CIEBA
Committee on Investment of Employee Benefit Assets Inc.

July 19, 2019

The Honorable Preston Rutledge
Assistant Secretary
Employee Benefits Security Administration
United States Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Alternative Investments in Defined Contribution Plans

Dear Assistant Secretary Rutledge:

This letter is submitted on behalf of the Committee on Investment of Employee Benefit Assets ("CIEBA") to provide the Department of Labor (the "Department") with CIEBA's views on how defined contribution plans covered by the Employee Retirement Income Security Act would be improved and modernized by encouraging the prudent utilization of private equity, real estate, hedge fund or other alternative investments (collectively referred to herein as "alternative investments"). CIEBA strongly supports efforts by the Department to issue guidance to assist ERISA fiduciaries by clarifying the application of their responsibilities when considering allocations to alternatives in defined contribution plans.

I. CIEBA's experience -- Our view that alternative investments would strengthen defined contribution plan portfolios.

CIEBA members are the chief investment fiduciaries of more than 100 of the Fortune 500 companies who voluntarily sponsor, manage and administer ERISA-governed corporate retirement plans. CIEBA members serve as investment fiduciaries for over $2 trillion of retirement assets on behalf of over 15 million participants, representing a very significant portion of the largest private defined benefit and defined contribution plans in the US.

Based on this experience, our view is that the Department could further its mission of assuring the security of the retirement benefits of America's workers and their families by taking affirmative steps to support fiduciaries who are considering the prudent use of alternative investments in defined contribution plans. Defined contribution plan fiduciaries are considering using alternative investments in ways such as: (i) through certain designated asset allocation investment options, such as target date funds, or (ii) as a structured investment alternative that may be part of an individual participant's investment portfolio.

As investment fiduciaries, CIEBA members are committed to helping defined contribution plan participants achieve successful retirement outcomes. In order to achieve this goal, we strive to make diversified investment options available that provide strong investment returns to participants and help participants appropriately diversify investment risk. As we describe below, an allocation to alternative investments, as part of a diversified investment portfolio, can enhance the returns of defined contribution investment options while providing greater diversification.

As a technical matter under current law, there are no prohibitions under ERISA today on a fiduciary undertaking the alternative investment strategies that we are discussing here. However, in light of practical concerns that ERISA fiduciaries have over becoming defendants in one of the increasingly more frequent ERISA fiduciary lawsuits in the defined contribution plan space, **we believe that guidance from the Department is necessary to clarify the factors a fiduciary should consider when deciding whether to offer an allocation to alternative investments.**

II. Alternative investments are proven components of a well-diversified investment portfolio.

As investment fiduciaries for many of the country's largest private sector defined benefit plans, CIEBA members have extensive practical experience investing in alternative investments. Many CIEBA members allocate a portion of their defined benefit plans to these investments in order to achieve optimal overall risk, return and diversification characteristics.

For example, a recent survey found that, on average, 9.3% of public pension plan assets and 6.2% of large corporate pension plan assets were invested in private equity.[1] Based on CIEBA's own proprietary Annual Membership Profile Survey, the alternative investment allocation percentage range is even higher: in 2017, fully 19.5% of CIEBA members' defined benefit plan assets were invested in alternative investments.

Alternative investments provide several important benefits to an investment portfolio. Historically, alternative investments such as private equity have outperformed public equity investments net of fees, boosting an investment portfolio's overall returns.[2] Private equity managers are often able to achieve these investment returns by investing in privately-owned companies and taking advantage of the early growth potential of these companies. Private equity managers not only use their expertise to identify companies with growth potential, but they also take an active role in improving the management and governance of the companies, and in identifying new opportunities for growth. Our experience is that effective private equity managers invest for the long term, allowing the companies they invest in to make fundamental changes to unlock their full potential value.

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[1] *Private equity, real assets make gains with funds wanting safety*, Pension & Investments (Feb. 4, 2019), *available at* https://www.pionline.com/article/20190204/PRINT/190209966/private-equity-real-assets-make-gains-with-funds-wanting-safety

[2] Global Private Equity Report 2019, Bain & Company, 32, *available at* https://www.bain.com/contentassets/875a49e26e9c4775942ec5b86084df0a/bain_report_private_equity_report_2019.pdf; Cliffwater, An Examination of Private Equity Performance Among State Pensions (May 2018), *available at* https://www.cliffwater.com/Research/DownloadFile?path=docs%2FAn%20Examination%20of%20Private%20Equity%20Performance%20among%20State%20Pensions%202002-2017.pdf

Perhaps more important, alternative investments such as private equity investments can provide a crucial diversification benefit. Over the past twenty years, the number of U.S. publicly traded companies has dwindled to over half of their previous number.[3] Thus, a public equity portfolio today may not be as diversified as it once might have been. Moreover, many of the companies that do go public only do so following their initial growth periods. Investing in private equity provides access to a wider array of companies, including companies that have the potential for significant growth, offering an important diversification benefit for any prudently allocated investment portfolio.

CIEBA members must invest the assets of the plans we manage in a manner consistent with ERISA's fiduciary duties. Accordingly, when investing the defined benefit plans we manage in private equity and other alternative investments, we apply ERISA's prudence standards as interpreted by the Department's applicable regulation.[4] This regulation provides that, when considering a potential investment for a plan's portfolio, a fiduciary must consider how the investment would potentially impact the plan's portfolio as a whole. Specifically, the Department's prudence regulation provides that a fiduciary must consider how an investment would further the purposes of the plan, in relation to the investment's risk and return characteristics, as well as the diversification and liquidity requirements of the plan.

To help satisfy these prudence responsibilities, CIEBA members perform careful due diligence on each private equity or alternative investment, including on the manager's historical investment returns, the total fees and expenses the plan would be required to pay, the manager's investment strategy and philosophy, and the manager's staff and resources. CIEBA members may also receive assistance from professional investment consultants in identifying and performing diligence on potential private equity and other alternative investments. Finally, CIEBA members ensure that any investment meets the parameters of the plan's investment policy statement.

In summary, our experience has been that alternative investments offer significant investment benefits for any prudently diversified investment portfolio. By following a prudent investment process, CIEBA members meet their fiduciary duties when investing defined benefit plan assets in alternative investments; CIEBA members are equally convinced that the same would hold true when alternative investments are similarly employed in defined contribution plans.

III. Why fiduciaries rarely use alternative investments in defined contribution plans.

As explained in more detail below, due to litigation risks that are much more prevalent today in defined contribution plans than defined benefit plans, defined contribution plan investment fiduciaries are much more reticent to even consider an appropriate allocation to alternative investments. CIEBA members are keenly aware of the surge in class-action cases challenging the investments and fees paid

[3] *The Death of the IPO*, The Atlantic (Nov. 2018), *available at* https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/

[4] 29 C.F.R. § 2550.404a-1.

under defined contribution plans, which include over 100 new cases filed in 2016 to 2017.[5] In contrast, the risk of litigation with respect to defined benefit plans is, today, meaningfully lower.

We are concerned that the outcomes of some of the recent defined contribution plan class-action disputes have promoted a potentially short-sighted school of thought that a plan fiduciary can only safely satisfy his or her ERISA fiduciary responsibilities by offering only passively managed index funds to defined contribution plan participants. For example, the First Circuit Court of Appeals recently held that "any fiduciary of a plan . . . can easily insulate itself by selecting well-established, low-fee and diversified market index funds."[6]

On the other hand, a lawsuit was brought against the fiduciaries of defined contribution plans sponsored by Intel Corporation because allocations to hedge funds and private equity investments were included in target date funds and a balanced asset allocation fund offered to participants.[7] When viewed together, these disputes promote a clear, and, we think, short-sighted, incentive for defined contribution plan fiduciaries to avoid private equity and other alternative investments in order to minimize the risk of personal liability from a breach of fiduciary duty claim.

IV. The Department could help fiduciaries modernize defined contribution plan investments by providing guidance on using alternative investments.

CIEBA members believe that defined contribution plan participants could substantially benefit from alternative investments if such investments were selected pursuant to a prudent process and offered as part of a diversified portfolio, such as a target date fund or other structured investment alternative. Much like the portfolios of the defined benefit plans that CIEBA members manage, defined contribution portfolios would be professionally managed and diversified among asset classes. The Georgetown Center for Retirement Initiatives studied how allocations to alternative investments could improve defined contribution participants' investment outcomes in a target date fund, finding that such investments could increase participants' retirement income by 11 to 17 percent.[8]

Similarly, CIEBA members believe that in the right circumstances, other uses of alternative investments could also substantially benefit defined contribution plan participants (for example, through a designated investment alternative that is substantially invested in alternative investments, where participants are given the ability to diversify and select from a menu of broadly diversified designated investment options).

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[5] *401(k) Lawsuits: What are the Causes and Consequences?*, Center for Retirement Research at Boston College, 2 (Number 18-8, May 2018), *available at* https://crr.bc.edu/wp-content/uploads/2018/04/IB_18-8.pdf

[6] *Brotherston v. Putnam Investments*, LLC, 907 F.3d 17, 39 (1st Cir. 2018).

[7] *Sulyma v. Intel Corp. Inv. Policy Comm.*, No. 15-cv-04977 (Compl. Filed Apr. 26, 2016). Intel's fiduciary committee is one of the only a few corporate defined contribution plan committees to offer alternative investments to defined contribution plans.

[8] *The Evolution of Target Date Funds: Using Alternatives to Improve Retirement Plan Outcomes, Georgetown University Center for Retirement Initiatives*, Policy Report 18-01 (June 2018), *available at* https://cri.georgetown.edu/wp-content/uploads/2018/06/PolicyReport18-01.pdf

CIEBA members believe that guidance from the Department is needed to address fiduciaries' legitimate concerns of litigation risk for offering allocations to alternative investments. In our view, **the guidance should state that alternative investments are not *per se* imprudent, and that there is no presumption of their imprudence**. Additionally, the guidance should provide a framework consisting of factors fiduciaries should consider when evaluating alternative investments in defined contribution plans. We believe that key factors include the following:

- The liquidity characteristics of the investment, and how the level of liquidity may affect the ability of participants' to direct the investment of their individual accounts or obtain a distribution (and whether strategies may exist to manage liquidity);
- Whether the investment's time horizon could affect participants' ability to obtain a return or cause losses, based on the timing of the participant's initial investment and redemption;
- To the extent the investment holds securities that are not publicly-traded, the methodology that will be used for valuation, as well as the timing of valuations;
- The total fees and expenses participants will be required to bear in connection with the investment relative to the expected value added by the strategy;
- The historical investment returns of the fund or manager under consideration, and with respect to the manager, its staffing, resources, investment philosophy, and investment strategy; and
- The legal structure by which the investment will be made available, including whether the manager of the investment will act as a fiduciary under ERISA.

CIEBA appreciates the Department's willingness to carefully consider these issues. CIEBA strongly supports the Department's efforts to modernize defined contribution plans by clarifying the circumstances under which a fiduciary could, consistent with its prudence obligation, offer an allocation to private equity or other alternative investments. Again, we appreciate your consideration of these issues and we would be pleased to discuss further and provide any additional information that we can that may assist the Department in this effort.

Sincerely,

Dennis Simmons
Executive Director
CIEBA

CC: Jeanne Klinefelter Wilson, Deputy Assistant Secretary for Policy, US DOL
Timothy Hauser, Deputy Assistant Secretary for Program Operations, US DOL
Joe Canary, Office Director of the Office of Regulations and Interpretations, US DOL