.
- Plan fiduciaries have a responsibility to be prudent in selecting and monitoring any investment alternative. Understanding and evaluating exposure to private equity is part of this responsibility.
- As explained in the 2020 Letter, prudent evaluation of private equity requires specialized expertise. Fiduciaries considering private equity must have this expertise or seek it from qualified managers or advisers. The DOL is concerned that a "typical" plan fiduciary might not have the expertise.

Ultimately, the Supplemental Statement does not change the bottom line from the 2020 Letter. Limited private equity allocations within a defined contribution plan investment are still permitted. The Supplemental Statement simply highlights the importance of rigorous analysis when evaluating the prudence of an investment, and it stresses the particular complexity of private equity.

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We doubt the Supplemental Statement will be the last word on this topic. We will continue to monitor developments.

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