The Investment Lawyer
Covering Legal and Regulatory Issues of Asset Management
VOL. 32, NO. 10 • OCTOBER 2025

Private Funds in 401(k) Plans: ERISA Considerations for Fund Managers

By Carol McClarnon

On August 7, 2025, the President signed an Executive Order (EO) entitled "Democratizing Access to Alternative Assets for 401(k) Investors," which is designed to promote the use of alternative investments, including private equity and digital assets, in 401(k) plans.[1] The order defines alternative assets as follows:

- Private market investments, including direct and indirect interests in equity, debt, or other financial instruments that are not traded on public exchanges, including those where the managers of such investments, if applicable, seek to take an active role in the management of such companies;
- Direct and indirect interests in real estate, including debt instruments secured by direct or indirect interests in real estate;
- Holdings in actively managed investment vehicles investing in digital assets;
- Direct and indirect investments in commodities;
- Direct and indirect interests in projects that finance infrastructure development; and
- Lifetime income investment strategies, including longevity risk-sharing pools.

While such investments currently are not *per se* impermissible,[2] uncertainties regarding the appropriateness of their use in 401(k) plans has stymied their use. Accordingly, the EO directs the Department of Labor (DOL) to revisit earlier guidance and clarify the department's position in 2020 on alternative investments. The EO instructs that "[s]uch clarification must aim to identify the criteria that fiduciaries should use to prudently balance potentially higher expenses against the objectives of seeking greater long-term net returns and broader diversification of investments."[3] The EO also instructs the DOL to address any litigation risk associated with the use of funds that include alternative investments.

As background, in 2020 during the first Trump administration the DOL issued an information letter discussing two specific collective investment trusts (CITs) that included a private equity component.[4] The 2020 letter concludes that "a plan fiduciary would not, in the view of the Department, violate the fiduciary's duties … 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" under the provisions described in the letter. In 2021, the Biden administration issued a "Supplement[al] Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives" that criticized the 2020 Information Letter and cautioned against broad reliance. Within days of the EO, the current DOL officially withdrew the 2021 supplement statement. As of this writing, the DOL has not yet issued new guidance.[5]

This article addresses considerations under the Employee Retirement Income Security Act of 1974 (ERISA) for private fund asset managers seeking to access the estimated 8.9-trillion-dollar 401(k) plan market.[6] The article begins with an overview of ERISA's fiduciary framework. It next discusses ERISA's "Plan Asset Regulation" and the extent to which the underlying assets of a private fund are treated as assets of the investing plan. The article then explains the consequences of plan asset treatment, including ERISA liability and excise taxes, and discusses strategies private managers may wish to take to mitigate specific risks associated with prohibited transactions. Finally, included are thoughts pending additional guidance.

ERISA'S Framework

ERISA is a comprehensive statute regulating US private-sector employee benefit plans. Title I of ERISA governs the administration of employee benefit plans and includes provisions governing the conduct of plan administrators and other fiduciaries. The applicability of these provisions is largely dependent on the definition of "fiduciary." Fiduciaries include not only "named fiduciaries" such as trustees and plan administrators, but also functional fiduciaries. Thus, in general, a person is a (functional) fiduciary under ERISA to the extent that he:

- Exercises any discretionary authority or control over management of the plan or exercises any authority or control regarding the management or disposition of its assets,
- Has any discretionary authority or discretionary responsibility in the administration of a plan, or
- Renders investment advice for a fee or other compensation.[7]

The functional fiduciary definition can result in "inadvertent fiduciary" status.

ERISA sets forth strict standards of conduct derived from the common law of trusts. An ERISA fiduciary must act for the exclusive benefit of participants and beneficiaries (duty of loyalty), with the care, skill, and ability of a prudent expert familiar with the matter (duty of prudence), and generally diversify assets and follow the terms of the plan document. What sets ERISA fiduciary duties apart from trust law and other fiduciary laws, is the additional duty to avoid "prohibited transactions."[8]

Under ERISA's prohibited transaction provisions, a fiduciary is prohibited from causing a plan to enter into a broad range of direct and indirect prohibited transactions with certain persons known as "parties in interest,"[9] having actual or constructive knowledge that such a transaction is prohibited. Of particular relevance:

- ERISA § 406(a)(l)(C) prohibits a fiduciary from, among other things, knowingly causing the plan to engage in a transaction which constitutes the furnishing of goods, services or facilities between the plan and a party in interest, and
- ERISA § 406(a)(l)(D) prohibits a fiduciary from, among other things, causing a plan to engage in a transaction which constitutes a direct or indirect transfer of plan assets to a party in interest or which involves the use of plan assets by a party in interest.

In addition, Section 406(b) of ERISA prohibits fiduciaries from engaging in certain acts that present conflicts of interest.

- ERISA § 406(b)(l) prohibits a plan fiduciary from dealing with the assets of a plan in his own interest or for his own account. The DOL takes the position that a fiduciary that uses its authority to cause itself to be paid additional compensation violates Section 406(b)(1).

- ERISA § 406(b)(2) prohibits a fiduciary from acting on behalf of a party whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.
- ERISA § 406(b)(3) prohibits a plan fiduciary from receiving any consideration from a party dealing with the plan in connection with a transaction involving the assets of the plan.

The prohibitions against fiduciary self-dealing in Section 406(b)(1) and Section 406(b)(2) of ERISA are interpreted by the Labor regulations as prohibitions against plan fiduciaries acting in situations where they have a conflict of interest even if they do not allow themselves to be improperly influenced by the conflict.[10]

Because the prohibited transaction rules, standing alone, would prevent many common and necessary business transactions with plans, there are a number of prohibited transaction exemptions permitting otherwise prohibited transactions. First, ERISA sets forth a number of statutory exemptions for specific transactions that technically violate the prohibited transaction rules, but are considered beneficial to plans. In addition, the DOL has granted several prohibited transaction class exemptions. These exemptions permit certain classes of transactions involving parties-in-interest provided that specific conditions set forth in the exemption have been met. Finally, if neither a statutory nor class exemption is available, an individual prohibited transaction exemption can be requested from the DOL.[11]

Plan Asset Regulation and the "Look-Through" Rule for Plan Investments

Private fund managers looking to enter the 401(k) market should be aware of the possibility that they can become ERISA fiduciaries. The fiduciary definition, and the application of most of the prohibited transaction provisions, requires identification of plan assets. With the potential influx of 401(k) assets, asset managers seeking to access such money should become familiar with the Plan Asset Regulation and the extent to which invested assets may retain their character as ERISA plan assets following the plan's initial investment.

In situations where a plan, although nominally investing its assets in a separate entity, is, as a practical matter, retaining the persons who manage the entity to provide investment management services to the plan, it would be "inconsistent with the broad functional definition of "fiduciary" in ERISA if persons who provide services that would cause them to be fiduciaries, if the services were provided directly to plans, are able to circumvent the fiduciary responsibility rules of [ERISA] by the interposition of a separate legal entity between themselves and the plans."[12] The DOL's "Plan Asset Regulation" determines when a plan's investment in another entity causes that entity's assets to be treated as "plan assets." It sets forth a "look-through" rule under which the DOL may "look through" an equity investment to treat the underlying assets of that entity as plan assets. The result is that the entity's managers may become ERISA fiduciaries and must comply with ERISA's fiduciary standards and prohibited transaction rules.

Unfortunately, the Plan Asset Regulation is not at all straightforward. One court has described it as a "labyrinthian regulation …best analyzed one step at a time."[13] The first step is to consider the general rule:

> Generally, when a plan invests in another entity, the plan's assets include its investment, but do not, solely by reason of such investment, include any of the underlying assets of the entity. However, in the case of a plan's investment in an equity interest of an entity that is neither a publicly offered security nor a security issued by an investment company registered under the Investment Company Act of 1940, ***its assets include both the equity interest and an undivided interest in each of the underlying assets of the entity***. . . . . (Emphasis added.)[14]

The Plan Asset Regulation also includes special rules under which an entity is always deemed to hold plan assets. When a plan invests in a common or collective trust fund maintained by a bank, including a group trust described in Rev. Rul. 81-100 (that is, a CIT) its assets include not only that investment but also an undivided interest in each of the underlying assets of the entity.[15] Thus, when a CIT invests in a private fund, ERISA applies as if each of the investing plans invested directly in the private fund. A similar provision exists regarding certain unregistered insurance company separate accounts.[16] In addition, if all of the equity interests of an entity are owned by a single plan or a related group of plans, the underlying assets will be considered plan assets.

Because the look-through treatment continues to apply to each underlying equity investment until an exception under the regulation is available to stop the process, a fund manager can become an ERISA fiduciary by reason of managing plan assets even when a plan has not directly invested in the fund.

Courts have affirmed a person can be a fiduciary via the Plan Asset Regulation even if there is no direct relationship with the plan or if the person lacks knowledge of that status.

The exceptions to look-through treatment reflect situations in which it is unlikely that the entity is in fact, a disguised plan investment management arrangement. Private funds tend to rely on the following exceptions discussed below for this purpose.

Publicly Offered Security

Applying the general rule, a mutual fund is never subject to the look-through rule because it is a registered investment company. The general rule similarly excludes a "publicly offered security" from look-through treatment. A publicly offered security is one which is:

- freely transferable,
- widely held (100 or more investors who are independent of the issuer and each other), and
- registered under Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act), or sold to the plan as part of an offering to the public under the Securities Exchange Act of 1933 (1933 Act) and registered under the Exchange Act within a specified period of time.[17]

While the second and third requirements are relatively straightforward, whether a security is freely transferable is determined based on the facts and circumstances. For that reason, the DOL has declined to issue opinions or sub-regulatory guidance on the topic.

The Plan Asset Regulation itself, however, sets forth a presumption naming restrictions that, alone or combined, will ordinarily not cause a security to be other than freely transferable. This presumption applies if the minimum offering price is $10,000 or less. The permissible restrictions include:

1. Certain requirements regarding the minimum number of shares or units that can be transferred or assigned;
2. Prohibitions against transfer to an ineligible or unsuitable investor;
3. Restrictions on transfers that would cause reclassification of the entity for tax purposes or violate law;
4. Reasonable fees in connection with a transfer;
5. Avance notice and specific document execution requirements;
6. Restrictions on substitution of an assignee as a limited partner of a partnership if the economic benefits of ownership of the assignor may be transferred or assigned without regard to such restriction;
7. Administrative procedures establishing an effective date or event prior to which a transfer or assignment will not be effective; and
8. Limitations or restriction on transfer or assignment not created or imposed by the issuer or person acting for or on behalf of the issuer.[18]

Note that the presumption is that "ordinarily" the listed factors will not be considered impermissible transfer restrictions. In declining to rule as to whether a specific restriction was permissible, the DOL explained "Section 2510.3-101(b)(4) merely establishes a presumption that securities will be considered freely transferable, notwithstanding the existence of the enumerated restrictions." Accordingly, the DOL has stated that "there may be circumstances where a restriction which qualifies under Section 2510.3-101(b)(4)(iii) [the condition at issue in the opinion] may affect a determination that a security is freely transferable."[19]

When the minimum investment exceeds $10,000, the DOL has stated that whether a security is freely transferable will be determined based on all the relevant facts and circumstances considering the minimum investment restriction as well as any other type of restriction. The DOL explained that the intent of the publicly-offered security exclusion is that "it will only apply to securities which in fact provide a plan investor a reasonable opportunity to liquidate its investment."[20] Some practitioners take the view that although the presumption does not apply, as a practical matter its factors should not affect the freely transferable determination. The reasoning is that the nature of these factors, particularly those involving the legalities of a transfer or that are necessary for protecting all of the investors in the fund, have important purposes beyond simply restricting transfers. Others recommend a more qualitative analysis that looks at the extent to which any restriction (including the eight factors) is likely to affect the ability of a fiduciary to transfer out of an investment. Transferability could potentially be resolved when the private fund is held within a CIT or other pooled investment vehicle that also includes sufficient liquidity components so that participants can cash out their interests as needed (that is, for the payment of benefits or to revise their investment strategies).

Operating Company

Given the purpose of the look-through rule, the Plan Asset Regulation distinguishes between companies that carry on an active trade or business, and therefore not likely to be disguised investment management arrangements, from pooled investment vehicles. If a plan acquires an equity interest in an "operating company" the underlying assets of the company will not be deemed to be plan assets, meaning that its managers do not become fiduciaries to the plan via the plan's investment. An operating company is defined as an entity that is primarily engaged in the production or sale of a product or service other than the investment of capital.[21] For these purposes there are two types of operating companies: (1) Venture Capital Operating Company (VCOC), and Real Estate Operating Company (REOC). The VCOC and REOC qualifications are complex, and it is extremely difficult to qualify for such treatment without a deliberate intention of the company as of inception.

At its most basic level, to qualify as an operating company (either VCOC or REOC), at least 50 percent of the company's investments (other than short-term investments pending long-term commitment or distribution to investors) must be in qualifying investments as of an initial valuation date and each year thereafter on any date within a pre-established 90-day annual valuation period thereafter. The initial valuation date is the date on which the entity makes its first long-term investment. If an entity fails the 50 percent test as of its initial valuation date, it can never qualify as an operating company. Similarly, if it fails the test for an annual valuation period, it ceases to be qualified.

VCOC

A qualifying investment must be either a "venture capital investment" or a "derivative investment. A venture capital investment is an investment in an operating company (other than a VCOC) as to which the investor has or obtains management rights. A derivative investment is either a venture capital investment as to which the investor's management rights have ceased as a result of a public offering, or certain securities acquired in a merger or corporate reorganization (provided the merger or reorganization is undertaken for independent business reasons other than extinguishing of an investor's management rights). Derivative investments can retain that status until the later of 10 years after the acquisition of the original venture capital investment to which the derivative investment relates, or 30 months after the investment becomes a derivative investment.[22] Prior to its first venture capital investment, the entity will not be considered a VCOC and will be deemed to hold plan assets (that is, the short-term investments).[23]

In addition, the company must actually exercise the management rights in the ordinary course of its business with respect to one or more of the qualifying investments. Management rights are contractual rights directly between the investor and an operating company to substantially participate in, or substantially influence the conduct of, the management of the operating company. The DOL has not provided specific guidance as to the meaning of "management rights" because it takes the position that this is a facts and circumstances analysis.[24] DOL guidance however tells us that a VCOC's rights with respect to a portfolio company's investments must be more significant than rights that are normally negotiated by institutional investors with respect to investments in established, creditworthy companies.[25] The preamble to the Plan Assets Regulation indicates that it is expected that "substantial resources" must be devoted to management efforts.[26]

REOC

Qualifying investments are real estate that the company manages or develops and with respect to which it has the right to substantially participate directly in the management or development activities. This is a factual question that is determined on a case-by-case basis.[27]

The Plan Assets Regulation does include illustrative examples. From these examples, it is clear that more is required than assuming the risks of ownership of income-producing real property where substantially all management and maintenance activities are the responsibility of a lessee.[28] Conversely, an entity that negotiates loan terms giving rights to substantially influence, or to substantially participate in, the management of the property acquired with the proceeds of the loan and that give the entity significantly greater rights to participate in the management of the property than it would obtain under a conventional mortgage loan, could qualify as a REOC.[29]

As is the case with VCOC, the REOC must actually engage in the real estate management and development activities. Thus, in *Hart Interior Design LLC 401(k) Profit Sharing Plan v. Recorp Investments Inc.*[30] the Court granted summary judgment in favor of the plaintiffs and against the defendant who asserted REOC qualification as a defense against ERISA claims. The court found that the defendant "has not demonstrated a substantial ongoing commitment to managing and developing real estate."[31]

Finally, it is important to remember that qualification as a REOC or VCOC means that the equity interest in the operating company is the plan asset, and that the underlying assets of the entity are not plan assets. There can still be prohibited transactions in the acquisition of a REOC or VCOC interest. Thus, the DOL has opined that a lease of property between a limited liability company (LLC) and a disqualified person constitutes a prohibited transaction regardless of whether the LLC qualifies as a REOC under the Department's plan assets regulation."[32]

Insignificant Benefit Plan Investors

If the equity interests of "Benefit Plan Investors" are not "significant," look-through treatment to the underlying assets will not apply. Participation by Benefit Plan Investors is significant on any date if immediately after the most recent acquisition of any equity interest in the entity, Benefit Plan Investors own less than 25 percent of the total value of any class of equity interest in the entity, excluding equity interests held by any person (other than a Benefit Plan Investor) who has discretionary authority or control with respect to the assets of the entity or who provides investment advice for a fee with respect to such assets, and any affiliates of such person (a Controlling Person). The insignificant benefit plan investor exception is widely used, but requires careful management. The issuer must either track securities held by Benefit Plan Investors and Controlling Persons or exclude Benefit Plan Investors entirely from participating in the class of securities. Typically, the offering materials, subscription agreements, and transferability restrictions are designed for this purpose.

The risks inherent in reliance on the insignificant benefit plan investor exception begin with the definition of Benefit Plan Investor. Benefit Plan Investors are defined to include the following:

- Any employee benefit plan subject to Part 4 of Title I (the fiduciary provisions) of ERISA, that is, retirement and certain other benefit plans sponsored by private-sector employers for US employees. Most commonly, these plans would include Section 401(k) plans, profit sharing plans, money purchase pension plans, and defined benefit pension plans.
- Any plan to which Section 4975 of the US Internal Revenue Code applies (generally the same plans as above plus individual retirement accounts or annuities (IRAs)).
- Any entity whose underlying assets include plan assets by reason of a plan's investment in such entity. These entities include not only bank-maintained collective trust funds, and unregistered insurance company separate accounts, as described above, but also any entity that itself holds plan assets as determined under the Plan Asset Regulation.

Non-US benefit plans and governmental plans are not considered Benefit Plan Investors.

Additional risks arise because the 25 percent calculation must be done immediately after each acquisition. The DOL's view is that "the term 'acquisition' is to be construed broadly in connection with transactions involving the transfer of equity interests for purposes of the significant participation test." Accordingly, in an Advisory Opinion the DOL confirmed that the *redemption* of an equity investment is considered an acquisition because it results in an increase in the interests of the remaining investors.[33]

Finally, uncertainties exist as to how to determine whether there are single or multiple classes of equity. The regulation does not define what a "class" of equity entails, and the preamble provides only a limited example of an entity that issues publicly offered securities and also provides a private placement offering class.[34] There is not a consensus in the industry as to a single way to make this determination. One method would be to simply look at the governing documents of the entity to see if different share classes have been named. Another common method is to determine whether the economics and related rights vary between certain issued interests (for example, fees, liquidity, voting rights) and if so, that suggests that there may be multiple classes. Finally, if under another body of law an equity interest would be treated as a separate class, that would suggest there might be multiple classes for ERISA purposes.

All of this is to say that the insignificant benefit plan test presents both opportunities and risks related to managing ERISA fiduciary exposure related to private fund investments.

ERISA Consequences

It is possible to structure a fund in a manner that avoids the look-through treatment altogether by designing it to qualify for one of the regulatory exceptions. Alternatively, if an ERISA plan asset vehicle is contemplated at the beginning, the governing document can be drafted with ERISA compliance in mind. As the amount of 401(k) plan assets in private funds increases, however, the risk of a fund manager unknowingly becoming an ERISA fiduciary also increases. This is particularly the situation when an intermediary plan asset vehicle is the investor in the private fund.

As noted above, if the underlying assets of a fund are considered to be plan assets, the manager will need to operate the fund in accordance with ERISA's strict fiduciary standards—for the exclusive benefit of plan participants and beneficiaries—and will be responsible for ensuring that non-exempt prohibited transactions do not occur. This requirement is further complicated because a fiduciary is responsible for ensuring that a prohibited transaction does not occur between the plan and *any* party-in-interest. The fund manager may not know that a particular entity is a party-in-interest to the plan. Two prohibited transaction exemptions cover this problem. Traditionally managers have complied with the PTE 84-24 for Qualified Professional Asset Managers (the QPAM Exemption.) The DOL recently amended that exemption in a manner that makes it more difficult to qualify and operate in accordance with the QPAM Exemption. A statutory exemption under Section 408(b)(17) is a less onerous exemption for transactions with parties in interest other than fiduciaries. To use that exemption, the manager will need to keep track a plan's fiduciaries but not the entire universe of parties-in-interest.

Specific Prohibited Transaction Issues

Following are examples that illustrate how standard private fund provisions may raise prohibited transaction issues.

Performance-Based Compensation

Performance-based or incentive fees are a common term in private funds, and they are not per se prohibited under ERISA. If not carefully structured, however, they can result in prohibited transactions. In particular, there may be a 406(b)(1) violation if the arrangement gives the manager the ability to make unilateral decisions that increase its own compensation (for example, through valuation of assets or the use of leverage.) This is in contrast to a standard asset-based advisory fee on a non-leveraged pool of assets where the interests of the manager and the plan are always aligned.

The DOL has opined on performance-based compensation arrangements. In a series of Advisory Opinions, the DOL addressed requests as to whether specific performance-based fees would violate Section 406(b)(1). The DOL opined that the following factors would not in and of themselves indicate a prohibited transaction.

- The investments are either securities for which market quotations are readily available, or are valued by an independent third party selected by the plan.
- The manager is not acting as a market maker.
- The arrangement complies with SEC Rule 205-3, governing performance-based compensation (and applicable CFTC rules in the case of commodities).
- The compensation formula must consider both realized and unrealized gains and losses.
- Determination of whether a performance fee has been earned is made on an agreed-upon specified date at the end of the annual performance period.

Each of the Advisory Opinions also considered representations as to the sophistication of the plan fiduciary. These representations included that:

1. A plan must have assets of at least $50,000,000;
2. The plan was given the choice to elect and negotiate the performance fee as an alternative to a standard fee;
3. The decision to accept the fee was made by a fiduciary independent from the manager;

4. No more than 10 percent of the plan's assets would be managed by the manager;
5. The financial capabilities of the approving plan fiduciary (for example, investment committees comprised of senior financial officers of the corporate plan sponsors); and
6. Specific contractual restrictions on the manager (for example, prohibition against taking straddle positions.)

The Advisory Opinions were based on specific facts and representations made to the DOL. Accordingly, a performance-based fee does not necessarily violate ERISA if it differs from those discussed in the Advisory Opinions. While in practice the Advisory Opinion factors are sometimes viewed as a type of checklist for ERISA compliance, what is important is that a performance fee be designed with sufficient guardrails to prevent the manager's from having the ability to make unilateral decisions that affect the factors in the compensation formula.

Conversely, there could be situations in which the DOL could take the position that a specific fee arrangement constitutes a prohibited transaction even if it includes the identical factors of the Advisory Opinions. In fact, the DOL caveated each of the opinions by noting that if, in operation, the arrangement results in a divergence of interests between a plan and the managers, violations of Sections 406(b)(1) and 406(b)(2) could occur.

Valuation of Assets

The valuation of plan assets, especially hard-to-value assets, is a fiduciary act under ERISA. The DOL has long considered the unique issues arising with hard-to-value assets, although little guidance has been given. Similar to the issue with performance fees, if a fiduciary's compensation is based all or in part on the value of plan assets, if that fiduciary has wide discretion to value those assets, it could be viewed as a 406(b)(1) prohibited transaction regardless of whether the fee has performance incentives.

There are several ways to avoid or at least mitigate the fiduciary and prohibited transaction risks associated with valuation. One way to avoid the prohibited transaction would be to hire an independent third party to value the assets. Because the valuation would not be done by the fiduciary receiving the asset-based fee, there generally would be no prohibited transaction because the fiduciary is not using its fiduciary authority to cause any increase in compensation resulting from the valuation.[35] Third-party valuations can be expensive, however, and in practice there are other methods used to at least mitigate the risk of prohibited transaction exposure. For example, some asset managers adhere to strict written valuation policies, disclosed to the plan-level fiduciary, that minimize the extent of the manager's discretionary authority in the valuation process. Similarly, because the DOL has suggested that a plan fiduciary selecting a hard-to-value investment should understand and approve the valuation methodology, a manager may gain some comfort if it communicates to a qualified plan fiduciary, such as a CIT trustee, reviews, and approves the methodology. This sets a basis for arguing that there is not a prohibited transaction because the fiduciary did not *unilaterally* set its own compensation, as it had to be approved by another fiduciary. The degree of transparency and the restrictions on detail on manager discretion would be important in the success of any mitigation strategy.

Liquidity Restrictions

It is possible that a fund manager/ERISA fiduciary could face challenges related to the operation of liquidity restrictions including gates, holdbacks, and lock-periods, as well as with general withdrawal and transferability restrictions. Liquidity restrictions serve a valid purpose in private equity, and historically plan investors have defined benefit pension plans where liquidity needs are not as critical. Under a defined benefit plan, participants receive a pension calculated under a formula generally based on each participant's compensation and years of service with the employer. The participant does not have any interests in any particular investments funding the pension.

In defined contribution plans, such as 401(k) plans, however, the participant has an interest in each investment in their account. When a participant retires, requests a withdrawal, or changes their asset allocations, generally the participant's pro rata share of each investment is cashed out. It follows that these plans have daily liquidity needs applicable to each investment option. In addition, a plan investment fiduciary has a duty to monitor the investment menu and may determine that including a particular investment is no longer in the best interest of the participants. In that case, fiduciary issues can arise for both the plan and the fund manager if liquid assets are insufficient.

When private equity is part of a larger investment vehicle, such as a CIT, liquidity needs can be managed by including more liquid investments to support the day-to-day liquidity needs of the plan. A private fund also can be designed to have sufficient liquid investments to meet anticipated participant needs.

Consequences of Fiduciary Breaches

Fiduciaries who breach their fiduciary duties are personally liable for such breaches. A court may award damages and order appropriate equitable relief, including removal of the fiduciary.[36] ERISA also permits an award of attorney fees[37] and imposes a 20 percent civil penalty if the matter is resolved by a settlement agreement or litigation with the DOL.[38]

Fiduciaries also may be held responsible for the breaches of other fiduciaries if the fiduciary (1) participated knowingly in, or knowingly undertook to conceal, an act or omission of another fiduciary, knowing that act or omission to be a breach; (2) enabled, by its failure to comply with the general fiduciary standards, another fiduciary's breach; or (3) had knowledge of the breach and did not make reasonable efforts under the circumstances to remedy the breach.[39]

Prohibited transactions have additional penalties. First, there is an excise tax under Section 4975 of the Internal Revenue Code, which may be imposed on any "disqualified person" (roughly equivalent to the party-in-interest definition in ERISA.) The tax is equal to 15 percent of "the amount involved" in the prohibited transaction for each year (or part of a year) until the transaction is corrected. The tax increases to 100 percent if not corrected within the taxable period. The amount involved is the greater of (1) the money and fair market value of any property given, and (2) the money and fair market value of any property received. When the prohibited transaction is the payment of excessive fees for necessary services the amount involved is the excess compensation over the reasonable compensation for such services.

The taxable period starts on the date of and ends on the earliest of (1) the day the Internal Revenue Service (IRS) mails a notice of deficiency for the tax; (2) the day the IRS assesses the tax; or (3) the day the correction of the transaction is completed. The DOL is authorized to impose civil penalties up to 5 percent of the amount involved in a prohibited transaction and up to 100 percent if the violation is not corrected within 90 days after a final agency order. The DOL penalty is offset by any excise tax paid with respect to the transaction.[40]

Finally, while rare, criminal penalties can be imposed under ERISA. ERISA's criminal provisions include willful reporting/disclosure violations (up to 10 years imprisonment and $100,000 fine), and coercive interference with participant rights (up to 10 years imprisonment).[41] Additionally, specific federal criminal statutes apply to ERISA for theft/embezzlement,[42] false statements to the DOL,[43] and kickbacks,[44] and are used to prosecute serious crimes related to ERISA plans.

Other ERISA Requirements

Reporting and Disclosure

A plan administrator may need certain financial information so that it may satisfy its reporting and disclosure obligations. Regardless of whether a fund holds plan assets, it is required to provide such information to the plan administrator in a timely manner. Large plans are subject to an annual audit requirement, and the auditor may request information from the fund in that regard, such as information on valuation of assets. If the fund manager is a "covered service provider" under Section 408(b)(2), it will be required to issue a disclosure to the plan administrator. Plan administrators, in turn, must provide certain fee disclosures to participants. Generally, an investment manager will provide fee information to the plan administrator for purposes of the disclosure.

Bonding

ERISA requires the bonding of persons who "handle" funds or other property of a plan, in the amount of 10 percent of the assets handled. Plan "funds or other property" include all plan investments, even those that are not in the nature of "quick assets," such as land and buildings, mortgages, and private securities. The term "handling" carries a broader meaning than actual physical contact with "funds or other property" of the plan. A person is deemed to be "handling" funds or other property of a plan so as to require bonding whenever his duties or activities with respect to given funds or other property are such that there is a risk that such funds or other property could be lost in the event of fraud or dishonesty on the part of such person, whether acting alone or in collusion with others. Thus, an investment manager will be deemed to be handling plan assets if it has access to plan funds or has decision-making authority that can give rise to a risk of loss through fraud or dishonesty.[45]

Indicia of Ownership

Section 404(b) of ERISA provides that the indicia of ownership of any plan asset be held within the jurisdiction of the US district courts except as authorized by the Secretary of Labor by regulation. The DOL has issued complicated regulations in that regard. Subject to conditions, foreign securities and currencies held outside the United States but under the management or control of a bank, insurance company, or registered investment adviser meeting certain specific financial requirements are permitted. Other assets in the physical possession of a US registered broker-dealer or in custody of an agent meeting requirements under Rule 15c3-3 of the Exchange Act, may qualify for a regulatory exception. These regulations include additional complex requirements.[46]

Concluding Thoughts

The EO has generated much excitement for investment providers and plan participants. It remains to be seen how plan-level fiduciaries will react. Products already have been developed that are making private equity and/or private credit available in the form of a component of a professionally managed asset allocation solution, generally through the use of a CIT and/or a target date fund. Under this structure, responsibility for the selection and monitoring of the private funds can be delegated to an ERISA fiduciary with the requisite expertise. Plan sponsors may be more comfortable with that route, especially if the DOL guidance contains real protections against excessive litigation. Although this article has been focused on private funds, anecdotal evidence is that participants have been asking about other types of alternatives, such as cryptocurrencies and other digital assets. The DOL withdrew its cautionary guidance on cryptocurrencies, and it is unclear the extent to which digital assets will be addressed in the upcoming guidance.

Finally, ERISA is not the only body of law applicable to the use of alternative assets in 401(k) plans. The EO also directs the Securities and Exchange

Commission (SEC) to "consider ways to facilitate access to investments in alternative assets," including revisions to "regulations and guidance relating to accredited investor and qualified purchaser status." The SEC's ultimate position will further dictate the role of alternatives in 401(k) plans.

Stay tuned.

Ms. McClarnon is a Shareholder at Carlton Fields, LLP.

NOTES

1 Executive Order 14330, 60 FR 38921 (Aug. 7, 2025).

2 Information letter to Jon W. Breyfogle (June 30, 2020); Anderson v. Intel Corp. Investment Policy Comm.,137 F.4th 1015, 1024 (9th Cir. 2025).

3 *Id*. While a number of specific alternative investments are listed, it should be noted that the EO's specific directive to the DOL is to issue guidance on "asset allocation funds that include investments in alternative assets" and not necessarily direct investment in alternatives.

4 Information letter to Jon W. Breyfogle. A CIT is a pooled investment vehicle with participation limited to qualified retirement plans and other specific plan investors.

5 The EO directed the DOL to issue guidance within 180 days, which would be February 3, 2026.

6 *See* Investment Company Institute 401(k) Resource Center, *www.ici.org/401k*.

7 ERISA § 3(2l)(A).

8 ERISA § 406(a)(1).

9 "Party-in-interest" is defined at ERISA § 3(14) and includes fiduciaries, service providers, plan sponsors, labor unions, and participants, as well as numerous individuals and entities related to those parties.

10 *See* Cutaiar v. Marshall, 590 F.2d. 523, 529 (3d Cir. 1979).

11 ERISA § 408(a).

12 51 Fed. Reg. 41262, at 41262-3 (Nov. 13, 1986).

13 In re Johns, 658 B.R. 401, 417 (2024).

14 29 CFR § 2510.3-101(a)(2). It is important to note that the look-through rule only applies to equity interests acquired by a plan. An equity interest is described as any interest in an entity other than one that is treated as indebtedness under applicable law, and which has no substantial equity features. 29 CFR § 2510.3-101(b)(1).

15 29 CFR § 2510.3-101(h)(1)(i)-(ii)

16 29 CFR § 2510.3-101(h)(1)(iii). Look-through treatment does not apply to an unregistered insurance company separate account that is maintained solely in connection with fixed contractual of the insurance company under which the amounts payable, or credited, to the plan and to any participant or beneficiary of the plan are not affected in any manner by the performance of the separate account. *Id.*

17 29 CFR § 2510.3-101(b)(2).

18 29 CFR § 2510.3-101(b)(4).

19 Adv. Opin. 89-14A (Aug. 2, 1989).

20 *Id. See* Preamble to Plan Asset Regulation, 51 Fed. Reg. at 41268.

21 29 CFR § 2510.3-101(c)(1).

22 29 CFR § 2510.3-101(d).

23 Adv. Opin. 89-15A (Aug. 3, 1989). Notwithstanding, the DOL has recognized that a manager might not be a fiduciary at initial capitalization if property is held in an escrow and the manager does not have discretion over those plan assets. Adv. Opin. 95-04A (May 3, 1995). *But see* Information Letter to Carol I. Buckman (Sept. 23, 1998) ("to the extent that employee benefit plan funds are transferred to a venture capital company on the initial valuation date solely for the purpose of the acquisition of an equity interest in a qualifying venture capital investment such funds would not constitute plan assets on that date.")

24 *See* Adv. Opin. 89-04A (Mar. 30, 1989); 2002-01A (Mar 26, 2002).

25 29 CFR § 2510.3-101(j), Example 6. Adv. Opin. 2002-01A sets forth examples of rights that may be considered management rights, depending on the particular facts and circumstances. These include….

[26] 51 Fed Reg, 41262, 41271.

[27] 51 Fed Reg, 41262, 41275.

[28] 29 CFR § 2510.3-101(j), Example 7.

[29] 29 CFR § 2510.3-101(j), Example 9.

[30] 63 Employee Benefits Cas. 2064; 2018 WL 1961643 (D. Ariz. 2018).

[31] *Id.* At *6.

[32] Adv. Opin. 2006-01A (Jan 5, 2006) (a lease of property between an LLC and a disqualified person constitutes a prohibited transaction regardless of whether the LLC qualifies as a REOC under the Department's plan assets regulation; *see also* Southern California, Arizona, Colorado, and Southern Nevada Glaziers Architectural Metal and Glass Workers Pension Trust v. Seay, 66 Fed. Appx. 114, 117 (9th Cir. 2003) ("the regulation defines the status of assets owned by a REOC when a plan owns an interest in the REOC, not whether or not the transfer of ownership rights and interests to an REOC is for the benefit of a party in interest.")

[33] Adv Opin 89-05 (Apr. 5, 1989).

[34] 51 Fed Reg. 41270.

[35] *See* ERISA Advisory Council Report on Hard-to-Value Assets and Target Date Funds (2008).

[36] ERISA §§ 409, 502(a).

[37] ERISA § 502(g).

[38] ERISA § 502(*l*).

[39] ERISA § 405.

[40] ERISA § 502(i).

[41] ERISA § 510-511.

[42] 18 U.S.C. § 664.

[43] 18 U.S.C. § 1027.

[44] 18 U.S.C. § 1954.

[45] 29 CFR §§ 2580.412-4 and 2580.412-6; DOL Field Assistance Bulletin 2008-04, Q/A-17-18.

[46] DOL Reg. § 2550.404b-1.