DOL Issues Supplemental Guidance on DC Plan Private Equity Investments

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On December 21, 2021, the Department of Labor ("DOL") issued a statement concerning the investment in private equity by ERISA-covered defined contribution plans (the "Statement," available here). The Statement is intended to supplement the June 3, 2020 Information Letter ("Information Letter," summary available here) that discussed including private equity as a component of a plan's asset allocation fund(s) (*e.g.*, a target date fund). The Statement does not amend or rescind the Information Letter. However, it does emphasize some of the key fiduciary considerations and attempts to limit the scope of the prior guidance.

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I. Background

DOL issued the Information Letter last year in response to requests for the agency to provide guidance with respect to the use of private equity investments in the context of defined contribution plans. DOL took the position that defined contribution plans can invest in private equity, stating that a fiduciary "may offer an asset allocation fund with a private equity component… in a manner consistent with the requirements of Title I of ERISA." DOL also provided an analytical framework for fiduciaries to use when considering a fund that includes private equity investments.

Now, the Biden Administration DOL has determined that it is necessary to prevent any misreading of the Information Letter by providing supplemental guidance. DOL has two rationales for this decision.

DOL's first justification for the Statement is that the agency has heard concerns from (unnamed) stakeholders that the recitation of the requestors' representations in the Information Letter could be perceived as an endorsement of private equity. This justification is curious as DOL routinely summarizes the facts presented by requestors and then provides an interpretation of the law. Examples include guidance addressing commodities and financial futures contracts adopted by the Reagan Administration in 1982 and 1987;[1] derivatives adopted by the Clinton Administration in 1996;[2] liability-driven investment strategies adopted by the Bush Administration in 2006;[3] and target date funds that include allocations to annuities adopted by the Obama administration in 2016.[4] There is no indication that such guidance has ever been viewed as an "endorsement" of the particular investment or investment strategy being discussed.

DOL's second justification is the release of a Risk Alert by the Securities and Exchange Commission's ("SEC") Office of Compliance Inspections and Examinations (available here) shortly after DOL's issuance of the Information Letter. The Risk Alert summarizes certain private fund compliance issues and offers guidance to fund advisers. However, this, too, is curious as the Information Letter explicitly states that DOL coordinated with SEC, so presumably, DOL knew about SEC's private fund enforcement efforts, including the Risk Alert's conclusion regarding the effectiveness of SEC's enforcement efforts and the changes in the industry.

II. The Statement

The Statement begins by reiterating DOL's view articulated in the Information Letter that "a plan fiduciary would not… violate the fiduciary's duties under section 403 and 404 of ERISA solely by reason of offering a professionally managed asset allocation fund with a [private equity] component as a designated investment alternative subject to important conditions set forth in the [Information Letter]." However, the Statement makes two clarifications.

First, the Statement clarifies that the representations in the letter do not reflect the views of all stakeholders and were "not balanced with counter-arguments and research data from independent sources." However, unlike the Information Letter, there is no data cited in the Statement to support this concern, and indeed, the liberal think tank the Urban Institute recently released a study further documenting the potential benefits of including private equity as an asset class in professionally managed accounts (available here). DOL then articulates the concerns of the stakeholders regarding private equity funds' performance disclosures, the lack of liquidity, and the challenge participants may have in understanding the investment. Notably, all of those issues were addressed in the Information Letter.

[1] DOL Information Letter to Donna J. Hollis (Nov. 24, 1987); DOL Advisory Opinion 82-49 (Sept. 21, 1982).

[2] DOL Information Letter to Eugene Ludwig (Mar. 21, 1996).

[3] DOL Advisory Opinion 2006-08 (Oct. 3, 2006).

[4] DOL Information Letter to Christopher Spence (Dec. 22, 2016).

Second, the Statement clarifies DOL's view that the Information Letter was intended to provide guidance to large plan fiduciaries who already have experience with private equity because they manage defined benefit plans. DOL states that only a minority of small plan fiduciaries are suited to evaluate the use of private equity. However, the agency does not explain why it is appropriate to use plan size as a proxy for fiduciary sophistication or why a small plan fiduciary could not rely on a sophisticated mutual fund company, professional investment manager or adviser to construct a portfolio that prudently allocates funds to private equity.

III. Observations

The views expressed in the Statement are, from a legal perspective, largely consistent with the Information Letter. The Statement reiterates some of the key issues fiduciaries should consider when evaluating an investment that includes a private equity component, and it emphasizes the need for plan fiduciaries to understand the investments they are considering. In our experience, the Information Letter was not viewed as an endorsement of the practice of utilizing private equity in defined contribution plans. Similarly, it is not clear that the Statement will be viewed as discouraging (or encouraging) the practice, provided a fiduciary follows an appropriate process in making such a decision. Although DOL is clearly attempting to cabin in the application of the Information Letter, there is no reason to believe a fiduciary would violate his/her duties under ERISA by operating within the four corners of the Information Letter, regardless of the size of the plan.