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Will the Trump Administration Re-'Order' 401(k) Plan 'Alternatives'?: Part 2

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This article is the second installment of an expansive discussion concerning the challenges imposed across multiple legal regimes and the potential opportunities associated with 401(k) plan access to alternative strategies such as private credit, private equity, and hedge funds. The Trump Administration's recent Executive Order to open up private funds and assets to investment by tax-favored retirement vehicles and accounts is analytically ambitious, as the regulation of those vehicles is extensive and involves a number of very important public policy considerations. Those include questions of government expense through tax incentives, investor protections having a long history and the regulation of pension fiduciaries in the interest of ensuring adequate retirement savings to broad sectors of the US population. This multi-series article is intended as a comprehensive reference guide to the principal relevant considerations.

Part 1, which appeared in the December 2025 issue of *The Investment Lawyer*, provided an overview of the recent Executive Order directing regulatory agencies to take action to enhance 401(k) plan access to such strategies, and continued by summarizing some prior history, moved on to outline concerns of plan fiduciaries and then offered some of the reasons proponents and opponents have concerns regarding alternative assets in 401(k) plans. This Part 2 focuses on the tensions inherent in the law that historically have served as substantial headwinds for 401(k) plan access to such strategies and provides a deeper dive into currently available pathways with a focus on recent Securities and Exchange Commission (SEC) reforms and traditional operational constraints that continue to make some strategies highly challenging under the Employee Retirement Income Security Act of 1974 (ERISA).

The next installment will explore a series of policy recommendations to the several regulators impacted by the Executive Order. The proposals have been developed in a manner designed to promote the objectives of the Executive Order while remaining consonant with the purposes of the applicable rules. This portion will include suggestions as to what market participants such as investment managers, fund sponsors, insurance companies, recordkeepers and intermediaries, as well as plan fiduciaries, can do now.

Though this examination is released in several portions, given the complexities involved, all portions should be read in combination with the others. Please note that capitalized terms not otherwise defined herein have the meanings assigned to them in Part 1.

Historical Multiplicity of Legal Regimes and Structural Constraints

The rules applicable to Plan participation in Alternative Assets in some cases work at cross purposes. Attempts to solve some of the issues that have historically thwarted Plan access presented by one regulatory regime often result in offsetting challenges under another one. In addition, apart from those often-conflicting rules, there are ERISA rules that are separate and have independent significance. This section first discusses the statutory "tug of war" and then proceeds to address the circumstances under which an investment option can become subject to ERISA. It describes some of the challenges that ERISA "plan assets" status may invite, as well as some of the primary exceptions from such treatment and their constraints. It then turns to other provisions of ERISA that are likely to be most relevant to an investing Plan fiduciary's calculus as to whether or not to choose a strategy involving Alternative Assets as a Plan option as to which Alternative Assets strategy sponsors would likely need to be sensitive.

Statutory Tug of War

The structural legal constraints associated with the offering of Alternative Assets in Plans are not new, but they are complex. Open-end registered mutual funds—mainstays of many Plan lineups—do not often work well with many Alternative Assets strategies as a standalone. Specifically, open-end registered funds require daily liquidity, with limitations on the amount of illiquid assets the fund may hold.[1] Many Alternative Assets strategies are unable to maintain daily liquidity because investors want the fund to be invested in Alternative Assets to a greater extent than would be consistent with offering daily liquidity. Alternative Assets strategies, like private equity, presume a longer-term investment horizon and often require a commitment for a duration typically ranging from 3 to 10 years, and potentially longer in challenging markets. Alternative Assets strategies also employ techniques to potentially boost investment returns. Leverage (borrowing to gain greater investment exposure and potential opportunities) typically magnifies investment returns, leading to higher highs and lower lows.

Operating an Alternative Assets strategy for open-end mutual funds under the Investment Company Act of 1940 (1940 Act) often would be unduly constraining and likely disrupt the basic value proposition offered by those strategies; and closed-end registered funds also face challenges for certain strategies.[2] These strategies therefore typically need to be offered in a way that except them from 1940 Act coverage. The most commonly used exception from registration under the 1940 Act for private (unregistered) funds is Section 3(c)(7). This exception requires that the fund's investors be qualified purchasers (QPs) or knowledgeable employees (KEs). Being a QP requires having substantial investible assets and being a KE means being associated in certain capacities with the fund or its manager.[3] Under SEC guidance, for purposes of the determination of QP and KE status the fund would need to look through to each Plan participant that chooses to allocate a portion of his or her Plan account balance to the fund.[4] Most Plan participants are neither QPs, nor KEs with respect to any given third-party fund, thereby making the Section 3(c)(7) exception from the 1940 Act registration of limited assistance.[5]

Similar concerns exist under the Securities Act of 1933. Most unregistered funds rely on an exemption from registration associated with the offering of interests in the fund. The most commonly utilized exception presumes that almost all investors are accredited investors (AIs).[6] It is fair to say that most Plan participants are not QPs, KEs, or AIs.

One might be tempted to conclude that the way to offer Alternative Assets funds in a Plan is to limit them only to participants who are QPs and AIs. While that would likely solve the 1940 Act and Securities Act of 1933 considerations, it would trigger a countervailing set of equally formidable challenges. This is because the Internal Revenue Code of 1986, as amended (Code) requires compliance with a set of baroque statutory and regulatory provisions as a condition for the Plan's "qualification" as a tax-deferred vehicle. Failure to satisfy any one of those requirements results in Plan disqualification, with the possibility that all participants are then subject to US Federal income tax on their plan accounts.[7]

Under the Code, a plan cannot discriminate in favor of "highly compensated" participants at the expense of "non-highly compensated" participants with respect to any plan "benefit, right or feature." Because investment options may be regarded as a "benefit, right or feature," those rules could effectively require "equal access" for all participants to all investment options offered under the Plan.[8] Stated differently, if these tax rules would work to require that a Plan offering a Section 3(c)(7) exempt unregistered fund as an investment option must give access to all Plan participants, then doing so could result in the fund's failure to satisfy the Section 3(c)(7) exception. Thus, solving the challenges under the 1940 Act and Securities Act of 1933 by limiting Plan participant access in an unregistered fund investment option to QPs, KEs, and AIs could result in nondiscrimination test concerns while not placing such a restriction could cause the fund to lose its securities law exceptions.

Some Alternative Assets strategies may be managed in a way that requires neither registration under the 1940 Act nor reliance on the Section 3(c)(7) exception. National banks sponsor collective investment trusts (also referred to as bank collective investment trusts, collective trust funds, collective investment funds, and frequently with the abbreviations of CIT, CIF, BCT and others) which are subject to Regulation 9 (Reg. 9) under regulations issued by the Office of the Comptroller of the Currency (OCC). Collective investment trusts are also established by state-chartered institutions (which frequently adopt similar rules to Reg. 9). These collective investment trusts have their own separate exception from 1940 Act registration where they are maintained by a bank.[9] That exception from the 1940 Act—Section 3(c)(11)—does not impose the above QP and AI related limitations and thus is more conducive for Plan access, regardless of the given participant demography. The tradeoff, however, is that bank collective funds are "plan assets" subject to ERISA's fiduciary responsibility and prohibited transaction rules.[10] While some Alternative Assets strategies can work within ERISA's restrictive parameters (although often with a lot of effort), others have proved much more challenging. It is to that topic to which this article turns next. In addition, collective investment trusts are available only to certain types of investors under applicable US Federal income tax (and securities) rules; generally, only ERISA plans, certain US Federal or state governmental retirement arrangements and other collective investment trusts.[11]

ERISA Plan Assets and Exceptions: Unregistered Private Funds

Collective investment trusts are subject to ERISA at the first investment of any ERISA assets. US registered mutual funds are exempt from the fiduciary responsibility and prohibited transaction rules of ERISA regardless of the quantum of plan investment. But unregistered funds are neither such category. This raises two threshold questions. The first is whether the unregistered fund will become subject to ERISA (that is, "plan assets"). If a fund manager wishes to consider managing a "plan assets" fund subject to ERISA it must examine whether it is even feasible (and if so, what impediments and limitations would apply) to do so given the strategy. If the manager does not want the unregistered fund to become "plan assets" subject to ERISA, the next question is whether an exception is available, and whether the fund can comply with the restrictions of that exception.

If subject to ERISA, the fund and its investment manager must comply with extremely broad and rigid fiduciary responsibility and prohibited transaction rules or they (and other parties to transactions involving the fund's assets) can suffer substantial penalties. The manager may have to restore losses and disgorge any profits relating to a breach of fiduciary duty arising in connection with any prohibited transaction.[12] In some respects the prohibited transaction could become subject to other equitable relief.[13] There also is the possibility of an additional 20 percent civil penalty under Section

502(l) of ERISA in the case of a judicial settlement with the Department of Labor (DOL). Those "prohibited transaction" rules come in two varieties. First, are the so-called per se prohibited transaction rules of Section 406(a) of ERISA and its accompanying provisions under Section 4975 of the Code. These prohibited transaction rules cover virtually every transaction entered into by a plan assets fund and every service imaginable provided to it. Most managers of plan assets funds operate on the premise that each and every transaction entered into by the fund manager on behalf of the plan asset fund is a potential prohibited transaction for which an exemption is required.[14] Counterparties and service providers to plan assets funds—such as broker-dealers, banks, futures commissions merchants, trustees and custodians, swap counterparties, and valuation agents—are potentially subject to rescission and confiscatory excise taxes on prohibited transactions as well, even though they are merely counterparties and service providers acting without fiduciary or privileged authority with respect to the plan assets funds. This reality leads to justifiable nervousness when they deal with plan assets accounts.[15] Given the risk profile, most require contractual assurances from the fund and the manager that an exemption is available and is met.[16]

Congress and the DOL have promulgated numerous exemptions from these "per se" prohibited transaction rules that allow most common financial transactions to proceed for a plan assets fund where the counterparty is not related to the manager or any affiliates and is not a person (and is not affiliated with a person) having certain fiduciary authority with respect to material plan investors in the fund. Probably the most ubiquitous is the so-called QPAM Exemption or Prohibited Transaction Class Exemption (PTCE) 84-14 which provides broad relief from the per se prohibited transaction rules in ways that other transaction-specific exemptions, which are limited to a particular type of transaction, cannot provide either alone or when used in concert.[17] For example, while there is a transaction-based exemption for purchases and sales of securities with US banks and US registered broker-dealers, there is no such exemption for extensions of credit from or to such institutions (other than in connection with the purchase or sale of securities), and there is no transaction-specific exemption for swaps.

ERISA's second set of prohibited transaction rules—its broad self-dealing proscriptions, are also challenging, but their burden may vary based on the particular strategy. Section 406(b)(1) of ERISA prohibits a fiduciary from dealing with plan assets under its authority for its own interest or account. Section 406(b)(2) of ERISA prohibits a fiduciary in its individual or other capacity from acting in a transaction involving the plan assets under its authority on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan assets under its authority. Section 406(b)(3) prohibits a fiduciary from receiving any consideration for his own personal account from any party dealing with the plan assets under the fiduciary's control in connection with a transaction involving such assets.

All "plan assets" mandates generally must be mindful of fee related conflicts that may apply in incentive or performance fees or allocations as well as with respect to base management fees. These potential self-dealing conflicts often are more easily resolvable for liquid strategies with annual net asset value-based fees and often are most challenging for "realization based" fee structures.[18] Separately, practitioner views vary about the extent to which there could also be fee-related conflicts when a fee is based on invested capital and the manager also retains substantial discretion to determine when to call investor money in a commitment-based fund.[19]

Aside from fees, most Alternative Assets strategies (and especially traditional private equity and private credit) also have to contend with other potential self-dealing prohibited transactions. Any transaction of a plan assets fund with or involving the manager or its affiliates generally involves a prohibited transaction. This would include "warehousing" transactions because principal (and riskless principal) transactions between a plan assets fund and its manager or affiliate (or other advised accounts) generally would constitute a nonexempt prohibited transaction. "Season and sell" transactions involving plan assets funds raise similar issues. Any transaction by the plan assets fund that causes the manager or any affiliate to earn any direct or indirect compensation (very broadly construed) could be a prohibited transaction. Separate "vertical conflicts" could arise, for example, where a plan assets fund owns a certain position in a given issuer or borrower's capital structure, where other accounts under the management or advisement of the manager or its affiliates, or even the franchise itself in a proprietary capacity, have an interest in other positions in that issuer or borrower's capital structure. Where those interests come into conflict, a self-dealing prohibited transaction could arise.[20] "Horizontal conflicts" could also occur where the plan assets fund is unfairly placed at a disadvantage vis-a-vis other accounts of the manager, its affiliates, or the franchise. That also can arise where the plan assets fund bears a portion of the expense or cost of other accounts of the manager or its affiliates (or the franchise in its proprietary capacity).[21] Cross-trades generally are prohibited, even though they can be said to benefit all accounts involved.[22] It is arguably possible that disparate interests of different investors within a fund could create conflicts under ERISA under certain circumstances, for example, if not properly addressed, through the operation of a fund's capital call structure, or the allocation of investment opportunities, including those that may arise with respect to a defaulting investor that frees up investment capacity.

Traditional private equity managers have historically found it especially challenging to operate under these broad and restrictive ERISA self-dealing rules. In addition to the considerations mentioned above there are other common practices of such strategies that are in many cases antithetical to ERISA's self-dealing prohibited transaction rules.[23] Some Alternative Assets funds, such as those that focus on US listed equities may be better suited to comply with these self-dealing prohibitions. Others, particularly those involving hard-to-value or illiquid assets, may raise additional challenges. Even though some managers have found success in managing a plan asset private credit strategy, doing so is still highly restrictive, costly, and challenging.

Assuming a manager has concluded that it cannot (or does not wish to) manage a given unregistered fund as plan assets subject to ERISA, there is additional planning required. When it accepts one or more equity investments by any account subject to the fiduciary responsibility provisions of ERISA or the analogous provisions of Section 4975 of the Code, the fund must meet one or more of the exceptions from an ERISA plan assets "taint." A regulation promulgated by the DOL, as modified by Congress in 2006, prescribes rules for when such an account's equity investment in an entity, such as an unregistered fund, may result in the fund becoming subject to the same provisions applicable to the plan account.[24] Exceptions, such as the so-called 25 percent test (or 25 percent limitation) and the venture capital operating company (or VCOC) exception each come with their own burdens.[25] Those exceptions are common to many unregistered funds already in existence that have historically accepted defined benefit plan money and thus are already well known to many managers.

Other Structural and Design Challenges

Termination of Contracts on Reasonably Short Notice Requirement

ERISA requires that plan fiduciaries be able to terminate the plan's contract "without penalty to the plan on reasonably short notice under the circumstances."[26] This would include any contract involving plan assets and a service provider, and in the case of a plan assets fund, this typically involves a "termination" of the fund's manager. Practically speaking, because an investor generally cannot fire a fund manager by itself, termination is effected through the plan's redemption or transfer from the investment fund. The regulations further stipulate that the reason for this specific rule is "to prevent the plan from becoming locked into an arrangement that has become disadvantageous."[27]

The regulations offer that a "long-term lease which may be terminated prior to its expiration (without penalty to the plan) on reasonably short notice under the circumstances" is not generally deemed to be unreasonable. In several opinion letters, the DOL appears to have become comfortable with a 60-day and a 90-day notice period.[28] Helpfully, the regulations also note that the "provision in a contract or other arrangement which reasonably compensates the service provider or lessor for loss upon early termination of the contract, arrangement, or lease is not a penalty." Practice varies in how these regulations may be interpreted. In connection with penalties, the regulations refer to a "minimal fee in a service contract" which is "charged to allow recoupment of reasonable start-up costs." The regulations also note that "a provision in a lease for a termination fee that covers reasonably foreseeable expenses related to the vacancy and reletting of the office space upon early termination of the lease is not a penalty." But the DOL also notes that a provision does ***not*** reasonably compensate for loss "if it provides for payment ***in excess of actual loss*** or if it ***fails to require mitigation of damages.***" [emphasis supplied] Therefore, there is some risk of prohibited transaction exposure where the termination (or other fee) exceeds the "actual loss" by any quantum.

Strategies such as traditional private equity and real estate are by their very nature premised on a long investment period such that early investor exits would not be practicable. In such cases, the fund would just not work. It would thus arguably seem reasonable that the "under the circumstances" prong of this rule could be interpreted to take this into account: "under the circumstances" for a leveraged buyout fund should be viewed differently from "under the circumstances" for a US listed equity strategy. It is important to point out that some fund structures involve withdrawals that are paid over a period of time. In other cases, the investor may be provided with a note. In the latter case, care must be taken to assure that the note does not result in a nonexempt prohibited transaction by reason of the extension of credit between the withdrawing plan on the one hand, and the fund, the manager or other investors in the fund on the other. Moreover, additional care must be taken to ensure that the note does not run the risk of intra-fund conflicts under ERISA.[29] These "delayed" withdrawal features generally are inconsistent with how most Plans currently expect to operate.

Regardless, since most plan investors in such funds have traditionally been defined benefit pension plans, many Alternative Assets funds have had to manage not only the legal constraints associated with this termination provision, but also commercial expectations and the legal calculus of plan fiduciaries considering the fund. Defined benefit plans' tolerance for liquidity restrictions has been comparatively more flexible than for Plans but not limitless. Some fund managers have now been able to engineer these provisions to accommodate the needs of some Plan investors, particularly Allocator products. But it is clear that as of this writing, there is no one-size-fits-all solution and challenges remain for stand-alone direct-access single-strategy Alternative Assets funds.

ERISA Section 404(c)

Most Plans operate to comply with Section 404(c) of ERISA. Section 404(c) shields fiduciaries from liability for investment losses from participant investment decisions in a Plan. While it insulates Plan fiduciaries from liability of participant selections of investments offered under the Plan, it does not relieve them from ERISA responsibility or from liabilities associated with the prudent selection and monitoring of the investment option lineup itself.

At their most elemental, regulations issued under Section 404(c) of ERISA require that a Plan (i) offer a selection of at least three "core" diversified investment choices with materially different risk and return characteristics which in the aggregate enable the participant choosing among them to achieve a portfolio with aggregate risk and return characteristics at "any point within the range normally appropriate for the participant" and each of such three, when combined with investments in other alternatives, "tends to minimize through diversification the overall risk of a participant's" portfolio; (ii) provide sufficient education and information about the plan to allow participants to make informed investment decisions; and (iii) provide the ability to change investment allocations at least quarterly, but with a frequency appropriate to the volatility of the investment options.[30]

Perhaps the biggest potential challenge for direct access to single-strategy Alternative Assets mandates (but not necessarily for Allocator products) is prong (iii) immediately above. The ERISA Section 404(c) regulations differentiate among the "core investment options" and other alternatives. For those other alternatives, liquidity may technically exceed the three-month frequency threshold. Perhaps most instructive in this regard, is the fact that the preamble to the Section 404(c) regulations expressly contemplate it. That language specifically references the availability of an illiquid real estate limited partnership investment that prohibits "transferability of ownership during the first three years."[31]

What is crucial to note, however, is that for purposes of ERISA Section 404(c) compliance, ***all*** investment options under the Plan must give the participant "the ability to transfer among investment options ***with a frequency appropriate for each investment's market volatility . . . .***" The regulations provide that ***"[i]n no event***, however, is such a restriction reasonable unless, with respect to ***each*** investment alternative made available by the plan, it permits participants and beneficiaries to give investment instructions with a frequency which is appropriate ***in light of the market volatility to which the investment alternative may reasonably be expected to be subject***." [Emphasis supplied].[32]

In the context of Alternative Assets strategies, fiduciaries (and thus fund sponsors seeking Plan investment) would likely need to address (or consider, in the case of fund sponsors) the following:

- How does an ERISA fiduciary assess "the market volatility to which an alternative investment fund may reasonably be expected to be subject?"
- How does one then consider the frequency with which a participant should be given concerning investment instructions?
- Are there structural requirements (sizeable liquidity buffer?) that may be called for and what impact would that be on returns?
- How does an ERISA fiduciary calibrate its "risk/return" from a legal liability standpoint?

Separately, the preamble to the Section 404(c) regulations suggests that fiduciaries of an ERISA Section 404(c) Plan "***should periodically review the volatility*** of its investment alternatives to ensure that the transfer frequency permitted with respect to each alternative continues to be appropriate." [Emphasis supplied][33] How a Plan fiduciary may "periodically review" volatility in the context of long-duration strategies like traditional private equity funds could understandably leave some Plan fiduciaries unsettled. What is a "frequency commensurate with the volatility of" the investment alternative when dealing with inherently volatile asset classes? The preamble itself acknowledges the difficulty, saying it is "not feasible [to offer an example or further guidance] because the application of the general volatility rule depends on the particular facts and circumstances which characterize each investment alternative, including its economic environment."[34]

Qualified Default Investment Alternatives

Qualified Default Investment Alternatives (QDIAs) are pre-selected investment options for Plans approved by the Plan's fiduciaries that are used as "defaults" when participants do not direct how they want their Plan accounts allocated. QDIAs help ensure that even those who don't actively manage their investments in their Plan have a diversified portfolio aligned with their retirement goals. They are often target-date funds, balanced funds, or managed accounts. The Pension Protection Act of 2006 (PPA) added the QDIA provisions to ERISA to address concerns that participants who could otherwise save for retirement choose not to, or more correctly, fail to take the steps necessary to enroll in their employers' plans.[35] Moreover, there was concern that employers had not adopted automatic enrollment features because of fears that they would be liable for investing participant account balances without affirmative investment instructions. The PPA and subsequent regulations issued by the DOL removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws.[36] Those rules had prevented many employers from adopting automatic enrollment or had led them to invest workers' contributions in low-risk, low-return "default" investments that were regarded as sub-optimal.

While a comprehensive discussion concerning QDIA requirements is beyond the scope of this article, it is important to point out that only certain investment options are permissible for the protections afforded under guidance. A QDIA must be managed by an investment manager meeting the requirements of ERISA Section 3(38), a professional trustee, or the plan sponsor who is a named fiduciary, be a registered investment company under the 1940 Act, or be one of certain limited purpose principal preservation vehicles. Because of their diversified nature, QDIAs are unlikely able to be structured as a single-strategy direct access product. However, they are conducive to multi-strategy Allocator arrangements.

The remainder of this section proceeds on this assumption.[37] Most recently, the DOL issued Advisory Opinion 2025-04A in which the requesting party (Alliance Bernstein or AB) sought confirmation that an option where Plan participants can receive a guaranteed lifetime income stream through the use of a variable annuity contract could form a portion of a QDIA. The advisory opinion describes AB's lifetime income strategy portfolios (LIS) pursuant to which AB constructs multiple allocation portfolios using investments on a Plan's investment lineup that are unique to the Plan participant, and which includes a guaranteed lifetime income component. While the AB LIS product has been reportedly offered/utilized for years, AB sought confirmation that the LIS could qualify as a QDIA "to provide plan sponsors with certainty when offering the LIS program and other similar programs as QDIAs." The advisory opinion clarified that in selecting the insurers for the LIS program, AB can follow ERISA's safe harbors (including, as discussed below, Section 404(e) of ERISA). These safe harbors include a number of requirements (such as engaging in an objective and thorough search, considering financial capacity and cost, and obtaining certain representations from the insurer) that, if met, protects plan fiduciaries from accusations of imprudence when selecting a plan's annuity.[38] In many respects, this development demonstrates Allocator strategies containing less liquid assets as feasible for QDIAs, including the use of guaranteed lifetime income streams through variable annuity contracts as a component.[39]

Importantly, DOL regulations contain a broad prohibition on the imposition of transfer or withdrawal fees in connection with withdrawals from a QDIA. Specifically, it provides that no fees, restrictions or expenses may be imposed on any transfer or permissible withdrawal from a QDIA within the 90-day period beginning on the participant's first elective contribution made to the Plan.[40] The regulations specifically provide that this precludes the imposition of any surrender charges, liquidation, exchange or redemption fees or similar expenses in connection with the liquidation of or transfer from a QDIA.[41]

Perhaps most relevant to the discussion is the regulations' requirement that a participant or beneficiary on whose behalf assets are invested in a QDIA must be able to transfer, in whole or in part, assets in the QDIA to any other investment alternative available under the Plan with a frequency consistent with that afforded to a participant or beneficiary who elected to invest in the QDIA, but not less frequently than once within any three month period.[42] Accordingly, Allocator strategies structured as QDIAs will need to manage liquidity to achieve these objectives, which may not always be easy, especially where there may be sudden precipitous drops in public asset values. Nevertheless, there are indications that some market participants have met, or are on their way to meeting this challenge.

Pathways: Current and Future

Some Alternative Assets strategies are offered as a direct stand-alone fund. Examples include a single private equity or a standalone hedge fund. Others, as mentioned above, are Allocators where a given provider offers a balanced multi-strategy fund or product as to which Alternative Assets are a mere component among many. Still others may be Allocators across a single-strategy, such as a fund of private equity funds. From the product design perspective and the Plan fiduciary's vantage point a diversified approach to Alternative Assets offered under a multi-strategy Allocator product mitigates some of the "idiosyncratic risks that can exist within individual private market asset classes."[43] In this way, it may have certain appeal to Plan clients and product sponsors alike. Where exposure to Alternate Assets is merely a sleeve of an Allocator mandate, Alternative Assets fees can be blended with comparatively less expensive public assets that comprise the overwhelming majority of the portfolio. Proponents of Allocators have pointed out that the value of Alternative Assets in a broad multi-strategy product such as a target-date fund may outweigh the Alternative Assets' incrementally higher cost.

These Allocator arrangements remain a current focus because they appear to be the best solution yet introduced to the market for addressing a fundamental problem with the use of Alternative Assets in Plans: Alternative Assets are not actively traded (by definition) and Plans today provide daily liquidity to participants. The challenge is how to value Alternative Assets for Plan liquidity purposes, and the answer may not always be simple or straightforward. Especially in market liquidity crises, which have tended to occur within the retirement savings years of most persons, there are likely going to be hard questions about how to reconcile claims based on valuation uncertainty.

But that does not mean, of course, that standalone Alternative Assets strategies should be regarded as unappealing. Nevertheless, in the current world, as described above, such single-strategy mandates in unregistered private funds are challenged because of the need to look through to participants' QP and AI status. While future guidance may change that situation, for present purposes, this section assumes that unregistered funds are largely unavailable to direct Plan investments. Whether they can be separately accessed through "plan assets" vehicles such as collective investment trusts (or less likely for practical reasons, managed accounts), will depend, at least in part, on whether the strategy is conducive for operation under ERISA. Meanwhile, growing opportunities may exist for registered closed-end funds, discussed below, which raise neither a "plan assets" taint nor the QP and AI related complexities.

At least at present, pathways for Allocator strategies that involve a sleeve of exposure to Alternative Assets would appear to suffer comparatively fewer structural and legal speedbumps. Because target-date and similar Allocator products continue to be growing in popularity and usage for Plans, with some studies suggesting that 85 percent (or more) of all Plans having a target-date or similar Allocator product, it would appear that Allocators are better positioned to offer access to Alternative Assets in Plans—at least for the foreseeable future.[44] This section addresses the pathways for both the Allocator and single-strategy direct approaches, however, first discussing the possibilities of registered funds, including both open-end and closed-end products, along with recent developments. It then proceeds to cover collective investment trusts. Finally, the section briefly covers managed accounts.

Registered Funds: Opening a Closed-(End) Door?

Overview

As noted above, the investment activities of a fund registered under the 1940 Act are not subject to the fiduciary responsibility and prohibited transaction rules of ERISA and Section 4975 of the Code. While this exclusion may be viewed favorably by some product sponsors, registration under, and compliance with the 1940 Act is not burden-free. Many fund sponsors choose not to register their alternative strategy funds under the 1940 Act for a host of reasons, as discussed above. Registered funds are subject to more extensive disclosure requirements than many other comparable financial products, such as separately managed accounts, and arguably, collective investment trusts, and private pools, although in some cases, those other products elect to harmonize aspects of their disclosure to investors to provide a more apples-to-apples comparison for Plan fiduciaries and for certain participant-facing ERISA regulatory reporting purposes. But more fundamentally, open-end registered funds often impose conditions that do not work well with Alternative Assets strategies.

Most importantly, open-end funds' limits on illiquid assets largely prevents them from investing in most Alternative Assets, while Alternative Assets strategies require limitations on liquidity so that the strategy can be deployed in a manner to maximize the intended value proposition. Thus, for such funds there is an inherent structural tradeoff between a fund's liquidity capacity and its ability to pursue its longer-term investment objectives. It is true that the 1940 Act does not completely limit open-end registered investment companies' assets from investing in illiquid assets. But its 15 percent cap is often highly challenging, if not impossible to achieve.[45]

Unlike open-end registered funds, traditional closed-end registered funds offer greater flexibility for the fund when it comes to liquidity. Historically, however, most Plans have avoided selecting them for their investment lineups, with liquidity concerns serving as a major headwind. Traditional closed-end registered funds do not issue redeemable shares but instead issue a fixed number of shares that trade intraday on stock exchanges at market-determined prices. Investors in a closed-end fund buy or sell shares through a broker, just as they would trade the shares of any publicly traded company. Thus, when compared to registered open-end funds which allow for daily transactions at net asset value, registered closed-end funds do not offer redemption rights, and have a fixed number of shares that trade on an exchange the value of which is based on market forces (which may not reflect the fund's net asset value). They are thus not required to meet daily shareholder redemptions as is the case for open-end registered funds. However, unlike open-end registered funds which substantially limit the amount of the funds' assets that can be held in illiquid assets, a traditional closed-end registered fund does not face the same degree of these impediments.

In addition to traditional closed-end registered funds there are non-listed closed-end registered funds. Those include interval funds and tender-offer funds. Interval funds are permitted to continuously offer their shares at net asset value (NAV) following their initial offering. Most interval funds differ from traditional closed-end registered funds in that they typically do not offer liquidity via the secondary market (that is, they typically are not listed on an exchange). Instead, they buy back shares by making periodic repurchase offers at NAV in compliance with SEC Rule 23c-3 under the 1940 Act.[46]

Specifically, Rule 23c-3 under the 1940 Act provides that an interval fund must allow for the repurchase of its securities from shareholders at periodic, predetermined intervals. An interval fund must adopt a fundamental policy that provides (i) that the fund will make periodic repurchase offers, (ii) the periodic intervals between "repurchase request deadlines," (iii) the schedule of the repurchase request deadlines or the means of determining the repurchase request deadlines, and (iv) the maximum amount of time between each repurchase request deadline and the next repurchase pricing date.[47]

Interval funds repurchase schedules are required by Rule 23c-3 to be quarterly, semi-annually, or annually. At each periodic interval, an interval fund must offer to repurchase between 5 percent and 25 percent of its common shares outstanding on the repurchase request deadline.[48] Purchases of interval funds thus resemble open-end mutual funds in that their shares typically are continuously offered and priced daily. However, unlike an opened-end registered fund, shares are not continuously available for redemption but are repurchased by the fund at scheduled intervals (for example, quarterly, semiannually, or annually). Moreover, unlike open-end registered funds which limit illiquid assets to 15 percent of the portfolio, closed-end registered interval funds may permissibly hold 75 to 95 percent of their assets in illiquid assets, (although additional limitations may apply so the fund maintains sufficient assets to cover repurchases).

A tender-offer fund usually offers greater flexibility to the fund on the periodicity of repurchases, with less predictability to investors. Tender offer funds generally are unlisted and continuously offer their shares at NAV. Unlike registered open-end funds and interval funds, there are no historic limits on the holding of illiquid assets (although as a practical matter, many maintain at least some liquidity buffer). Unlike interval funds which are committed to effect repurchases at fixed predetermined intervals to assure the appropriate levels of liquidity, tender offer funds repurchase shares on a discretionary basis through a tender offer which must comply with SEC Rule 13e-4 under the Securities Exchange Act of 1934 by filing a Schedule TO.

Some of these types of funds hold infrequent tender offers (for example, one every two to three years), but many offer them more regularly (for example, quarterly). The fund board must determine, usually based on the advice of the fund's sponsor, when a tender offer will be commenced and the number of shares to be redeemed in each tender offer.[49] Tender offer funds often are used for pools of assets, such as funds of funds, whose liquidity flows may be more episodic than those of other strategies. For example, a tender offer fund holding a portfolio of privately offered hedge funds could pay repurchase proceeds when received by the tender offer fund after the tender offer fund has requested withdrawal from its portfolio hedge funds—even for several months.

Because of liquidity challenges, closed-end registered funds have not been traditionally offered under most Plan investment lineups. But the recent developments described below may offer some promise and new opportunities.

Business Development Companies

Business Development Companies (BDCs) are hybrid types of closed-end funds that primarily invest in small and medium-sized private companies, developing companies, and distressed companies that do not otherwise have access to lending. In particular, BDCs must invest at least 70 percent of their assets in domestic private companies or domestic public companies that have market capitalizations of $250 million or less. They differ from other closed-end funds in that they are not registered under the 1940 Act but instead elect to be subject to and regulated by certain provisions of the 1940 Act. Thus, unlike registered opened-end and closed-end funds, BDCs do not necessarily fall outside of ERISA's fiduciary and responsibility provisions. In this respect, many believe that they are more akin to unregistered funds for purposes of ERISA's "look-through" rules described above. Typically, BDCs seek to comply with either the 25 percent limitation, the VCOC exception or another exception referred to as the "publicly offered securities exception" to avoid "plan assets" status. All BDCs must be SEC reporting entities (for example, filers of 10Ks, 10Qs, 8Ks, etc.) and are subject to the same rules and regulations as one another under the federal securities laws.

Like many "evergreen" or "permanent capital" funds, BDCs can be offered with no fixed lifespan, in contrast to many unregistered closed-end funds.

The fund has no stated end date and assets under management are not subject to decrease as a result of redemptions or other withdrawals of capital. BDCs may be either traded (that is, listed on the New York Stock Exchange or Nasdaq), publicly offered but not traded, or "private" pursuant to which shares are sold through private placement with fundings occurring through capital call features common to many unregistered private equity and private credit funds. The selection of which type of fund to use is primarily determined by asset managers' preferences for timing to market and target investors, including investors' needs for liquidity, and the receptiveness of the various distribution channels to the asset managers' product offerings.

"Publicly traded" BDCs appear to be in the minority and offer the most liquidity for investors. Non-traded BDCs conduct continuous offerings at NAV per share.[50] Such BDCs are not listed on an exchange and thus generally have limited liquidity (for example, via discretionary share repurchases) prior to conducting a liquidity event, such as an initial public offering (IPO). Liquidity events generally are scheduled to occur five to seven years after launch. QP or AI status is not required for a non-traded BDC; however, there are often state law (blue sky) issues that may make Plan investments challenging. Many state rules require that eligible investors earn $70,000 or more in order to avoid state law registration. Where a relevant state's blue-sky laws would look through the Plan to its underlying participants, all of its participants may effectively be required to meet that threshold. One can imagine circumstances where this will always be true, but there are many in which it may not be true, and monitoring for any given plan population could be burdensome.

Private BDCs are not listed on an exchange and have limited liquidity. (However, many private BDCs offer quarterly liquidity through tender offers, similar to interval funds, even though, as compared to interval funds, they also have flexibility to avoid offering liquidity in certain quarters). These kinds of BDCs do not register their offerings under the Securities Act of 1933. Thus, investors in private BDCs must generally be AIs. Given existing law as described above, each participant of an investing Plan would effectively need to be an AI if the private BDC were to be offered because of the interaction between SEC look-through rules and tax qualification rules. Private BDCs would therefore appear to be challenging for participant-directed Plans in much the same way as are unregistered funds—at least prior to becoming traded—which is often anticipated three to five years from launch.

BDCs often are thought to offer the US federal income tax efficiencies of a registered fund and require the diversification mandated by the US federal income tax rules applicable to registered funds, while being less restrictive on leverage and affiliated transactions. In fact, when compared to closed-end registered funds, BDCs have a higher leverage limit.

Recent Developments

Like open-end registered funds, closed-end registered funds historically have been precluded from investing more than 15 percent of their assets in Alternative Assets unregistered funds, unless the closed-end fund was limited to investors who were AIs and each such investor's initial investment was $25,000 or more. This restriction has itself been a major impediment for most Plans since, as discussed above, most Plan participants are not AIs—and limiting access to such an investment option to only those that are AIs could raise potential disqualification issues for a Plan under the Code.

Effective May 19, 2025 registered closed-end funds that do not explicitly limit their unregistered fund exposure to the 15 percent threshold are now able to invest in other unregistered funds without limiting their investor base to AIs or imposing the $25,000 minimum investment requirement.[51] As a large portion of the investing public does not satisfy the net worth or income requirements for AI status, the discontinuance of the restriction will expand significantly the pool of eligible investors for closed-end funds having a focus on Alternative Assets markets investments through unregistered funds.

Separately, the SEC has granted recent exemptive relief for certain registered closed-end interval funds. Specifically, in at least one case the SEC permitted such funds to make repurchase offers to its common shareholders every month in an amount not less than 2 percent of the common shares outstanding on the repurchase request deadline, subject to a "repurchase adjustment" and to provide notification to its common shareholders of an upcoming repurchase offer no less than seven and no more than 14 calendar days in advance of the repurchase request deadline.[52] The SEC in that case indicated that "there is no public interest nor investor protection concern that justifies prohibiting monthly repurchase offers of not less than [2] percent of the common stock outstanding on the repurchase request deadline" and also indicated that "monthly repurchases would provide significant benefits to common shareholders because their investments will be more liquid than an investment in a fund conducting only quarterly repurchase offers."[53]

Noteworthy are several new interval funds aiming to provide access to public and private equity markets through a single integrated solution. Over time, and subject to market conditions, these funds seek to allocate target amounts of net assets to stated percentages between publicly traded equity securities and private equity strategies. These new funds build on the launch in recent years of interval funds focused on credit strategies.

Application

Recent developments in closed-end registered funds may provide new avenues for Plan access to Alternative Assets strategies. How these recent changes will impact the Plan market remains to be seen. At the end of the day, any successful standalone direct single-strategy closed-end registered fund will need to be palatable to a given Plan fiduciary's risk-reward calculus. The same holds true for Allocator product sponsors who wish to consider closed-end registered funds as a component. Much remains uncertain, but greater exploration of closed-end registered funds is an increasing possibility, not only for multi-strategy Allocators such as a target-date fund or life-cycle fund, but also as a stand-alone single-strategy "Allocator." For example, closed-end registered funds could be good candidates for a "fund of private equity funds" suitable on either a standalone basis for Plans or, more likely as of this writing, as part of a third-party Allocator.[54] It would still remain more difficult, however, to manage a true private equity strategy through a registered closed-end fund. The same potential holds true for BDCs, especially with respect to private credit.

The recent changes to portfolio limitations that had historically applied to closed-end registered funds may help accelerate this exploration. While it is beyond the scope of this article to discuss all the comparative pros and cons of any given registered closed-end fund or BDC, the opportunity would certainly seem ripe for examination.

The use of a closed-end registered fund or BDC may offer some comparative legal and structural advantages over other corporate forms. Unlike a strategy that is delivered through a collective fund or separate account, a closed-end registered fund would be subject to the restrictions of the 1940 Act, but not the prohibited transaction rules of ERISA and the Code. Registered closed-end funds could also serve as Allocators in which the closed-end fund acts as a fund-of-funds that invests in closed-end registered funds or unregistered funds.

Whether product sponsors are able to build new "mousetraps" out of registered funds, open or closed, will be interesting to see. Future regulatory guidance will be important in this regard, along with the product innovation it will invariably spur. However, one of the keys is that all registered funds—open-end or closed-end, as well as BDCs—offer all of the investor protections of the 1940 Act, including with respect to fees, leverage, independence and disclosure. As in ERISA, the 1940 Act related nuances associated with such products can be important, and product manufacturers would be wise to consult counsel whom they believe to have top-of-market experience given the constantly evolving legal and regulatory dynamics.[55]

Collective Investment Trusts

Generally

Collective investment trusts may be offered as a stand-alone strategy of Alternative Assets. They may be accessed not only directly by Plans, but by managers of Allocator products structured as collective investment trusts at a "top" or allocating level. Such Allocator products may include asset allocation funds like target-date or life-cycle funds as well as other vehicles designed to access Alternative Assets strategies as a component of an overall diversified strategy. In addition to a multi-strategy Allocator, this category could also include a fund-of-funds approach that is strategy specific: for example, a bank collective fund that invests solely in private equity funds. In all of these Allocator arrangements, there is an "allocator" which in the context of a target-date or life-cycle fund is often referred to as a "glidepath" manager. As collective investment trusts presuppose for both SEC and other (that is, OCC or state banking or trust law) purposes that the trust be maintained by a bank (or trust company), only banks or trust companies may sponsor these vehicles. That said, it is common as of this writing for many bank- or trust-company sponsored institutions to engage sub-advisers where prudent so long as the trustee still retains the requisite management and control.[56]

Collective investment trusts have been widely used by Plan investors for decades and available evidence suggests they will continue to grow in market share, particularly for defined contribution plans. While such funds have historically accommodated many traditional strategies, their recent growth has been at least in part due to target-date life-cycle and similar allocation strategies that have found collective investment funds to be particularly advantageous.[57]

It is perhaps no surprise why collective investment trusts appear to be a favored product of choice for many Allocators and Plans. Many point to certain advantages of managing liquidity concerns occasioned by participant outflows, re-balancings, and other withdrawals. Collective investment trusts have been touted for their flexibility in dealing with recordkeepers, and in particular, for their ability to net public assets against participants' Alternative Assets inflows and outflows. Lockheed was reported to have incorporated a private equity strategy into its Plan, with the aim of gradually increasing such exposure over a two-year period until it reaches target allocations.[58] Earlier in 2025, there were reports that a private equity co-investment sleeve managed by Neuberger Berman was added to the plan. In addition, it was announced that State Street Investment Management launched a new target date fund that provides access to both public and private market exposures in a diversified strategy, with the Alternative Assets strategy being delivered through a pooled vehicle managed by Apollo.[59] Empower has been reportedly using bank collective investment trusts in partnering with several private investments fund managers and custodians, including Apollo, Franklin Templeton, Goldman Sachs, Neuberger Berman, PIMCO, Partners Group and Sagard.[60] There were announcements about BlackRock and Goldman Sachs Asset Management creating similar strategic partnerships with Great Gray[61] and Voya with Blue Owl Capital also involving collective investment trusts.[62] Partners Group and Prudential (PGIM) have also been reported to have partnered to bring multi-asset portfolios to Plans.[63] No doubt there are other such partnerships that will have launched as of this writing.

In contrast to registered funds—either of the open-end or closed-end variety—collective investment trusts are subject to ERISA at the first dollar of ERISA investment. As noted above, ERISA imposes a number of constraints on the operation of many funds and requires compliance both with ERISA "per se" and self-dealing prohibited transaction rules.

These include many of the "horizontal" and "vertical" conflicts, as well as fee-related, "termination without penalty" provisions and the more basic "per se" party in interest prohibited transaction rules.

With respect to the per se party in interest prohibited transaction rules, collective investment trusts may enjoy some competitive advantages. Most are often able to make use of PTCE 91-38, which is a special exemption specifically designed for and applicable only to bank collective investment trusts. Like the QPAM Exemption, PTCE 91-38 provides broad relief from otherwise nonexempt "per se" prohibited transactions with unrelated counterparties as well as certain otherwise prohibited transactions with respect to certain employer securities. While in many cases, the QPAM Exemption also may be available, PTCE 91-38 would appear to offer some distinct comparative advantages, particularly for private credit strategies.[64] In addition, PTCE 91-38 does not contain the disqualification provisions of Part I(g) of the QPAM Exemption. These provisions, which have been recently revised and expanded by the DOL, have the potential for increasingly enormous "bite."[65] None of this is to say that the QPAM Exemption is not going to continue to be widely used by investment managers when managing plan accounts. However, the fact that bank collective investment trusts have another broad-based exemption that is comparable, if not, in some cases, favorable, may confer certain advantages.[66]

While PTCE 91-38 and the QPAM Exemption both offer broad relief, other exemptions from the per se prohibited transaction rules may also be available even if many are limited to specific transactions.[67] Collective investment trusts also offer other structural advantages, including flexibility on fees and comparatively less expense on certain items when viewed against registered funds. These include marketing expenses and distribution costs. Some have also found them better able to provide customized solutions when compared with registered fund products. Collective investment trusts may also enjoy advantages in terms of speed with which they may be brought to market as against registered funds.

As noted above, collective investment trusts are not regulated by the SEC. Indeed, they are chiefly designed to be a pooled investment vehicle that relies on an exemption from registration from the 1940 Act—Section 3(c)(11) of that statute. This does not mean that they are not regulated. Quite the contrary. As noted above, at its acceptance of any ERISA money, the collective investment trust immediately becomes subject to the fiduciary responsibility and prohibited transaction rules of ERISA. Moreover, most collective investment trusts are regulated by the OCC or by relevant State banking and trust authorities. Collective investment trusts are also regulated by the Internal Revenue Service (IRS) with regard to the funds' tax qualification.[68]

Collective Investment Trusts Investing in Third-Party Funds

Many collective investment trusts may serve as the allocator in an Allocator product. As is the case with any ERISA fiduciary in a "fund of funds" product or otherwise in selecting investment managers, there are considerations for the Allocator (or fund of funds manager or manager selector) and for the downstream fund in which the Allocator (fund of funds or investing plan) invests. An Allocator structured as a collective investment trust will be "plan assets" and the trustee or other fiduciary with authority over the fund will be charged with prudently managing the strategy in accordance with the dictates of ERISA and its exacting requirements. This involves the prudent selection and monitoring of such downstream funds, including fees, manager capacity and capabilities, liquidity and other terms and conditions the Allocator fiduciary deems to be prudent to consider. It may also be required to negotiate the terms and conditions of the investment. In short, it involves the fiduciary of the investing collective investment trust undertaking a robust process not dissimilar to plans investing directly into the downstream strategy, or of a fund-of-funds or other manager selection service where the manager acts in a fiduciary capacity.

Many Allocators are exploring the recent innovations and regulatory changes with respect to closed-end registered funds, but some have been structured to serve as components for such Allocators for some time. Many are finding it difficult to match legal and commercial requirements so that they "line up" with the demands of the Allocators, although recent anecdotal market information suggests that this may change.

When a given downstream fund in which a collective investment trust invests is itself a collective investment trust or an unregistered fund that may be "plan assets," additional undertakings beyond a prudence analysis usually are required. Specifically, these relate to the collective investment trust's comfort with the downstream fund's approach to ERISA compliance.[69] Regardless of this point, it also will be important to assure that the Allocator has appropriately delegated its authority to any "plan asset" downstream fund manager.[70] Where delegation is proper, the delegator's responsibility is limited to the Allocator's selection, retention, and monitoring of the downstream fund manager. An improper delegation, at a minimum, would leave the Allocator potentially liable for the acts and omissions of the downstream manager. Note that satisfaction of proper delegation does not in any way limit the Allocator's responsibility to prudently select and monitor the downstream managers or strategies in its product—regardless of whether they may be "plan assets." There also are reputational risks and the practical costs of successfully defending against a claim should something go wrong.

Then there is the perspective of the downstream fund manager. One of the advantages of registered downstream funds (even if closed-end) is that they are not only exempt from ERISA but also do not have many of the capacity issues of unregistered funds relying on the 25 percent test. While a downstream fund that is itself a collective fund generally will be subject to ERISA, downstream funds that are neither collective investment trusts nor registered funds under the 1940 Act will need to consider whether they are able, and willing, to assume ERISA fiduciary responsibility. When the third-party unregistered fund determines it is unwilling or unable to manage the fund as "plan assets," the manager of that fund will not wish to impair its own ERISA exception status. Issues of ERISA investor capacity may be relevant for certain third-party funds, particularly if relying on the 25 percent test described above.[71] Underlying third-party unregistered fund managers also would need to be confident that investments from the collective fund would not jeopardize their own funds' securities law exemption. This should generally not be problematic if the downstream fund is itself also a collective fund or a registered closed-end fund. But even if it is an unregistered alternative fund, the fact that the Allocator itself is housed in a collective fund may be helpful. From the perspective of the downstream third-party unregistered fund, investments by bank collective funds usually do not usually raise the sorts of QP and AI issues that would come along with a Plan's direct investment in the unregistered fund. In addition to the Section 3(c)(7) and Section 3(c)(1) exemptions from the 1940 Act registration, the applicability of Section 3(c)(11) and Section 3(c)(3) exceptions from registration under the 1940 Act also may be helpful depending on the circumstances.[72]

Collective investment trusts that invest in third-party funds also need to be mindful about ERISA's self-dealing proscriptions. Potential issues could arise with respect to valuation (less likely for registered closed-end funds than unregistered funds), and in particular, fees. Collective investment trust Allocators would need to consider not only the prudence of fees, but also the possibility of fee conflicts. Since many of the third-party downstream funds may charge different fees, legal, mechanical, operational, and commercial considerations often arise.[73] Additional considerations can be necessary, particularly, when the Allocator sponsor is affiliated with a private equity firm or other large diversified financial institution engaged in banking, brokerage, underwriting, loan syndications, or other activities. Potential prohibited transaction issues could arise in such contexts when the downstream "plan asset" fund engages in certain transactions on behalf of that fund with or through the Allocator or its affiliates.

In addition, there are many features of such an Allocator plan asset bank collective fund besides their fees that raise the potential for other inadvertent prohibited transaction exposure. While fee and termination provisions are important parts of a successful design, the product would likely need to be thoroughly "scrubbed" for many of these "below the radar" issues. The complexity of the strategy may involve important nuances, but our experience strongly suggests that to assure that a given fund or strategy is operated properly under ERISA always involves considerable time, energy, and expertise to get it right.[74]

Collective Investment Trusts Investing in Affiliated Funds

There also are collective investment trusts that invest in affiliated fund strategies. To be sure, many of the same considerations that are applicable to bank collective investment trust that invest in third-party funds would be equally salient here. Collective investment trusts that invest in affiliated funds still need to be mindful of prudence, duties of loyalty, diversification, fee conflicts, "termination on reasonable notice" and "without penalty" provisions, costs, liquidity, terms and conditions and other key features discussed above.

But investing in affiliated funds raises potential and quite separate prohibited transaction issues from those by investing in third-party unaffiliated funds. Unlike third-party investment vehicles, the fiduciary or its affiliates may have an interest (financial or otherwise) in the downstream affiliated fund. Certainly, there is the potential issue of "double dipping" on investment management fees (a practice generally frowned on in our experience regardless of ERISA related considerations). But there also may be other interests for a trustee to allocate to any given affiliated fund. Conflicts such as these could give rise not only to potential breaches of loyalty under ERISA (as well as similar violations under Reg. 9), but also nonexempt prohibited self-dealing transactions. Fortunately, Congress enacted broad relief that many collective-investment trust complexes rely on when the investment is in an affiliated bank collective investment trust. Section 408(b)(8) of ERISA offers relief from ERISA's prohibited transaction rules (and those of the Code) where an investment manager, having discretion over plan assets, causes those assets to be invested in a collective investment trust maintained by the manager, or other affiliate, where the bank or trust company receives no more than reasonable compensation, and such transaction is expressly permitted by the instrument under which the plan (or plan asset vehicle, such as a collective investment trust) is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who engages the trustee or affiliate manager.[75] Thus, Section 408(b)(8) is often utilized for relief from prohibited transactions where an investment manager of a separately managed ERISA account directs the plan account into a collective investment fund sponsored and maintained by a trustee which is the manager of the separate account or its affiliate where the plan independently approves and the fees are reasonable. It also affords relief for trustees of collective investment trusts to direct the assets of that fund into other collective investment trusts sponsored or maintained by the same trustee, or another affiliate trustee. Such structures offer the possibility of a "collective fund of affiliated collective investment trusts." Many already are common in the marketplace, particularly in the target-date and life-cycle fund markets. In such cases, the participation agreement for the collective investment trust typically contains express permissive language for investment in other affiliated collective investment trusts, which is signed by the investing plan fiduciary (independent of the collective investment trust sponsor).

Of course, not all downstream affiliated funds that a collective investment trust may wish to access are bank collective investment trusts. Some may be open-end registered mutual funds sponsored and managed by the trustee or affiliate. Some collective investment trusts also utilize PTCE 77-4, which allows a collective investment trust to allocate its assets to an affiliated open-end registered mutual fund meeting certain conditions.[76] PTCE 77-4 requires that the investing (independent) plan fiduciary be provided certain written information about the registered funds, prospectuses, and full and detailed written disclosure of the investment advisory and other fees charged to or paid by the plan (or collective investment trust) account and the investment company, including the nature and extent of any differential between the rates of such fees, the reasons why the fiduciary or investment adviser may consider investments in such affiliated registered funds appropriate, and whether there are any limitations on the fiduciary or investment adviser with respect to which the plan (collective investment trust) assets may be invested in the registered fund, and the nature of such limitations.[77] On the basis of the disclosure and prospectuses provided, independent plan fiduciaries must consent to the manager being able to allocate the assets under its management to the affiliated open-end registered fund whose information has been provided. This consent must be in writing.

In addition, PTCE 77-4 conditions relief on either foregoing (or offsetting) the collective investment trust level investment management, investment advisory or similar fee with respect to the allocation of assets directed to an affiliated open-end registered fund, or that the investment company's investment management, investment advisory or similar fee be offset against the account level (that is, the collective investment trust) investment management, investment advisory or similar fee. No loads, commissions, or other similar payments may be received by the trustee, adviser, or any affiliates in connection with the collective investment trust's purchase and holding of such affiliated registered fund shares. As a matter of practice, collective investment trusts that anticipate investments in affiliated open-end registered funds typically will include in the participation agreement the necessary disclosures required along with prospectuses of all the possible such funds that could be expected to be utilized. Since affirmative written consent is required for the exemption, a "phonebook" or "kitchen sink" approach for disclosure at the time of investment is often regarded as most efficient.

It should be noted that there is no published prohibited transaction exemption dedicated to investments in either affiliated closed-end registered funds or unregistered funds. Allocating collective investment trust assets to such affiliated investments (or affiliated registered funds without reliance on PTCE 77-4) raises the potential for nonexempt prohibited transactions, and a fiduciary considering allocating plan assets on a discretionary basis to any such affiliated closed-end registered fund or unregistered fund would likely need to conclude that there was no prohibited transaction involved with respect to the purchase or holding of the investment for which an exemption would be required in the first place.

Managed Accounts

A managed account is an account of a plan, such as a Plan, that is not pooled with other investors. Managed accounts may be preferred when a plan wishes particular specification, customization, or other investment or tax-related attributes that may otherwise make a pooled strategy suboptimal because these features are undervalued by other investors. Some Plans prefer the greater transparency that often comes along with managed accounts. Separately managed accounts often offer better pricing than pooled funds, because they do not incur the types of set up, fund administration costs, and other regulatory associated with funds.

Increasingly, managed accounts may be favored where Plan fiduciaries wish to create individualized participant accounts based on the specific participant's personalized goals. They thus offer the possibility for more personalized asset allocation than pooled vehicles such as a bank collective investment trust, so that different participants in the same Plan may have different allocations that are designed to match specific individualized investment profiles. At the same time, while offering such flexibility, managed accounts may also result in higher liquidity constraints, because they cannot generally benefit from the liquidity of other participants' accounts under the product. Separate accounts have historically been available to larger plan accounts and have been less accessible by smaller plans. However, with the rapid increase in products and services targeted at the retail market, this may be changing.

A separately managed account of an ERISA plan is subject to ERISA. Depending on what the separate account is invested in informs the complexity of ERISA-related limitations and compliance. Some Allocator products may be delivered through a separately managed account rather than a pooled vehicle. One sponsor has been reported to have taken this approach in concert with downstream investments in collective investment trusts. It has been reported that this sponsor uses managed accounts to provide a tailored investment approach and a collective investment trust that pools the capital and invests it in the sponsor's flagship US private equity fund.

Managed accounts increasingly are accessed by retail investors through broker-dealer, banking, wealth management, insurance company, or other similar platforms. Many such financial institutions may be poised to offer companies participant-specific management of their respective Plan accounts. As most generally will take on fiduciary responsibilities, significant planning and structuring is often involved at the financial institution level—no different from the full panoply of fiduciary responsibility and prohibited transaction discussed throughout.[78] Many diversified financial firms already manage substantial amounts of ERISA money and are well familiar with the constraints associated with prohibited transactions, and in particular, potential conflicts with their affiliated "sell sides." However, many financial institutions also have been providing "advice-only" services at the participant level in retail, high net worth, private wealth management, and private banking businesses. In such circumstances, when the institution provides advice that rises to the level of fiduciary status, many have sought to comply with PTCE 2020-02, a new exemption that allows advice fiduciaries to make recommendations to plans and participants (unaffiliated with the institution) with respect to investments (service based compensation, and more limited relief for principal transactions with the institution), and to earn variable compensation when the advice-giver and institution has satisfied numerous "impartial conduct standard," conflict mitigation, disclosure and other requirements.[79] However, PTCE 2020-02 is not available for discretionary management.

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NOTES

1 Rule 22e-4 under the 1940 Act.

2 In addition, the 1940 Act imposes diversification requirements on funds that assert their status as a "diversified company." Under Section 5(b)(1) of the 1940 Act, a registered fund must comply with the "75-5-10 Rule," which requires that at least 75 percent of the fund's assets must be invested in cash, government securities, securities of other registered investment companies, and other securities; within that 75 percent basket, no more than 5 percent of the fund's total assets may be invested in the securities of any single issuer; and within that same 75 percent basket, the fund cannot own more than 10 percent of the outstanding voting securities of any single issuer. Under SEC Staff positions, funds that operate for three years or more consistent with these requirements become "diversified companies" and must continue to comply with them. Moreover, tax rules impose limitations so that (1) no single issuer can exceed by value 25 percent of the value of the fund's total assets, and (2) the value of the sum of the assets invested in issuers whose values exceed 5 percent of the fund's total assets or of which the fund holds 20 percent of the voting stock cannot in the aggregate exceed 50 percent of the fund's total assets. *See* Section 851(b)(3) of the Internal Revenue Code. The effect of this test is that a fund with a modest cash position and no government securities would need to hold securities from at least 12 different issuers. In total, these provisions make it difficult for a registered fund to operate a traditional private equity strategy, although such a vehicle may be conducive for a fund-of-funds strategies that is diversified.

3 15 USC § 80a-2(a)(51); Rule 3c-5, 17 CFR 270.3c-5. Relying on the KE definition also requires that the manager of the Alternative Assets be an affiliate of the Plan sponsor, which raises separate risks and considerations.

4 *See* H.E. Butt Grocery Company, SEC No-Action Letter (avail. May 18, 2001) (HEB); Standish, Ayer & Wood, Inc. Stable Value Group Trust, SEC No-Action Letter (avail. Dec. 28, 1995) (Standish Ayer); PanAgora Group Trust, SEC No-Action Letter (avail. Apr. 29, 1994) (PanAgora).

5 Section 3(c)(1) of the 1940 Act provides a separate exception for privately offered funds in which there are no more than 100 investors. When investing in an unregistered fund through a participant directed 401(k) Plan, the SEC has indicated that *each* participant must be counted for purposes of the 3(c)(1) limitation, and *each* participant must be looked at for qualified purchaser and knowledgeable employee status. *See, e.g.,* PanAgora Group Trust and H.E. Butt Grocery Company, *supra* n.4.

6 For individuals, "accredited investor" status currently requires either a net worth of $1 million (excluding the positive value of the individual's primary residence) or an annual income of $200,000 ($300,000 with a spouse or domestic partner) in each of the prior two years, with a reasonable expectation of the same earnings in the current year.

7 A plan that becomes disqualified could have calamitous repercussions as all participants would become subject to US Federal income tax on their account balances, and in some cases, result in additional excise tax penalties.

8 *See*, Treasury Regulation § 1.401(a)(4)-4.

9 Regulation 9 Section 9.18(a)(1) refers to common trust funds, while Regulation 9 Section 9.18(a)(2) refers to those collective investment funds that are based on the trust's exemption from US Federal income taxation by qualifying under Rev. Rul. 81-100, 1981-1 C.B. 326 and its progeny. This article deals with these "(a)(2)" trusts which will generally seek to meet the Section 3(c)(11) exception from 1940 Act registration. For purposes of the Section 3(c)(11) exception under the 1940 Act, the term "bank" is defined under Section 2(a)(5) of the 1940 Act to include state-chartered banks and trust companies with fiduciary authority that is "similar to those permitted for national banks."

10 29 CFR 2510.3-101(h).

11 Rev. Rul. 81-100, 1981-1 C.B. 326.

12 Section 409 of ERISA.

13 *See generally* ERISA § 502(a).

14 These "per se" prohibited transaction rules apply to transactions between a plan assets fund and "parties in interest" as defined under ERISA, or disqualified persons, the term used in Section 4975 of the Code. For purposes of organizational clarity, references to "parties in interest" should be read as including those of disqualified persons under the Code, understanding that there are some minor differences between the two. Parties in interest include persons that sponsor the plan, act as fiduciaries to the plan, and most broadly, those that provide services to the plan along with certain affiliates of any of the foregoing. Given the difficulties of determining at any juncture whether any financial institution may be providing services to any given plan—for example, brokerage, consulting, advisory, management, trustee, custodial or other financial services (or may do so during the life of the intended transaction)—most managers operate on the presumption (although not necessarily the conclusion) that each and every financial counterparty or service provider, and potentially in the context of a credit fund or direct lending fund—every borrower since, it is possible that the borrower may be a plan sponsor or an affiliate—is or may become a party in interest, thus necessitating the availability of one or more prohibited transaction class exemptions. Fortunately, Congress and the DOL have issued class exemptive relief that are commonly used, discussed in part, below.

15 Note that a party to a nonexempt prohibited transaction (such as a bank, broker-dealer, futures commissions merchant, swap counterparty, or other financial intermediary transaction with the plan assets fund) is required to report the nonexempt prohibited transaction to the Federal government, it must rescind the transaction and make whole any losses to the affected plan account, and it must additionally pay excise taxes of 15 percent of the "amount involved" in the nonexempt prohibited transaction for each year or part of year the transaction is outstanding and not fully corrected. In certain cases, an additional 100 percent excise tax may be assessed. Certain so-called continuing transactions, such as extensions of credit embedded in the purchase and holding of a bond or note may produce cascading excise tax exposures. *See* Rev. Rul 2002-43, 2002-2 C.B. 85. "Sell side" firms are generally keenly aware of this potential exposure. "In effect, the counterparty is exposed to what may be colloquially characterized as a 'put' risk on a transaction-by-transaction basis, as well as to an excise tax risk. The counterparty may have yet additional losses or costs associated with the termination or adjustment of any hedges entered into with respect to the offending transaction," Steven W. Rabitz and Andrew L. Oringer, "A 'Clear' Guide to Swaps and to Avoiding Collateral Damage in the World of ERISA and Employee Benefit Plans," in *ERISA Fiduciary Law*, (Oringer & Rabitz, eds.) (Bloomberg Law, 2022).

16 In most cases, the satisfaction of the conditions to the exemption is under the control of the plan party or the fiduciary making the decision on behalf of the plan party to engage in the transaction on behalf of the plan (or plan assets fund). In the context of a plan assets fund, this would typically be the fund's investment manager.

17 Most managers of unregistered private "plan assets" funds usually regard the availability of the QPAM Exemption as a "must," even though, as a technical matter, other prohibited transaction exemptions may be available to a given transaction. As distinguished from other exemptions which are transaction-specific, "it is the time-tested QPAM Exemption, unlike many other exemptions, that provides for broad relief with conditions that are not generally tied to the type of transaction or service involved, without requiring the use of any particular form or type of investment vehicle." Dechert LLP Testimony at United States Department of Labor Employee Benefits Security Administration, "Hearing on Proposed Amendments to Qualified Professional Asset Manager Exemption (Prohibited Transaction Class Exemption 84-14)," Nov. 17, 2022, pp. 151-194, transcript available at *https://www.dol.gov/sites/dolgov/files/ebsa/pdf_files/hearing-transcript.pdf*. It is our experience that the availability of the QPAM Exemption is often an unstated (and some cases stated) requirement by banks,

broker-dealers, futures commissions merchants, swap counterparties and other service providers and counterparties when dealing with plan assets funds. It is not atypical for plan assets funds, and their managers (in their individual or corporate capacities) to be required to make representations and in some cases provide indemnities that the transaction or service will not result in a nonexempt prohibited transaction by reason of the availability of the QPAM Exemption (or some other mutually agreeable exemption).

18 Under Section 406(b)(1) of ERISA, a fiduciary cannot act in a manner that is adverse to the plans whose assets it manages. *See also* 29 CFR 2550.408b-2(e):

> A fiduciary may not use the authority, control, or responsibility which makes such person a fiduciary to cause a plan to pay an additional fee to such fiduciary (or to a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary) to provide a service.

The DOL believes that this provision includes a prohibition on a fiduciary using its authority to affect its own compensation or the timing of its compensation. Although it may not be immediately obvious, according to the DOL, potential prohibited transactions may arise where a manager merely has the power to value the fund's assets—even when charged to act solely in the best interest of the plan assets account. The entire universe of DOL guidance on incentive fees is contained in four advisory opinions, cited below, and in all of them, only a small portion of the investments of the portfolio subject to the incentive fee had readily available market price quotations. For this small remainder that did not have readily available market quotations an independent appraiser approved up-front by the plan account was required. In many cases, the use of a third-party independent valuation agent may thus reduce this particular risk.
Separately, "realization" based fees are common for most private equity "carried interest" or incentive fees and may raise separate significant concerns under ERISA. The DOL's general insistence on regularly-scheduled periodic incentive arrangements being based on **realized and unrealized** gains and losses avoids two potential abuses: a fee based only on realized gains might cause a manager to accelerate the disposition of portfolio assets prematurely in order to crystalize its performance fee, which could give the manager benefits such as additional short-term cash or provide increases in the immediate incentive compensation of the sponsor's employees. It may also distort performance results by enhancing immediate returns to the detriment of a more accurate longer-term picture. More fundamentally, a realization-based fee also may incentivize an investment manager to sell the highest performing assets first so that it achieves the performance hurdle allowing it to take the fee, while allowing lesser performing assets to remain in the portfolio. This has been traditionally difficult to manage for most private equity funds given the nature of the fee and the waterfall structure which generally calls for payments to the sponsor (or affiliate) after the fund returns the investors' initial capital and has met a pre-determined "hurdle rate" (minimum return).

See DOL Advisory Opinion 89-28A (Sept. 25, 1989); DOL Advisory Opinion Op. 86-20A (Aug. 29, 1986); DOL Advisory Opinion Op. 86-21A (Aug. 29, 1986); and DOL Advisory Opinion Op. 99-16A (Dec. 9, 1999). The DOL has also separately granted individual exemptive relief in certain cases.

19 In our experience, many fund managers have taken steps to reduce the potential for such risks. A manager of a plan assets fund would already be under a duty to call capital when it was solely in the best interests of the investing plans. There are some who argue that the manager's authority is merely contractual; facts and circumstances are critical for the analysis.

20 Conflicts may arise where the issuer is impaired or there is an insolvency and different clients of the same family of managers may have different risks or interests in the issuer as a result. The inquiry is highly dependent on the facts and circumstances.

Possible violations of Section 406(b)(2) and Section 406(b)(1) of ERISA could arise in such situations where the plan assets funds' interests are compromised. The absence of a prohibited transaction should not necessarily automatically be presumed if a manager seeks to act in the collective interest of all of its affected accounts. In some contexts, the use of an independent fiduciary may be called for. However, it is important to point out that while a credit-triggering issue is often the cause of potential conflicts, it is not necessarily exclusively so. There may also be some circumstances in which impermissible conflicts could be found to exist under ERISA even where there is not an impairment of the issuer and could occur merely by buying, holding or selling a position in which other accounts of the manager or its affiliates (or of the manager or its affiliates themselves) have divergent interests. To be sure, most sophisticated managers in our experience do not lose sight of their responsibilities to act with an "eye single" towards the interest of the plan assets under their management and have developed substantial protocols reasonably designed to meet the compliance burdens associated with ERISA's "exclusive benefit" rule and to avoid self-dealing prohibited transactions. *See*, Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982), cert denied, 459 U.S. 1069.

Note that the above examples assume that the ERISA accounts are all only in one position in an issuer or borrower's capital stack. Even greater complexities would arise, of course, if ERISA accounts are in multiple positions in the issuer of borrower's capital structure.

21 An example of the extent to which these rules are applied can be seen with respect to "soft dollar" research. But for the statutory relief afforded by Section 28(e) of the Securities Exchange Act of 1934, as amended, which pre-empts ERISA, a manager could likely not execute a transaction on behalf of a plan assets fund and receive research credits unless the research would only be used for the exclusive benefit of that account itself. Information being fungible, this is often easier said than done, since once obtained, it may be utilized for other clients across the franchise—or the franchise itself. *See*, A. Richard Susko & Steven W. Rabitz, "ERISA Aspects of Soft Dollar Arrangements," *Practising Law Institute, Pension Plan Investments: Confronting Today's Issues* (1999).

Similarly, plan assets accounts cannot be used to "fill out" an order and investment opportunities must be allocated in a way and operationalized in a manner that does not result in an impermissible benefit to the manager or otherwise to other fiduciary accounts of the manager or its affiliates. Managers should be aware that ERISA's exclusive benefit rule under Section 404 as well as prohibited transactions under Sections 406(b)(1) and (2) can be implicated. Most managers in our experience have policies and procedures that are designed to allocate opportunities fairly and objectively among similarly situated accounts.

22 *Notice Requesting Information on Cross-Trades of Securities by Investment Managers*, 63. Fed. Reg. 13696 (Mar. 20. 1998) (emphasis added) (1998 Notice Requesting Information) (stating that "[w]here an investment *manager has investment discretion with respect to both sides* of a cross trade of securities and at least one side is a [Plan] . . . *a violation of Section 406(b)(2) would occur)"*. The [DOL] has also taken the position that by representing the buyer on one side and the seller on the other in a cross trade, a *fiduciary acts on behalf of parties that have adverse interests to each other*. Moreover, the prohibitions embodied in Section 406(b)(2) of ERISA are per se in nature. "*Merely representing both sides of a transaction* presents an adversity of interests that *violates* Section 406(b)(2) even absent fiduciary misconduct reflecting harm to a plan's beneficiaries. [Emphasis supplied]" *Id.*

See also Reich v. Strong Capital Management Inc., No. 96-C-0069, USDC, E.D. Wis. (June 6, 1996); Cutaiar v. Marshall, 590 F.2d 523 (3d Cir. 1979). The DOL noted that ". . .[w]hen identical trustees of two employee benefit plans whose participants are not identical effect a loan between the plans without a [Section] 408 [of ERISA] exemption, a per se violation of ERISA exists." *Cuitair,* 590 F.2d at 529. Congress and the DOL have issued exemptive relief but those have been of very limited use. *See*, John V. O'Hanlon, Kaitlin McGrath, Steven W. Rabitz and Andrew L. Oringer, "Cross Trading in Focus: Decoding the Regulatory Framework," 26 *Investment Lawyer*, No.2 (Feb. 2019).

23 These include otherwise commonly (and commercially) accepted provisions and practices relating to expense reimbursements, the receipt of direct or indirect compensation arising out of the fund's investment in portfolio companies (for example, directors' fees, IPO-related fees, financing fees, break-up fees, monitoring fees, deal fees, loan origination fees, administrative services fees, asset management fees, consulting services fees etc.), co-investments, formation of successor funds, deal flow allocations, warehousing, cross transactions, termination and penalty provisions, and other conflicts which may involve the manager, its affiliates, and their respective managed or advised accounts.

24 29 CFR 2510.3-101, as modified by Section 3(42) of ERISA. The purpose of these provisions is to prevent investment managers from avoiding ERISA (and the Code's) fiduciary responsibility and prohibited transaction rules by managing assets indirectly through other entities.

25 The 25 percent test requires that less than 25 percent of each class of equity interests in the fund be held by ERISA and similar investors (after disregarding the investment of certain non-plan persons associated with the fund being tested). *See* 29 CFR 2510.3-101(f), as modified by Section 3(42) of ERISA. The VCOC exception requires compliance with a host of conditions, including that the fund's first long term investment and during certain specified annual periods the value of the assets of the fund be primarily in "operating companies" (which is its own term of art), as to which the fund negotiates direct contractual management rights. The fund must also exercise such management rights (although the specifics may vary among strategies). While conducive to many private equity funds that choose not to rely on the 25 percent test, this exception has more limited use among private credit strategies unless the strategy involves active management by obtaining and exercising contractual management rights obtained from the qualifying borrower. Passive "buy and hold" strategies are not good candidates for this exception. *See* 29 CFR 2510.3-101(d). There is also the publicly offered securities exception, but it is generally not conducive to most traditional unregistered private funds that do not wish to be publicly available, 29 CFR 2510.3-101(b)(2)-(4).

26 29 CFR 2550.408b-2.

27 *Id.*

28 *See, e.g.,* DOL. Advisory Opinion 96-15A (August 7, 1996) (60-day notice for asset manager termination permitted); DOL Advisory Opinion 92-08A (Feb. 2, 1992) (60 day redemption notice for investing plan in pooled fund); Prohibited Transaction Exemption 95-100, issued to Fidelity Management Trust Company, 60 Fed. Reg. 55864 (Nov. 3, 1995); Application No. d-09500 (appearing to sanction a 90-day termination period for a single client withdrawal, but 60-days for multiple client pooled funds).

29 In the context of an unregistered private fund that seeks to comply with the 25 percent limit, sponsors would need to carefully consider the risk of inadvertently creating a separate class of equity interests. Additional complexities could arise with respect to so-called "liquidating" classes, features that as of this writing appear to be more common with European-based funds than those of American managers. It is our experience that liquidating classes are generally avoided in the market when there are any ERISA (or similar) investors given the complexities and difficulties involved, or, conversely, that such accounts are prohibited from investing in the fund where those classes are part of the fund structure.

30 29 CFR 2550.404c-1; 5. The first requirement could be satisfied by a simple three-fund lineup, including equity (stock), fixed income (bond), and capital preservation (money market or stable value) funds where the equity and fixed income funds are sufficiently

diversified. Most Plans, of course, offer significantly more investment options. In the equities category alone, there are diverse types of investment styles (*i.e.*, core, value, or growth) each of which may be paired with a different market capitalization focus (*i.e.*, large, medium, small or "total market")—and that ignores specialty strategies like real estate and differences between active and passively managed products. The second condition required for compliance under the ERISA Section 404(c) regulations is satisfied through disclosure, given prior to the participant's first allocation to an investment in the Plan, and provided every year thereafter, and other specified quarterly information.

Very generally, the regulations require certain Plan-related information, including general Plan information about how participants give investment directions, administrative expense information (such as fees and expenses for general administrative services that are deducted from participants' accounts, including legal, accounting, and recordkeeping services), and expense information for specific services based upon actions taken by the participant (such as a fee for taking out a loan). In addition, the rules require identifying information for each investment (such as the type of investment), performance data, benchmark information, fee and expense information, and website addresses providing additional information about investment options. This information is typically presented in a comparative format to aid easy comparison of investment options. While the disclosure rules are detailed, most 401(k) plan administrators and recordkeepers have generally been able to comply with these rules.

31 *See* 57 Reg. Fed. 57 (46914) (1992).

32 *Id.* "[A limited partnership investment option which contains a three-year lock-up] would, however, be subject to the general volatility rule . . . (which requires that the frequency of opportunity to give investment instructions be determined relative to the anticipated market volatility of the investment) as a condition to affording section 404(c) relief for amounts invested in that alternative."

33 *Id.*

34 *Id.*

35 According to the DOL, one-third of eligible workers do not participate in their employers' 401(k)-type plans. Studies suggest that automatic enrollment plans (in which workers "opt-out" of plan participation rather than "opt-in") could reduce this rate to less than 10 percent significantly increasing retirement savings. *https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/default-investment-alternatives.pdf.*

36 Auto-enrollment was premised on behavioral economic theory and an emphasis on "choice architecture." Evidence suggested that many employees were either too busy, lazy, inertial or otherwise to take the steps needed to elect to participate in their employer's 401(k) plan. What was thought to be needed was a "nudge" so that employees' participation was automatic, with an option to opt-out rather than opt-in. *See* Richard H. Thaler & Cass R. Sunstein, *Nudge: Improving Decisions About Health, Wealth and Happiness* (2008). The SECURE 2.0 Act of 2022 (Division T of the Consolidated Appropriations Act, 2023, Pub. L. 117–328) requires most new Plans (established for plan years following December 31, 2024) to automatically enroll employees unless they opt out. New plans must start contributions at a minimum of 3 percent of pay, increasing by one percent each year until they reach 10 percent.

37 QDIA investment strategies may include: (1) a "lifecycle" or "target date" strategy that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy; (2) a "balanced" fund that applies generally accepted investment theories, is diversified so as to minimize the risk of large losses and that is designed to provide long-term appreciation and capital preservation through a mix of equity and fixed income exposures consistent with

a target level of risk appropriate for participants of the plan as a whole, but which does not necessarily take into account the risk tolerances, investments or other preferences of an individual participant; (3) a "managed account of plan investment options" that applies generally accepted investment theories, allocates the assets of a participant's individual account to achieve varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures, offered through investment alternatives available under the plan, based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy; or (4) certain investment options offered by a State or Federally regulated financial institution designed to preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with liquidity, but only for 120 days.

38 DOL Advisory Opinion 2025-04A states that under the program under consideration: "Participants may specify the percentage of their account balance to be allocated to the [account that will be allocated to lifetime income] and that will receive lifetime income protection. For participants who do not make a selection, the plan sponsor selects a default allocation percentage."

39 Based on public statements and reported stories, some product sponsors have considered in-plan annuity options, and out-of-plan annuity options. In the former case, it is possible that the sponsor could choose to remain responsible for one or more of the following: selecting the provider or providers; monitoring the provider or providers; and providing advice or taking discretion to allocate the participant's account balance to an annuity option. In some cases, a sponsor may choose to be more circumspect in its authority given the potential for fiduciary exposure and conflicts and may also leverage investment education tools for participants' decisions. In the latter case, the participant gains access to an annuity by converting the plan at an eligible distribution event (i.e., meeting normal retirement age under the plan) into a rollover IRA, through which an annuity is then purchased at the direction of the participant. In the former case, the participant typically provides a direction at a specific time (*i.e.*, age 55) where it may decide to cause their account balance to be allocated to the annuity made available in the Plan.

40 29 CFR 2550.404c-5(c)(5).

41 *Id.*

42 72 Fed. Reg. 60452, 60455-56 (October 24, 2007).

43 Brendan Curran, head of U.S. Retirement at State Street Global Investors, as quoted in Hannah Zhang, "Tapping the trillions: private equity's 401(k) ambitions," *Private Equity International*, July 7, 2025.

44 The data support an ever-growing number of Plans utilizing target-date or similar fund strategies, even if the individual results may differ. A 2024 Vanguard report found that 96 percent of Plans offered target-date funds at year-end 2024. An important factor driving the use of target-date funds is their role as an automatic or default investment strategy. The qualified default investment alternative (QDIA) regulations promulgated under the PPA continue to influence adoption of target-date funds. Among Plans designating a QDIA, 98 percent were target-date funds. Two percent were balanced funds. 84 percent of all participants used target-date funds, and 71 percent of target-date investors had their entire account invested in a single target-date fund, "How America Saves," *Vanguard Viewpoints* (June 2025). "At year-end 2022, 85 percent of 401(k) plans, covering 88 percent of 401(k) plan participants, included target date funds in their investment lineup." Sarah Holden, Steven Bass and Craig Copeland, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2022," *EBRI Issue Brief*, (April 30, 2024); "By 2027, target-date funds will capture roughly 66% of all 401(k) contributions, and about 46% of total 401(k) assets will be in TDFs, according to a 2023 estimate by Cerulli Associates, a market research firm," Greg Iacurci, "Target-date funds — the most popular 401(k) plan investment — don't work for everyone," *CNBC Personal Finance*, (Jan 6, 2025).

45 Rule 22e-4 under the 1940 Act. Some open-end registered funds have sought exposure to private equity

and other strategies, but they are the exception rather than the rule. Almost always they are not made through direct investments in Alternative Assets but through other funds which in turn hold such assets. But even holding Alternative Assets through unregistered funds does not relieve the pressure on the 15 percent illiquid asset cap: the underlying funds in which the registered fund invests likely also have liquidity constraints and thus could be counted for purposes of the registered open-end fund's 15 percent limit.

46 There are some interval funds, however, that are listed on an exchange and are bought and sold in the secondary market—and these funds continue to make periodic repurchases at NAV via Rule 23c-3.

47 Rule 23c-3(a)(1) under the 1940 Act.

48 Rule 23c-3(a)(3) under the 1940 Act.

49 Many tender offer funds institute a repurchase policy that sets a schedule as to when investors can expect the fund to tender for the repurchase of shares. However, the fund must reserve for board approval as noted above prior to commencement each tender offer.

50 In the past two years, however, there has been significant growth in "perpetual-life" non-traded BDCs, which are designed to have an indefinite duration and reduce the risk of such BDCs being forced to liquidate assets during market downturns.

51 ADI 2025-16 - Registered Closed-End Funds of Private Funds, available at *https://www.sec.gov/about/divisions-offices/division-investment-management/fund-disclosure-glance/accounting-disclosure-information/adi-2025-16-registered-closed-end-funds-private-funds?utm_medium=email&utm_source=govdelivery.*

52 *In the Matter of Lord Abbett Credit Opportunities Fund, et al.,* Rel. No. IC- 35663 (July 1, 2025) (notice), Rel. No. IC- 35699 (July 29, 2025) (order).

53 *Id.*

54 *See supra* n.2.

55 Significant breadth is required and interdisciplinary teamwork is often involved in our experience. As examples of recent current developments that relate to this multidisciplinary approach, see the following sampling from Dechert LLP: *https://www.dechert.com/knowledge/podcasts/2025/8/committed-capital-sidecar-new-order-targets-401k-plan-alternatives.html*; *https://www.dechert.com/knowledge/onpoint/2025/8/new-order--targets--401-k--plan--alternatives---president-takes-.html*; *https://www.dechert.com/knowledge/onpoint/2025/9/sec-s-investor-advisory-committee-issues-recommendations-to-faci.html*; *https://www.dechert.com/knowledge/onpoint/2025/8/sec-staff-weighs-in-on-expanded-retail-access-to-private-funds.html*; *https://www.dechert.com/knowledge/onpoint/2025/4/sec-eases-burden-of-co-investment.html.*

56 *See* 12 CFR Part 9.18(b)(2); OCC Comptroller's Handbook, Investment Management Services (2001), at 135, ("In the context of investment management, this section authorizes a national bank to delegate its fiduciary authority to third-party service providers such as investment managers, advisers, property managers, appraisers, and custodians"); Questions and Answers 12 CFR Part 9, OCC, Q&A No. 15 (May 15, 1997); 12 CFR 9.18(b)(2) (1997); Fiduciary Activities of Nat'l Banks, 60 Fed. Reg 66163, 66169 (Dec. 21, 1995) (preamble to proposed amendment to Reg. 9); DOL Advisory Opinion 2006-07A (Aug. 15, 2006); DOL Advisory Opinion 96-15A (Aug. 7, 1996); DOL Advisory Opinion 2007-03A (June 8, 2007); Frank Russell Trust Company, SEC No-Action Letter (Jul. 11 1980). The balance of responsibilities between the trustee and sub-adviser may involve some tension between competing regimes. *See*, Part I(c) of PTCE 84-14 (discussed further below).

57 *See*, Ted Godbout, "CITs Lead Over Mutual Funds Grows," *Plan Sponsor Council of America*, Feb. 13, 2025, available at *https://www.psca.org/news/psca-news/2025/1/cits-lead-over-mutual-funds-grows/*; Robert Steyer, "Among target-date funds, CITs are now bigger than mutual funds: Morningstar," *Pensions & Investments*, Aug. 9, 2024.

58 Remy Samuels, "Fiduciary Risk Continues to Pose Barrier to Mass Adoption of Alts in DC Plans," *PlanSponsor,* March 3, 2025; Remy Samuels,

"Empower to Offer Private Investments in 401(k) Plans," *PlanSponsor*, May 14, 2025.

59 "State Street Global Advisors Announces State Street Target Retirement IndexPlus, Providing Defined Contribution Investors Access to Both Public and Private Markets Exposures, *BusinessWire*, April 10, 2025.

60 *Id*.; Samuels, *supra* n.58.

61 Anne Tergeson, "BlackRock Deepens Push Into Private Investments for the Masses," *Wall Street Journal*, June 26, 2025; Leo Almazora, "Goldman Sachs' new private credit fund aims to bring alternatives to 401(k) plans, joining a wave of asset managers targeting the DC market." *InvestmentNews*, July 21, 2025.

62 James Van Bramer, "Ahead of Executive Order, What to Know About Private Equity in 401(k) Plans," *PlanSponsor*, July 18, 2025.

63 Sophie Baker, "PGIM, Partners Group collaborate to bring multi-asset portfolios to the masses," *Pensions & Investments*, September 17, 2025.

64 First, the QPAM Exemption excludes securities lending transactions (with the plan assets fund as lender) from coverage, while PTCE 91-38 does not appear to do so. Second, while the QPAM Exemption only provides relief for otherwise nonexempt per se prohibited transactions, PTCE 91-38 also provides limited self-dealing Section 406(b)(2) relief. Third, PTCE 91-38 also provides helpful relief for certain transactions between the collective investment trust and certain contributing sponsors (and affiliates) of investing multiemployer plans. Fourth, PTCE 91-38 also provides additional relief from the separate employer securities and real property prohibited transaction rules of Section 407 of ERISA. Fifth, while most of the relief listed above applies when there is no single plan (or group of related plans) that owns more than 10 percent of the interests in the collective investment trust, Section 1(b) of PTCE 91-38 provides relief for these otherwise prohibited transactions—as well as relief under Section 406(b)(1) of ERISA—where the person opposite the transaction with the collective investment trust (or providing the service to the collective investment trust) is not the bank, trust company or any affiliate maintaining the collective investment trust and is otherwise a party in interest solely because it provides services to the 10 percent or more plan (or collective investment trust) or is an affiliate of such a person. Like the QPAM Exemption, PTCE 91-38 also requires that at the time the transaction is entered into, and at the time of any subsequent renewal thereof, the terms of the transaction are not less favorable to the collective investment trust than the terms generally available in arm's-length transactions between unrelated parties. *Cf.* Section 408(b)(17)(B).

65 If the investment manager (*i.e.*, the QPAM) or certain of its affiliates is convicted of certain felony crimes—regardless of whether those convictions have anything to do with the conduct of the investment management business, let alone the pension investment management business—the exemption becomes unavailable for 10 years, and a manager generally needs to apply for individual relief. Many observers believe the DOL's historical approach to individual relief occasioned by a QPAM Exemption disqualification event changed demonstrably under the Obama Administration with an approach that was arguably more punitive and exacting than in years prior. This is the case even where the prohibited misconduct occurred at an affiliate that was not engaged in the pension investment management business or the investment management business at all and was otherwise generally "firewalled" from the offending businesses for a host of legal and regulatory reasons. Indeed, shock waves were felt when two institutions, BNPP and RBS were denied individual relief. Brian Croce, "DOL Denies BNP Paribas Exemption to Manage U.S. Retirement Assets," *Pensions & Investments*, December 21, 2018; Hazel Bradford, "Labor Department Denies RBS Request for Money Management Exemption," *Pensions & Investments*, October 13, 2016. Obtaining individual relief has been made more difficult by recent changes in the procedures pursuant to which applicants must seek individual exemptive relief. *See* 89

Fed. Reg. 4662. Even more recent changes to the QPAM Exemption in 2024 enhance the potential scope of such prohibited misconduct, including certain deferred prosecution agreements and non-prosecution agreement. For a broader overview of the recent amendments to PTCE 84-14, *see*, Steven W. Rabitz and Jonathan W. Schuch, "Not Quite QPAMdemonium: DOL Issues Final Changes to the QPAM Exemption," *Dechert LLP News & Insights*, available at *https://www.dechert.com/knowledge/onpoint/2024/4/not-quite-qpamdemonium--dol-issues-final-changes-to-the-qpam-exe.html*. For some of the challenges of the proposed changes to the QPAM Exemption, *see* Dechert LLP Testimony at United States Department of Labor Employee Benefits Security Administration, "Hearing on Proposed Amendments to Qualified Professional Asset Manager Exemption (Prohibited Transaction Class Exemption 84-14)," *supra*, n.17.

66 Sub-advisers to a collective investment trust may often seek to rely on the QPAM Exemption where PTCE 91-38 is not available. Since arrangements between trustees maintaining collective investment funds and sub-advisers may vary significantly, the choice of the particular exemption or exemptions utilized is highly facts and circumstances dependent.

67 Other common exemptions that may be utilized include PTCE 75-1 (for certain purchases and sales of securities from US registered broker-dealers and banks); PTCE 2006-16 (for certain securities loans with the collective investment trust as lender); Section 408(b)(2) of ERISA (for US futures transactions executed on an agency market); and the statutory exemption for foreign exchange transactions under Section 408(b)(18) of ERISA and the accompanying section of the Code, Section 4975(d)(21). That said, as noted herein, individual exemptions, are limited to the transactions covered by them and are thus far more restrictive than broader institutional exemptions such as the QPAM Exemption and PTCE 91-38. *See supra* n.17. In certain cases, the statutory exemption located at Section 408(b)(17) of ERISA and its corresponding provision of Section 4975(d)(20) of the Code may be considered. Certain institutions may also have received individual exemptive relief.

Although not discussed in detail in this article, insurance company pooled separate accounts may offer many of the same ERISA-related benefits and challenges as collective investment trusts. For example, they have an exemption (PTCE 90-1) that offers similar coverage to PTCE 91-38. Insurance company pooled investment accounts are similar arrangements to bank collective funds but are established and maintained by insurance companies pursuant to the provisions of state laws relating to separate accounts. They are pooled by holding assets which fund obligations under several insurance contracts. Generally speaking, as in the case of bank collective funds, but for the Section 3(c)(11) exception, such funds would be required to be registered under the 40 Act. Insurance company pooled accounts are typically regulated by the DOL under ERISA as well as the applicable state insurance company in the State in which the sponsoring insurance does business.

Note that separate accounts that are investment options for variable annuities that are sold broadly to the public *are* investment companies and required to be registered as such. *See*, *Prudential Ins. Co. of America*, SEC Investment Co. Act Release No. 3620, Jan. 22, 1963.

68 Compliance with Rev. Rul 81-100 1981-1 C.B. 326 and its progeny is an essential for this purpose.

69 An Allocator product may, to some extent. require the plan sponsor, or plan participant, to direct it to allocate a specified percentage or amount of assets to a given asset class or strategy. Depending on the exact nature of the direction, it is possible in such scenarios that the top-tier Allocator would not act as an ERISA fiduciary with respect to the selection of the particular sleeve, the manager of the sleeve, or the amount allocated to the sleeve. Countervailing considerations may exist under both Reg. 9 and Section 3(c)(11) of the 1940 Act which would be facts and circumstances dependent.

70 *See* Section 402(c) of ERISA.

71 The VCOC and real estate operating company (REOC) exceptions may be available in actively managed private equity, real estate and similar strategies, and where applicable, which would not have the same capacity constraints as funds relying on the 25 percent test limitations.

72 Definition of "qualified purchaser," Section 80a-2(a)(51) of the 40 Act; Cornish & Carey Commercial, Inc., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 625 (June 21, 1996). An unregistered private fund that accepts investments from a collective investment trust that takes investments from defined contribution plans does not generally need to count plan participants as beneficial owners of the private fund provided the collective investment trust and trustee are able to satisfy the definition of QP. This assumes that the collective investment trust was not formed for the specific purpose of investing in the unregistered fund. *See* Rule 2(a)(51)-3(a) under the 1940 Act.

73 Where an Allocator's fee includes an incentive or performance fee, and that fee, in turn, is dependent, in part, on the performance of the underlying funds in which the Allocator invests, additional care must be taken. For purposes of valuing the assets from which it computes its fee, the Allocator would likely rely on the third-party downstream managers' marks. However, arguably, it is possible that timing and other conflicts could arise unless the Allocator adhered to a strict "buy and hold" approach to the downstream funds.

74 A description of all of these issues cannot be undertaken in this article. Suffice it to say that a plan assets fund with such an Alternative Assets strategy requires a significant amount of work, involving many traps for the unwary. Some of the potential for prohibited transactions have been mentioned throughout, but the list is not exhaustive and depends on the specific facts. Additional prohibited transaction issues could arise, for example, if the collective investment trust invests in independently managed private equity or venture capital funds and those funds, in turn, obtain financing from an affiliate of the sponsor of the collective investment trust. Similar issues could arise where the downstream independent fund into which the collective investment trust invests is a hedge fund, and the hedge fund has certain trading relationships with the collective investment trust fiduciary or its affiliates. *See* 29 CFR 2550.408b-2(f), Example 5. Each arrangement requires an in-depth analysis with expert practitioners in ERISA, fund formation, bank regulatory and other allied subject matters.

75 Technically, Section 408(b)(8) would also apply to a pooled investment fund maintained by an insurance company qualified to do business in a State. The analysis for insurance company pooled separate accounts would be similar in respects to bank collective investment trusts. Insurance company separate accounts are not generally discussed in detail in this article but remain yet another possible viable approach for Allocator strategies.

76 Where a collective trust contemplates allocations to both proprietary and third-party funds or strategies, additional prohibited transaction considerations may apply.

77 PTCE 77-4 would allow a manager or affiliate to retain certain administrative and servicing fees paid by the registered open-end fund. PTCE 77-4 also applies to registered mutual funds that are ETFs. Advisory Opinion 2002-05A (Jun. 2002).

78 Separately managed accounts would not be able to rely on PTCE 91-38; but as noted above, Section 408(b)(8) may be available when the manager of a separate account takes discretion to allocate the account to a collective investment trust maintained by it or another affiliate.

79 For an overview of PTCE 2020-02, *see* Steven W. Rabitz, Andrew Oringer and Aryeh Zuber, "Will ERISA's Fiduciary Exemption 'Rollover' to the New Administration? DOL Issues Year-End Package Relating to 'Investment Advice, *Dechert LLP*, available at *https://www.dechert.com/content/dam/dechert%20files/knowledge/onpoint/2021/1/Will-ERISAs-Fiduciary-Exemption-Rollover-to-the-New-Administration.pdf.*