DOL APPROVES USE OF PRIVATE EQUITY IN 401(k) PLANS

The Department of Labor (DOL) recently issued a letter approving the use of private equity in 401(k) and other defined contribution plans, but with some caveats. As a plan sponsor, you should be aware of the risks as you act in the best interests of your retirement plan participants.

DOL Requirements for This Investment

The main limit the DOL applies is that 401(k) plans can't offer stand-alone private equity investments—they must be employed as an investment sleeve within a broader fund. That broader fund must be a custom target date, target-risk or balanced fund. In addition, to meet with DOL requirements, plan sponsors must offer this option via a separate account, or as a fund-of-funds structured as a collective investment trust or other pooled vehicle rather than via a traditional mutual fund.

Need for Annual Audit

What that means for your plan participants is that they can only hold a limited amount of the asset. They also won't have to understand the valuation process or how returns are calculated—good news, since these calculations can vary and are sometimes vaguely communicated by the managers—hence the name, "private" equity. As unregistered funds, private equity investments aren't required to report their holdings. Because their assets aren't traded, they can be very difficult to value. The DOL letter suggests that fiduciaries confirm that these investments will be valued according to accounting standards and be audited annually.

Most Plan Sponsors Have Avoided the Investment

This type of offering seems to be more suited to larger firms that are in a position to offer custom-designed funds versus the more common mutual fund lineup.

Up to now, most plan fiduciaries have avoided offering these investments to steer clear of potential liability under ERISA rules. This letter clarifies the fact that plan sponsors are not prohibited from offering private equity investments as part of a plan option.

Meeting Your Fiduciary Responsibility

Should your company choose to include this investment as a component of a broader fund, you would have to have the needed skills to evaluate it, otherwise it would be prudent to hire an investment consultant or delegate the investment selection to an investment manager. You will also need to ensure that appropriate risk disclosures are provided to plan participants.

Contact the RPS Team for Guidance

If you're wondering whether it is prudent for you to offer a private equity option as part of a broader investment, contact the Mariner Wealth Advisors' Retirement Plan Solutions team. The team can offer plan design suggestions and help ensure you are meeting DOL and ERISA requirements for your plan.

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Sources:

"Private Equity in 401(k) Plans: More Smoke Than Fire", https://www.morningstar.com/articles/988664/private-equity-in-401k-plans-more-smoke-than-fire
"Department of Labor Guidance on Private Equity Adds Flexibility for Defined Contribution Plans", https://www.groom.com/resources/department-of-labor-guidance-on-private-equity-adds-flexibility-for-defined-contribution-plans/