



June 3, 2020

Jon W. Breyfogle, Esq.
Groom Law Group, Chartered
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

Dear Mr. Breyfogle:

You asked on behalf of Pantheon Ventures (US) L.P. (Pantheon) and Partners Group (USA), Inc. (Partners Group), for the views of the Department of Labor (Department) on the use of private equity investments in designated investment alternatives made available to participants and beneficiaries in individual account plans, such as 401(k) plans, subject to the Employee Retirement Income Security Act of 1974 (ERISA).¹

Your inquiry involves the use of private equity investments within professionally managed asset allocation funds that are designated investment alternatives for participant-directed individual account plans. Both Pantheon and Partners Group have developed private equity investments designed to be used as a component of a managed asset allocation fund in an individual account plan. Both investments are offered as collective investment trusts that invest in private equity and have a liquidity component to manage the participant directed deposits and withdrawals from the fund.

You represent that these investment alternatives offer plan participants who have longer investment horizons an equities-based investment choice that may enhance retirement outcomes when compared to investment choices containing only publicly traded securities.² You note that asset allocation funds with a private equity component could give individual participants access to the type of asset allocation used by many actively managed defined benefit plans for various purposes, including diversifying investment risk and enhancing investment returns.³ You state that certain private equity investments may present

¹ The Department has also been coordinating its consideration of your request with the Chairman of the Securities and Exchange Commission who urged the Department to address uncertainties regarding ERISA that may be impeding plan fiduciaries from considering private equity investment opportunities as a way to enhance retirement savings and investment security for American workers. The Committee on Investment of Employee Benefit Assets Inc. (CIEBA) also submitted a letter to the Department in support of guidance being issued in this area. According to CIEBA's website, it is the largest organization of corporate pension investment officers, represents more than 110 of the country's largest pension funds, and its members manage more than \$2 trillion of defined benefit and defined contribution plan assets on behalf of more than 17 million plan participants and beneficiaries.

² You cited a study modeling investment returns over time in the target date fund context. See *The Evolution of Target Date Funds: Using Alternatives to Improve Retirement Outcomes*, Georgetown University Center for Retirement Initiatives, Policy Report 18-01 (June 2018).

³ You cited a study showing that defined benefit plans frequently invest a portion of their assets in private market assets, such as private equity investments, private company debt, and real estate to diversify investment risk and to enhance investment returns. You noted that the study indicates that defined benefit plans that invest in private equity investments hold, on average, 19% of their assets in private market investments. See *Center for Retirement Research at Boston College, Public Plans Database (2018)* (represents average weighted by plan size) (at <https://publicplansdata.org/quick-facts/national/>). You also pointed to developments in other countries where pension regulators are revising their guidance related to defined contribution plan investment in private equity. The Pensions Regulator (a component of the United Kingdom's Department

the opportunity for enhanced diversification of investment risk and for greater returns on participant investments than could be achieved solely in the public market. You indicate that there has been a reduction in the number of public companies over the past 20 years, and that many companies now access private capital in lieu of public markets for longer periods of time.⁴ As a result, you represent that some private equity investments may offer the potential for enhanced returns over time by giving investors a stake in privately held companies during their early growth stages. You also state that private equity investments may also contribute to diversification and provide a hedge against market downturns by offering investment opportunities that do not move in tight lockstep with the broader public market.

You indicate that private equity investments would be offered as part of a multi-asset class vehicle structured as a custom target date, target risk, or balanced fund. Each asset allocation fund with a private equity component would have a sufficient pool of assets to diversify the exposure of plan participants to the private equity investments with other investments in a range of asset classes with different risk and return characteristics and investment horizons. The asset allocation fund's overall exposure to private equity investments would have a target allocation that does not exceed a specified portion of the fund's assets, with the remainder of the fund's portfolio invested in publicly traded securities or other liquid investments with readily ascertainable market values. In this manner the fund would be designed to provide sufficient liquidity to participants to take benefit distributions and direct exchanges among the plan's investment line-up in accordance with plan terms and to meet periodic capital calls on private equity investments. You represent that one typical structure of the asset allocation fund would be a custom target date fund structured by a plan investment committee as a separately managed account with the committee retaining responsibility for management of the account with the assistance of an independent ERISA section 3(21) fiduciary investment adviser, or alternatively, the plan investment committee could delegate those investment responsibilities to an ERISA section 3(38) investment manager. In some other cases, the asset allocation fund with a private equity component would be in the form of a prepackaged investment option offered by a financial institution to individual account plans as a "fund of funds" (structured as, e.g., a collective trust fund or other pooled vehicle) that invests in other funds, with one of the underlying funds being a fund that invests primarily in private equity. In no case would the private equity component of the asset allocation fund be available as a vehicle for direct investment by plan participants and beneficiaries on a stand-alone basis.⁵

Finally, you represent that plan sponsors who offer their workers both defined benefit and defined contribution plans may invest in private equity for their defined benefit plans but they do not do so for

for Work and Pensions), revised its guidance on defined contribution plan investment governance responsibilities to include private equity under the headings "unregulated investments" and "patient capital." A Guide to Investment Governance, *The Pensions Regulator*, pp. 29, 47-50 (June 2019) (at www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/dc-investment-guide.ashx).

⁴ You provided citations to the following in support of this representation: Financial Times, The incredible shrinking stock market (June 26, 2019) (at www.ft.com/content/0c9c0b64-9760-11e9-9573-ee5cbb98ed36); U.S. Department of Treasury, Capital Markets, A Financial System that Creates Opportunities (Oct. 2017), p. 21 (at www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf); Jay Clayton, Chairman, Securities and Exchange Commission, Testimony on "Oversight of the U.S. Securities and Exchange Commission" before the Committee on Banking, Housing, and Urban Affairs, United States Senate (Sept. 26, 2017) (stating that "fewer companies are choosing to go public in their growth phase or at all and, consequently and significantly, there are fewer investment opportunities for Main Street investors.") (at www.banking.senate.gov/imo/media/doc/Clayton%20Testimony%209-26-17.pdf).

⁵ This 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.

their participant directed individual account plans. You indicate that without ERISA Title I guidance, plan sponsors are concerned that they may have fiduciary liability even where they believe that providing prudently selected and monitored exposure to private equity investments is in the best interest of their individual account plan participants.

Whether a particular fund or investment alternative satisfies the requirements set forth in sections 403 and 404 of ERISA is an inherently factual question upon which the Department will not issue opinions. We have determined that it is appropriate to respond to your inquiry in the form of an information letter, the effect of which is described in section 11 of ERISA Procedure 76-1.

ERISA, under section 403 and 404, establishes comprehensive standards to govern fiduciary conduct. Among other things, fiduciaries with respect to an employee benefit plan must discharge their duties with respect to a plan solely in the interest of the plan's participants and beneficiaries, and with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.⁶

Of particular relevance to your request, 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. *See, e.g.*, 29 CFR 2550.404c-1(d)(2)(iv) and 29 CFR 2550.404c-5(b). 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.⁷

The Department believes that a plan fiduciary of an individual account plan may offer an asset allocation fund with a private equity component of the type you describe in a manner consistent with the requirements of Title I of ERISA. However, there are important differences between a fiduciary's decision to include private equity investments in the portfolio of a professionally managed defined benefit plan, and the decision to include an asset allocation fund with a private equity component as part of the investment lineup for a participant-directed individual account plan. As compared to typical public market investments available in individual account plans, private equity investments tend to involve more complex organizational structures and investment strategies, longer time horizons, and more complex, and typically, higher fees. A typical private equity investment is structured to reflect the longer-term nature of the commitments required to achieve the investment's objectives. The typical structures also allow the vehicle's investment professionals to guide the management and operations of the portfolio companies in which the vehicle invests to maximize the returns for investors over a multi-year period during which investors' ability to redeem or sell to obtain a return of capital may be limited. As compared to public market investments, private equity investments are subject to different regulatory disclosure requirements, oversight, and controls. In addition, valuation of private equity investments is more complex because private equity investments often have no easily observed market value, and there is often an element of judgment involved in valuing each of the portfolio companies prior to their sale by the investment fund or other liquidity event (e.g., initial public offering).

⁶ Under ERISA, a fiduciary includes anyone who (i) has any discretionary authority or discretionary responsibility in the administration of an employee benefit plan; (ii) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of the plan's assets; or (iii) renders investment advice for a fee with respect to any plan assets.

⁷ *See* 29 CFR 2550.404a-1 (fiduciary investment duties). The Department has previously observed in the case of other complex investments that plan fiduciaries are responsible for securing sufficient information to understand the investment, and its attendant risks, prior to making the investment. Information Letter from Olena Berg to Eugene A. Ludwig (Mar. 21, 1996) (at www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/information-letters/03-21-1996).

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.

With respect to valuation and liquidity in particular, a plan fiduciary, for example, could require that the private equity investments in the investment alternative not be higher than a specific percentage,⁸ ensure that the private equity investments be independently valued according to agreed-upon valuation procedures that satisfy the Financial Accounting Standards Board Accounting Standards Codification (ASC) 820, "Fair Value Measurements and Disclosures,"⁹ and require additional disclosures needed to meet the plan's ERISA obligations to report information about the current value of the plan's investments.

It would also be important for the responsible fiduciary to consider the asset allocation fund with a private equity component in light of the plan's features and participant profile (including, e.g.,

⁸ For example, a fiduciary could consider whether to follow the U.S. Securities and Exchange Commission (SEC) rule that includes a 15% limitation on illiquid investments applicable to registered open-end investment companies (i.e., mutual funds and exchange traded funds). See Investment Company Liquidity Risk Management Programs, Release No. 33-10233; IC-32315 (Oct. 13, 2016) (at www.sec.gov/rules/final/2016/33-10233.pdf). The rule formalized a similar longstanding SEC guideline that generally limited registered open-end funds' aggregate holdings of "illiquid assets" to no more than 15% of the fund's net assets. See *id.*, notes 38-40 and accompanying text. We also understand that some mutual funds, including target date funds, currently invest in private equity, although only in very low allocations. See generally Concept Release on Harmonization of Securities Offering Exemptions, Release 33-10649, section IV (June 18, 2019) (at www.sec.gov/rules/concept/2019/33-10649.pdf). See also Comment Letter of Fidelity Investments (Sept. 24, 2019) (at www.sec.gov/comments/s7-08-19/s70819-6190605-192467.pdf) (stating that target date funds have the sufficient flexibility under this rule to invest directly or indirectly in growth stage issuers, including unregistered funds or securities).

⁹ In the United States, private equity managers generally are required to register as investment advisers under the Investment Advisers Act of 1940, as amended (Advisers Act). There is an exemption from registration available for advisers with less than \$150 million in private fund assets under management in the United States, however, most private equity funds and private equity fund assets are managed by registered investment advisers. To comply with Rule 206(4)-2 under the Advisers Act, private equity managers can obtain an annual audit of their funds' financial statements prepared in accordance with United States generally accepted accounting principles (GAAP). GAAP requires that investments of investment companies (including private equity funds' investments in underlying portfolio companies) be reported at "fair value." Fair value for GAAP purposes is defined primarily in ASC 820. Private equity managers outside of the United States may obtain an annual audit of their funds' financial statements prepared in accordance with International Financial Reporting Standards (IFRS) instead of GAAP, so long as financial statements information is substantially similar to statements prepared in accordance with GAAP, and any material differences with GAAP are reconciled. See Staff Responses to Questions About the Custody Rule, FAQ VI.5 (at www.sec.gov/divisions/investment/custody_faq_030510.htm). IFRS 13, Fair Value Measurement, uses the same definition of fair value as ASC 820. Regardless of whether private equity managers prepare their funds' financial statements under GAAP or IFRS, their annual audits must meet the requirements of auditing standards generally accepted in the United States.

participant ages, normal retirement age, anticipated employee turnover, and contribution and withdrawal patterns) and make a considered decision about whether the characteristics of the investment alternative align with the plan's characteristics and needs of plan participants, taking into account, among other things, the investment alternative's investment allocation and strategy, fees and other expenses, and the nature and duration of any liquidity restrictions, the participants' ability to access funds in their accounts (e.g., loans and distributions when employees separate from service with the sponsoring employer), and their ability to change investment selections on a potentially frequent basis.¹⁰

Additionally, 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.¹¹ The fiduciary also must periodically review whether the investment vehicle continues to be prudent and in the best interests of plan participants, taking into account the considerations outlined above and any other factors that the plan fiduciary deems appropriate in light of its fiduciary duties under ERISA.

The fiduciary must also determine whether plan participants will be furnished adequate information regarding the character and risks of the investment alternative to enable them to make an informed assessment regarding making or continuing an investment in the fund. This factor would be especially important in the case of a plan or responsible plan fiduciary claiming limited fiduciary liability under ERISA section 404(c) for participants exercising control over their accounts (see 29 CFR 2550.404c-1) and/or deciding that a particular investment alternative would be prudent to use as a qualified default investment alternative (QDIA) for the plan under 29 CFR 2550.404c-5. Moreover, as noted above, the fiduciary responsible for including the fund on the plan's investment menu always retains responsibility for ensuring that the decision to retain the fund is consistent with the fiduciary responsibility provisions of Section 404 of ERISA.

In conclusion, a plan fiduciary would not, in the view of the Department, violate the fiduciary's duties under section 403 and 404 of ERISA 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 in the manner described in this letter. 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 individual account plan. Private equity investments, however, present additional considerations to participant-directed individual account plans that are different than those involved in defined benefit plans. In making such a selection for an individual account 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

¹⁰ EBSA Fact Sheet entitled "Target Date Retirement Funds - Tips for ERISA Plan Fiduciaries" (Feb. 2013) (at www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/target-date-retirement-funds.pdf) ("TDFs may have different investment strategies, glide paths, and investment-related fees. Because these differences can significantly affect the way a TDF performs, it is important that fiduciaries understand these differences when selecting a TDF as an investment option for their plan[,] . . . consider how well the TDF's characteristics align with eligible employees' ages and likely retirement dates[, and] . . . the possible significance of other characteristics of the participant population, such as participation in a traditional defined benefit pension plan offered by the employer, salary levels, turnover rates, contribution rates and withdrawal patterns.").

¹¹ For example, the responsible fiduciary should be able to determine, either alone or with the assistance of a qualified adviser, whether the particular investment arrangement complies with applicable requirements under securities, banking, or other relevant laws and regulations.

component, anticipated opportunities for investment diversification and enhanced investment returns, as well as the complexities associated with the private equity component.¹²

We hope you find this information to be helpful.

Sincerely,

Louis J. Campagna
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

¹² This letter does not address any potential prohibited transaction issues under section 406 of ERISA or the application of any statutory or administrative prohibited transaction exemptions that may need to be considered in connection with the structure, investments, or fees of any individual designated investment alternative or private equity investments. This letter also does not address any issue with respect to the structure or operations of any particular investment arrangement that may arise under the federal securities or banking laws, the Internal Revenue Code, or any other applicable federal or state law.