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The Animals in the Employee Benefits Investment Product Zoo

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Although ERISA imposes an exacting standard of conduct on fiduciaries, the law does not specify the types of investment vehicles and other property that a plan can own or the types of investment transactions in which a plan can engage. Possible investments include mutual funds, individual securities, options, private equity partnership interests, real property, and more. With so many choices, how do fiduciaries know what type of investment they should explore? In this article, we examine the role of the fiduciary, provide an overview of different investment options, and consider what fiduciaries need to know to make the right choices for their plans.

When it comes to designing a benefit plan's investment array, the governing law is at once extremely strict and extremely flexible. Section 404 of the Employee Retirement Income Security Act of 1974, as amended (ERISA), requires that plan fiduciaries act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar

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with such matters would use in the conduct of an enterprise of a like character and with like aims." ERISA also insists that fiduciaries act for the exclusive benefit of plan participants, diversify sensibly,[1] and refrain from engaging in transactions presenting certain conflicts of interest (popularly known as "prohibited transactions") except within specified parameters. ERISA thus imposes an exacting standard of conduct. Indeed, the duties of ERISA fiduciaries are "the highest known to the law."[2]

However, aside from restricting investments in securities and real property associated with the sponsoring employer[3] and requiring that the "indicia of ownership" of plan assets be held within the jurisdiction of the US district courts,[4] ERISA does not set forth any guidelines as to the *types* of investment vehicles and other property that a plan can own, or the types of investment transactions in which a plan can engage. A plan's portfolio might include mutual funds, individual securities, options, private equity partnership interests, real property and more. Fiduciaries have many choices, and with roughly $22.1 trillion in assets held in employer-based retirement plans as of the end of 2014,[5] there are numerous investment providers eager to attract fiduciaries' interest.

As always, however, fiduciaries would do well to bear in mind that just because you can do something, that does not mean you necessarily should. Naturally, every investment selected for a benefit plan must be determined by the fiduciaries to be a prudent choice that is expected to generate cost-effective returns appropriate for its risk level. Fiduciaries also must confirm that making the investment (and engaging in any other activities associated with the purchasing, holding, and eventual redemption or sale of the investment) will not constitute a "prohibited transaction" under Section 406 of ERISA and Section 4975 of the Internal Revenue Code of 1986, as amended (the Code), unless an exemption from the relevant prohibition is available.

Even before reaching the stage of selecting an individual investment, however, the fiduciaries need to reach a considered decision as to whether they should even be looking at that type of investment in the first place. An illiquid partnership interest in the best-performing, most cost-effective private equity fund in the world would be inappropriate for a small, daily-valued 401(k) plan, for example. Fiduciaries need to be sure they understand the advantages and disadvantages of available strategies for their particular plan, and should never authorize investment in a particular type of asset if they do not understand it.

THE ROLE OF THE INVESTMENT PROFESSIONAL

Section 402 of ERISA requires all plans to have at least one "named fiduciary." Typically, the "named fiduciary" will be an employee or (more frequently) a committee of employees employed by the sponsoring employer or union. In many cases, of course, some or all of the individuals serving as named fiduciaries for a plan will lack extensive professional training in investments. In addition, many of these individuals have other duties that demand the bulk of their time and attention. Hiring a professional adviser enables the fiduciaries to obtain the expert guidance of someone with the education, time, and informational resources that the fiduciaries do not themselves possess.

Roughly speaking, ERISA fiduciaries can choose from three possible tiers of investment assistance:

- **Provision of investment data:** A plan's recordkeeper, consultant, publication service, or other vendor may simply collect and format data to render it accessible to the plan fiduciaries, without making investment recommendations or otherwise injecting its viewpoint into the process. In most cases, a vendor performing this service is not a fiduciary.

- **Investment advice, with final decision-making authority reserved to the plan's named fiduciary:** Often called a "3(21)" arrangement (a reference to the statutory section containing ERISA's definition of "fiduciary"), this arrangement involves the rendering of investment advice for a fee or other compensation.[6] Accordingly, a vendor providing services of this type is a fiduciary and will be liable as such if the vendor offers imprudent advice. However, the ultimate responsibility (and associated liability) remains with the fiduciary committee.

- **Investment management:** Often called a "3(38)" arrangement (referring to ERISA's definition of "investment manager"), this relationship involves a bank, insurance company, or registered investment adviser that has acknowledged fiduciary status in writing, and that has the authority to make investment decisions without further involvement from the named fiduciary. This arrangement removes the most risk and responsibility from the named fiduciary. However, the named fiduciary remains responsible for setting and enforcing the investment parameters within which the manager must operate, as well as for overseeing the manager's performance.

Accordingly, while hiring an investment adviser or (especially) an investment manager can remedy the shortfall in a named fiduciary's own investment expertise, it does not excuse the named fiduciary from understanding the nature of the plan's investments and chosen investment strategies. Although a named fiduciary may be able to sue an investment professional that recommended imprudent investments or implemented a strategy not in keeping with the named fiduciaries' directions, the named fiduciaries themselves are at risk and may be liable to the plan if they cannot obtain recourse from the investment professional. At best, the named fiduciaries will have to endure the expense and stress of litigation in order to remedy the plan's losses. Therefore, it is very much in their interest to understand the investment professional's strategy in the first instance, and to make sure they obtain enough information about investments to verify that the chosen strategy remains appropriate and that the plan's actual investments align with the strategy.

SETTING THE PARAMETERS

This article is not intended to resolve the question of whether any given plan should or should not invest in mutual funds, exchange-traded funds, collective investment trusts, hedge funds, private equity, or any other specific type of vehicle, much less whether any particular investment is appropriate. Each plan's fiduciaries and professional advisers will need to decide for themselves what types of arrangements will best suit the plan's individual needs. Instead, this article focuses on the types of legal and contractual questions that a well-informed fiduciary should ask when deciding whether to put a given type of investment vehicle on the table for consideration, and then during the process of implementing a decision to invest.[7]

Mutual Funds

Legally classified as "open-end investment companies," mutual funds are subject to regulation under the Investment Company Act of 1940. They must meet regulatory standards regarding liquidity of the portfolio, presence of independent directors on the governing board, compliance oversight, and other matters. Mutual funds issue redeemable shares, meaning that investors wishing to leave the mutual fund sell their shares back to the fund. Mutual funds are available in a wide range of asset classes and management styles.[8]

Because mutual funds are highly regulated and designed to be available to the general public, they are generally the most user-friendly and liquid options available in a given asset class. The fiduciary of a plan investing in a mutual fund can generally expect the investment to be liquid in normal market circumstances, easy to value (because a daily share price will be available), and fully transparent in terms of its portfolio, its management, and its costs. The mutual fund is required to provide appropriate disclosure documents, meaning that the fiduciaries of a participant-directed plan do not need to design customized fund descriptions for participants.

Because a mutual fund is not subject to direct regulation by ERISA, even if its shareholders include benefit plans,[9] the plan's governmental reporting obligations are also greatly simplified. The plan must report its ownership of the mutual fund on Form 5500, but does not need to report everything that the mutual fund owns in turn. As another advantage, the mutual fund manager does not need to worry about potential prohibited transactions when it manages the fund. Hence, the manager does not need to track the identity of its benefit plan investors and their fiduciaries and other vendors the way a manager selecting investments for the plan directly would need to do. That, in turn, means the manager has less need for information about the investing plan, plan sponsor, and their affiliates than a manager working directly for the plan or managing an investment vehicle subject to ERISA's regulation.

For smaller plans, or a plan anticipating only a limited investment in a given asset class, mutual funds may be the only viable pooled investment choice. However, larger plans often have access to other types of investment vehicles that may offer a similar investment experience at less cost without material increases in risk, and in some cases may even prefer to create customized investment portfolios rather than using a pooled vehicle. Plan fiduciaries should understand the available options.

Also, as with any investment, fiduciaries selecting a mutual fund should be familiar with that fund's particular terms and strategy. As a threshold matter, fiduciaries should be sure to understand whether the fund uses an "active" or "passive" strategy, because that topic has attracted increased attention from plaintiffs' counsel in ERISA cases in recent years.[10] "Passive" funds typically seek to match an index of securities, meaning that the fund usually will align fairly closely with the return of the index (less fund expenses). In contrast, actively managed funds attempt to produce enhanced returns. Actively managed funds often are notably more expensive than passive funds, due to the resources required for investment oversight, and put the plan at risk of losses that may exceed general market declines. However, actively managed funds also offer the potential for returns that may exceed the overall market performance, if the manager's strategy is successful. Fiduciaries need to weigh the possibility of favorable returns against the increased costs and downside risks presented by the active manager's strategy.

Once fiduciaries have identified the desired asset class and decided between active and passive strategies, they will need to select a particular fund. In doing so, fiduciaries should consider the fund's performance, expenses, alignment with the desired asset class parameters, and other relevant factors. Fiduciaries should also be aware of any redemption fees, "gates" that may cap redemptions above a certain size or in certain market conditions, and other restrictions on liquidity.[11]

Finally, fiduciaries should make sure that they have selected the appropriate share class. For example, plans making a large enough investment may qualify for more favorably priced "institutional" class shares. Fiduciaries should be aware that although mutual fund investments generally are offered on the same terms to all holders of a given class of shares, it nonetheless may be possible to negotiate waivers or other arrangements that allow a plan to benefit from a less expensive share class that it normally would not qualify to receive.[12] Seeking consolidated pricing for a plan looking to make investments in multiple asset classes within a fund family, or for multiple affiliated plans, can also be beneficial. However, fiduciaries engaging in consolidated arrangements need to be sure that:

(1) All selected investment products are prudent and appropriate, and

(2) All involved plans are at least as well off as they would be negotiating on their own.

In addition, fiduciaries need to review more than just the expense ratio when selecting a share class. Redemption fees, minimum holdings, and other terms may vary by class. A plan that needs frequent liquidity may be better off paying a higher expense ratio in exchange for a share class that does not carry a redemption fee, for example, while a plan with a stable portfolio might make the reverse arrangement. Also, mutual funds may offer plans a choice between share classes that pay a fee to the plan's recordkeeper directly for certain fund-related services (often known as "revenue sharing") and share classes that do not make such payments. This can affect the fee arrangement between the plan and its recordkeeper. Revenue-sharing arrangements have been another key litigation focus,[13] and fiduciaries need to understand the advantages and disadvantage of revenue sharing and its impact on plan participants.

Other Investment Companies

Besides the classic mutual fund, the Investment Company Act regulates other types of registered investment companies. Exchange-traded funds (ETFs) normally are established as a type of open-end investment company (like classic mutual funds) or "unit investment trust." They sell shares in large blocks (Creation Units), typically in exchange for payment in securities rather than cash. Investors who buy the blocks of shares can resell them on the secondary market or can sell the Creation Unit back to the ETF. ETFs are often (though not always) passively managed funds with securities portfolios that track a specified index. As a result, ETFs generally have low expense ratios and do not carry the fees associated with mutual funds.[14] However, the logistics of allowing ETFs to function on a participant-directed plan's recordkeeping platform can add back expense, and a plan large enough to qualify for institutional share classes may actually find that a mutual fund can be more cost-effective.[15] Accordingly, while any plan considering an investment in an ETF must ensure that the plan can handle the ETF method of trading and limits on redemption opportunities, a participant-directed defined contribution plan interested in offering ETF investment options will need to coordinate carefully with its recordkeeper in advance.

Closed-end funds, in contrast to open-end mutual funds and ETFs, generally do not redeem their shares, although some do so at specified intervals. Instead, investors sell shares on the market to other investors. This structure makes them problematic for participant-directed plans. These funds tend to be actively managed, and thus often are more expensive.

As registered investment companies, closed-end funds and ETFs are not subject to direct regulation by ERISA.[16] As was the case for mutual funds, this simplifies their administration and the compliance burden on an investing plan's fiduciary. However, also like mutual funds, closed-end funds and ETFs are subject to regulatory requirements intended to protect investors, although the rules vary somewhat for different types of funds. In general, funds must comply with disclosure requirements, conduct an appropriate audit, and abide by specified governance standards.[17] In normal market circumstances, a plan's investment in a closed-end fund or ETF will carry a readily ascertainable market price, avoiding valuation difficulties, and typically will be liquid. However, these funds are not subject to the same liquidity safeguards as mutual funds.

The overall approach to investing in closed-end funds or ETFs is similar to the approach to investing in mutual funds. The fiduciaries select the asset class and management style that suits the plan's needs, and then select an appropriate fund. Fiduciaries should pay particular attention to the anticipated market for the shares and the exit strategy in the event the plan decides to discontinue its investment. As with mutual funds, fiduciaries typically will not need to engage in individual negotiation over investment terms, but should investigate opportunities to negotiate on price. Investment strategies involving these funds also call for special attention to the valuation of the fund's underlying assets versus its share price.

Collective Investment Trusts

Tax-exempt collective investment trusts have become increasingly popular among larger plans as a more cost-effective alternative to mutual funds. Pooled investment funds are offered by a bank that acts as trustee and managed by the trustee or a professional investment manager; they come with a wide variety of features. Some appear functionally identical to mutual funds to the typical layperson, offering similar or even identical investment programs with daily valuation, while others may be more esoteric in design or investment strategy.

Collective investment trusts are offered only to benefit plans. Assets in the trust are subject to regulation by ERISA, exactly as if the individual investing plans owned those assets directly (commonly referred to as holding "plan assets" or being a "plan assets fund").[18] This means that the trust's trustee and any investment managers are fiduciaries to the investing plans and must manage the trust in compliance with ERISA's standard of conduct. The trust must also avoid engaging in nonexempt prohibited transactions.[19]

Collective investment trusts are not subject to the same disclosure requirements as mutual funds, but many offer similar documentation to investors, particularly if they are designed for participant-directed plans. For example, many funds produce "fact sheets" that offer a user-friendly summary of the fund and can be distributed to plan participants, mitigating the absence of a formal prospectus. At the least, the DOL requires investment providers to ensure that fiduciaries have access to certain fee and performance information, including information that the fiduciaries, in turn, must provide to participants in participant-directed plans.[20]

In addition, although ERISA normally would require an investing plan to report not just its interest in the collective trust but the trust's ownership of all of the trust's investments, a number of collective trusts mitigate this reporting complication for investing plan fiduciaries by filing Form 5500 with the DOL as Direct Filing Entities (DFEs). This enables the investing plans to simplify their own reporting.

However, fiduciaries will need to review the disclosures and filings offered by a particular collective investment trust, in order to understand what will actually be available to their plan. Fiduciaries will also need to be sure that they understand the fund's valuation and financial oversight processes. Funds that focus on marketable securities will generally have relatively transparent valuations, but some funds may include harder to value assets. Fiduciaries of investing plans are legally obligated to be sure the valuations provided to them by their plan investment providers are reasonable and appropriate.[21] Before investing in a fund with difficult to value assets, the fiduciaries need to be sure that they can meet this obligation. Likewise, before investing in any fund, fiduciaries should be comfortable with its financial reporting and audit process. This is less of a concern for bank collective investment funds than for private investments not overseen by a regulated financial entity; however, a plan's fiduciaries should not ignore the issue.

Most collective investment trustees require investors to abide by relatively uniform terms of investment, taking into account differences across share classes and investment pools.[22] However, it is still important for fiduciaries to obtain copies of all the governing documents and review them with legal counsel and their investment professional to be sure they understand all of the terms and conditions. If the documents contain undesirable provisions, the fiduciaries will have to determine whether to approve the investment. Even if the concerns do not rise to the level of derailing the investment decision, they still can be worth pursuing. Especially for larger investors, trustees may be willing to enter into side letters resolving points of concern or ambiguity in the documents, offering assurances about how certain types of discretion will be exercised, or agreeing to fee waivers or rebates.

Unsurprisingly, collective trust fund documents, having been drafted by the trustees, tend to favor the trustees' perspective. By their nature, the documents give fund management the authority to buy and sell investments, but they also generally allow for changes to the investment strategy and even amendments to the governing documents, by unilateral trustee action. There are good and sound reasons for this, of course, especially in large funds. Trustees want the freedom to adapt easily to changing market norms and legal developments, and to resolve issues as they arise. Because the trustee is also an ERISA fiduciary, obligated to operate the fund prudently and in the best interest of participating plans, a plan's own fiduciaries can be more comfortable handing over that level of discretion than in other situations. However, the fiduciaries need to be sure that key terms cannot be changed before the plan has an opportunity to review and react to a proposed change. For example, the process for implementing material amendments should require sufficient advance notice for a plan that dislikes the proposed change to redeem its investment and move its business elsewhere.

In that regard, as well, fiduciaries need to be comfortable with the collective trust's liquidity rules. Many funds are daily valued and highly liquid, aside from standard clauses reserving the right to restrict redemptions in the case of market closures and certain other emergency events, but some limit redemptions to specified intervals. It is also not uncommon for a fund to impose a "gate" on large redemptions to prevent disruption to remaining investors.[23] Fiduciaries need to understand these terms and plan accordingly.

Finally, since collective investment trusts are not subject to the same rules that apply to investment companies and are subject to direct regulation by ERISA, a fund's securities-lending practices may merit extra scrutiny. In particular, fiduciaries should understand whether a fund permits securities lending, what sort of risks and returns are involved, what rules are in place to prevent prohibited transactions, and what sort of fees are charged in connection with securities lending activities.

Insurance Products

If a plan's assets are held by an insurance company, they may be invested through one or more types of vehicles.

Pooled separate accounts are similar to bank collective investment trusts in many ways and present many of the same issues discussed previously, but are offered by insurance companies. Naturally, pooled separate accounts are subject to state insurance law. Like collective investment trusts, pooled separate accounts are regulated by ERISA;[24] insurance companies are required to provide certain information to fiduciaries and can assist plans with their reporting obligations by filing a Form 5500 for the account directly with the DOL.

Conversely, an insurance company may offer plans the opportunity to participate in investments made by the company's "general account," rather than through a separate account. The Supreme Court has held that assets held by a plan through a general account are subject to direct regulation by ERISA, and that the insurance company must manage the account in accordance with ERISA's prohibited transaction rules.[25]

Many plans, particularly smaller plans, invest through a group annuity contract. Assets held under the contract can be directed to various mutual funds or other approved vehicles, and the contract may or may not offer participants the ability to purchase an annuity when a distribution is requested from the plan. Fiduciaries need to be familiar with the terms of the group annuity contract, particularly restrictions on cancellation or liquidation of contract assets. Group annuity contracts are state-approved and typically cannot be changed, so a fiduciary should obtain a copy of the contract and review it prior to making a final decision to use the insurance company's product. Because recordkeeping arrangements with insurance companies are often linked to use of group annuity products, the contract should be requested as part of the process of selecting an insurance company as a recordkeeper.

Insurance companies also provide annuity contracts for defined benefit plans and other plans that offer participants the opportunity to receive lifetime income. Contracts may be purchased individually or offered through a group annuity contract, and may be purchased for individuals as needed or as part of a plan termination or "de-risking" transaction.[26] Specific rules apply to a fiduciary's selection of an annuity contract,[27] in order to protect participants' expectations of payment. Fiduciaries should document their conclusions regarding the ways in which the chosen annuity provider meets the criteria outlined in the regulations and should work with a professional adviser familiar with the annuity marketplace.

Another insurance product popular with benefit plans is the "stable value" fund. These funds, specifically designed for defined contribution plans, are intended to protect principal and offer a stated return. A stable value fund will invest in a variety of bonds and short-term investments while also purchasing "wrap" contracts from insurance companies that attempt to protect the fund's ability to obtain a specified return. The funds are not risk-free, however. In addition, plan fiduciaries need to be aware that stable value funds may impose a significant delay on liquidation of the plan's investment if the plan terminates or if the plan fiduciaries decide to eliminate the fund, and may require advance notice of certain events (such as a downsizing) likely to cause participant distribution requests to increase. Stable value funds also apply "equity wash" rules barring participants from transferring to or from the stable value fund and a "competing" type of fund within 90 days. Although this is primarily just a planning point for participants, fiduciaries need to be sure the rule is properly disclosed and can be appropriately enforced. Finally, the fund itself may take a variety of forms (*e.g.*, commingled investment fund, separate account, or group annuity contract), and fiduciaries should consider the usual types of issues for the relevant type of arrangement.

Insurance companies offer other investment products as well, such as guaranteed investment contracts, products offering various types of lifetime income guarantees, deposit administration contracts, and so forth.[28] A number of these products require special handling for investment and accounting purposes. As with any investment, the fiduciaries should be sure to understand exactly what the plan is purchasing, how it will be accounted for, and what documents and fees are relevant.

Individual Securities

Fiduciaries and participants making investments in individual securities need to be prepared for greater risk and volatility than is commonly associated with mutual funds and other diversified investment vehicles.

Because individual participants may not understand the importance of addressing this issue by means of a diversified portfolio, many fiduciaries prefer to avoid individual securities entirely for participant-directed plans, even if the plan offers a brokerage window in addition to the plan's "core" investment line-up of designated pooled funds, and permit investments only in mutual funds, collective trusts, and possibly exchange-traded funds or closed-end investment companies.[29]

However, some participant-directed plans offer brokerage windows that permit access to individual securities.[30] In addition, defined benefit plans and defined contribution plans that do not permit participant direction often hold individual securities as part of their portfolios, particularly in the case of large plans. And, as discussed at more length later, participant-directed plans offering one or more investment options featuring a separate investment management account (on its own or as part of a "white label" fund) will do so as well.

Beyond typical stocks and bonds, the modern financial marketplace offers a variety of other instruments, such as options, warrants, derivatives, and so forth. These more complex instruments should be approached with caution. These types of instruments can present significant liability risks, and plans engaging in extensive activity of this type often prefer to do so through a separate vehicle (either specific to the plan or a pooled vehicle such as a hedge fund) to protect the rest of the plan's assets.

In order to trade individual securities, plan fiduciaries will need to set up the appropriate accounts and hire the necessary investment professionals. The plan may hire one or more investment managers, custodians, brokers, and other vendors. The plan fiduciaries need to review the contracts governing all of these arrangements and make sure that the contracts align with ERISA and the plan's fiduciary governance structure and investment policies. In particular, the fiduciaries need to be sure they understand the compensation arrangements associated with the various vendors and have received full disclosure of all amounts those vendors receive.[31] The fiduciaries should also set clear policies for all vendors regarding securities lending, investment in derivatives, non-US investments, and other specialized activities.

Although a number of vendors will insist on use of their form agreements, fiduciaries should nonetheless review all contracts carefully and make sure that they align with ERISA and the plan's intended investment program. In particular, plan fiduciaries will need a detailed investment management agreement with any investment manager. The agreement should:

- Establish the investment and proxy voting guidelines,
- Identify any special brokerage arrangements or restrictions,

- Set the manager's compensation,
- Include representations by the manager regarding its fiduciary status and professional qualifications,
- Protect the confidentiality of plan information,
- Provide for appropriate indemnity protection,
- Identify any threshold insurance requirements,
- Set expectations regarding recordkeeping and reporting by the manager to the plan, and
- Establish a procedure for amendment and termination that ensures that the plan (in accordance with Section 2550.408b-2 of the Labor Regulations) can terminate on reasonably short notice without penalty.

As appropriate, the agreement can also include additional terms, such as notice provisions for certain events, provisions regarding legal claims tied to plan-owned securities, desired restrictions on assignment of the agreement, and "most favored nations" provisions assuring the plan that other similarly situated clients are not benefiting from more favorable terms and conditions than the plan.

'White Label' Funds

In an effort to reduce expenses, customize the plan's investment array, or both, fiduciaries of participant-directed plans may use a "separate account" that invests directly in stocks, bonds, or other types of individual securities, in lieu of a pooled fund. The account, consisting of plan assets managed by a professional investment manager in accordance with plan guidelines, may be offered on its own or as part of an investment option combining the account with other managers' accounts or a pooled vehicle. These arrangements are often called "white label" funds. For example, a plan might establish the "Plan X Large Cap Equity Fund" and hire two or three managers to manage different large-cap equity portfolios under the fund. A plan using this approach operates on one level like a defined benefit plan or a fiduciary-managed defined contribution plan, with the plan's fiduciary selecting the managers and setting the investment guidelines for each account. However, the participants in the plan can then choose which of the white label funds they wish to use.

White label funds have gained increasing attention from participant-directed plans' fiduciaries in the wake of lawsuits and media coverage highlighting the cost of investment management for traditional 401(k) plan investment vehicles like mutual funds. For a plan large enough to attract favorable pricing from investment managers, a white label arrangement may be cheaper than a mutual fund or even a collective trust, at least for actively managed strategies—although, as discussed later, this premise should be investigated carefully. A white label fund gives the plan fiduciaries the flexibility to design an investment strategy they believe is more appropriate to the plan and to adapt that investment strategy as desired. For example, a white label fund might offer more than one investment strategy within that one "fund," as in the case of an equity fund encompassing both a growth and a value strategy, or a fund that combines large and small/mid cap equity investing. This allows the plan to reduce its total number of investment options without forgoing strategic diversification, limiting the plan's administrative overhead, and simplifying communications to participants.[32] White label funds can also facilitate changes to investment strategies and managers, because a manager can be added or removed and strategies adjusted without needing to change the plan's investment menu or participant investment elections. Ultimately, however, white label funds are excellent when they work but are not for the faint of heart.

This is because white label funds may involve significant costs and burdens. The actual cost of managing the account *may* be less than a comparable mutual fund or even than a collective trust; however, other costs such as higher recordkeeping fees, higher audit fees, legal fees for manager contracts, legal and vendor fees for preparation of customized fund disclosures, and transaction costs all need to be factored into the total price tag. Furthermore, especially for smaller and midsize plans, investment managers may not be interested or affordable. For passive investment strategies, institutional shares in a mutual fund, ETF, or collective trust that tracks the appropriate index may well be more affordable than a customized account.

In addition, white label funds also require a considerable investment of time by plan fiduciaries and staff. Managers need to be selected, monitored, and replaced as necessary. This may be a more time-consuming and complex process than simply benchmarking an array of mutual funds, ETFs, and collective trusts. Disclosure documents need to be created and kept up-to-date. The fund's financial information needs to be prepared, analyzed, and reported to participants and the government as necessary. Plan fiduciaries should be sure that they and their staff have the requisite time and expertise to perform these tasks and to oversee the vendors hired to assist. As noted previously, plan fiduciaries will need to be sure they have appropriate contracts in place with those vendors.

Fiduciaries also need to be sensitive to the special regulatory issues associated with white label funds. Although there is no specific exemption from registration under the Investment Company Act of 1940 for white label funds, the Securities and Exchange Commission (SEC) through no-action letters has declined to require white label funds to register as investment companies under the Investment Company Act of 1940.[33] The type of investment activity in which a plan may engage through its separate accounts may also trigger obligations. For example, the fiduciary or sponsor of a participant-directed plan holding certain types of investments (such as derivatives) may need to file for an exemption from registration as a "commodity pool operator" under Commodity Futures Trading Commission (CFTC) regulations.[34] Fiduciaries will also need to be sure that disclosure materials are adequate to meet ERISA's standards and sufficient to give participants the necessary information to make investment decisions.

Employer Securities

A number of plans still offer participants the opportunity to invest in employer securities, and employee stock ownership plans focus on employer stock investments. The issues presented by investment in employer stock have filled numerous articles all on their own.

In 2014, the Supreme Court decided *FifthThird Bancorp v. Dudenhoeffer*,[35] holding that fiduciaries may permit a plan to hold employer stock only if investment in employer stock aligns with ERISA's general requirement of prudence. However, the Court also held that fiduciaries could, absent "special circumstances," rely on the market price of publicly traded employer securities as representing the stock's value. Case law regarding the scope of fiduciaries' responsibilities to oversee employer stock held under an ERISA-governed benefit plan continues to evolve.[36]

At present, benefit plan investments in employer securities remain a significant litigation risk. If the price of the employer's stock declines significantly, and particularly if the employer experiences severe distress or bankruptcy, a lawsuit is likely to follow. Conversely, fiduciaries are at risk if they opt to divest employer stock and the price then goes up.[37] Fiduciaries who have inside information face a conflict between their fiduciary duties and restrictions imposed by the securities laws. Although the Supreme Court confirmed in *Dudenhoeffer* that fiduciaries will not violate their duties under ERISA by refusing to violate securities laws, plaintiffs remain free to allege that fiduciaries could have taken action to protect participants without violating securities laws and that the fiduciaries accordingly should be liable for failing to do so.[38] All told, investments in employer stock should be permitted only after careful consideration of these issues, and sponsors and fiduciaries of plans with existing investments in employer stock should be trained in the special risks and responsibilities involved.

Alternative Investments

The broad term "alternative investments" generally encompasses private equity investments, hedge funds, and other private vehicles. These types of vehicles vary broadly in design and form of organization but tend to present a number of similar issues. Given their complexity and restricted liquidity, these types of investments have traditionally been the preserve of large defined benefit plans. In recent years, however, the increased concentration of assets in participant-directed defined contribution plans and the corresponding decline in large, professionally managed defined benefit plans have urged investment providers to find ways to make a wider variety of products feasible for daily valued, highly liquid, participant-directed investment programs.[39]

Private investments nonetheless remain complex arrangements. Thus, whatever the merits of their investment thesis, most are suitable only for sophisticated fiduciaries with experienced professional advisers knowledgeable about the relevant investment product. In the first instance, fiduciaries need to understand the investment vehicle itself. It is essential to confirm that the vehicle is duly organized, offers limited liability to investors,[40] and has appropriate governance provisions. If the vehicle has been formed outside the US, as many hedge funds and some private equity vehicles are, local counsel should be consulted, and fiduciaries should pay particular attention to forum selection clauses, governing law clauses, and other provisions that may result in the need to litigate any disputes in a foreign country or under foreign law.

Fiduciaries also need to know whether the vehicle is or might be subject to direct regulation by ERISA, or whether the fund qualifies for one of the exemptions from "plan assets" status under Section 2510.3-101 of the Labor Regulations, as modified by Section 3(42) of ERISA.[41] If ERISA applies, the fiduciaries need to confirm that the vehicle's governing documents are consistent with ERISA's requirements. For example, many hedge funds grant powers and protections to directors, the general partner, or manager that are incompatible with their roles as ERISA fiduciaries and with the requirement that only a qualified investment manager exercise investment discretion. Hedge funds may grant their directors, general partner, or manager the ability to override the investment manager, include protective indemnity clauses that are incompatible with Section 410 of ERISA, and give directors, the general partner, or manager the ability to set their own compensation and the right to engage in self-dealing transactions in violation of ERISA's prohibited transaction rules. Private equity funds may likewise contain inappropriate grants of authority and protection to the general partner. Separately, the fiduciaries will also need to ascertain what information they will have to provide to the fund's management to enable the fund to comply with ERISA's prohibited transaction rules.

If the fund is not subject to ERISA, the fiduciaries will have less concern about the fund's terms and activities creating a facial violation of ERISA, but still need to make sure that the investment is prudent. A determination of prudence requires the fiduciaries to inquire as to whether the fund's terms permit the fund's management to behave in a way that could endanger the plan's best interest, and to arrange for appropriate safeguards as needed. Fiduciaries should be sensitive as well to the optics of an arrangement, even if they are confident that fund management's actual behavior would never be inappropriate. Many private investments authorize a wide variety of conflicts of interest in the fine print, and this creates an appearance of impropriety that can be problematic if an investment ends up performing poorly (even when the poor performance occurs for other reasons).

The fiduciaries will also want to understand what actions a non-ERISA fund will take if the fund subsequently becomes subject to ERISA. For example, the plan might be permitted or required to redeem its investment in order to reduce fund ownership by benefit plans down below the threshold that triggers ERISA regulation. That could result in forced liquidation at an undesirable time and price.

Many funds also offer fund management a great deal of latitude in shaping the fund's investment strategies. Although this is less of a concern in a fairly liquid fund, a plan fiduciary generally will not be comfortable allowing the fund's management carte blanche if the fund has, for example, a five- or 10-year term before the plan can redeem its investment. Likewise, plan fiduciaries should pay attention to the ways in which the fund's management can control the terms of the fund's governing documents. Hedge funds, in particular, often give the directors, general partner, or manager broad amendment powers and significantly restrict the ability of the shareholders, limited partners, or members to vote or participate in the governance decisions of the fund. Private equity funds may be less aggressive in this regard but still reserve a great deal of discretion to the general partner or manager, and are also often less liquid. In all cases, fiduciaries should review the documents carefully and make sure that material adverse amendments either require the plan's consent or have to be conditioned on sufficient notice to allow the plan to exit the fund.

The fiduciaries should also be aware of the potential for terms and conditions to be varied for different investors. This flexibility can work both ways: a plan may be able to negotiate customized protections for its own benefit, but conversely needs to be aware that other investors may be seeking to protect themselves at the potential expense of the plan. A plan's fiduciaries should inquire regarding the fund's policies on side letters and special arrangements. A plan's fiduciaries should also request "most favored nations" rights to ensure that the plan obtains the benefits of arrangements negotiated by similarly situated other investors.[42]

Liquidity is another key concern for private investments. Every vehicle is different. Restrictions on exit from the vehicle may last months or years and may be subject to extension, particularly in poor market conditions. Even vehicles that offer regular liquidity often grant the fund's management broad powers to suspend or limit redemptions in the event of market disruptions and other events. If a vehicle is relatively illiquid, fiduciaries should be comfortable that appropriate safeguards are in place for investors in the event of the departure of key personnel. Finally, fiduciaries considering an investment's liquidity terms should take note of the extent to which distributions might be paid in kind. Payments in kind present a variety of potential concerns, including potential liability risks, prohibited transaction compliance considerations, and logistical obstacles to liquidation of the assets. Fiduciaries may need to negotiate appropriate protections against these issues, such as use of a liquidating trust and assistance disposing of the assets.

Alternative investments also may present special tax implications. Because many hedge funds use leverage, a plan may need to invest in an offshore fund if it wants to avoid unrelated business taxable income, adding to the expense and complexity of the investment.[43] A fund may generate unrelated business taxable income in other circumstances as well. The plan also needs to understand the state, local, and foreign tax consequences of participating in the fund.

An ERISA plan is not prohibited from investing in a fund simply because the investment is not tax-exempt; however, the cost of paying the taxes and the compliance costs associated with tax filings (particularly state, local, and foreign tax filings) will affect the ultimate return on the plan's investment in the fund, and thus need to be factored into the investment decision. Administrative considerations should also be taken into account. For example, once a plan has invested in a 15-year real estate fund that generates state and local tax liabilities, it will be too late to decide that the tax filings involved are too much work.

Naturally, as with any investment, the fiduciaries also need to understand the overall economics. In addition to stated management fees and performance data, fiduciaries should review anticipated expenses (including costs for underlying investment vehicles, if the fund invests in other funds). The plan's fiduciaries must be sure that total compensation to the manager is reasonable, and that the management of an ERISA-governed fund has complied with ERISA's prohibited transaction rules in structuring and disclosing its compensation. If the fund's general partner or manager/adviser receives an incentive fee, the fiduciaries must be sure that the fee incentivizes the right kind of behavior, and that performance results are verifiable.[44]

Whether an incentive fee is involved or not, the fiduciaries need to understand how the fund values and reports its assets, and whether there is any independent third-party review of the valuation process. As discussed previously, the fiduciaries cannot simply rely on values provided to them; they must assess the reasonableness of the fund's valuation. Private investments typically consist in whole or in part of hard-to-value assets, so fiduciaries need to be sure they will have access to enough information about the fund's underlying assets to meet their obligations. Given the proprietary nature of private investment fund strategies, this can be a concern for fund management, so expectations need to be set in advance. Fiduciaries also need to be sure that the information will be available in time for the plan to meet its audit and Form 5500 reporting obligations.[45] On a related note, the fiduciaries must be comfortable with the fund's own custody and audit arrangements, and exercise appropriate loss-prevention due diligence.

Finally, there are a variety of other terms and conditions that may be of interest to a given plan fiduciary. When it comes to investing in alternative investments, there is no substitute for obtaining all the documents and having them reviewed by counsel and the plan's investment professional.

KEY CONSIDERATIONS

When entering into an investment transaction, plan fiduciaries should consider the following:

- If you are investing in a pooled vehicle, do you understand what types of vehicles are available for the desired investment program and what their respective costs, advantages, and disadvantages are? Have you selected the appropriate share class and put in place a system to monitor eligibility for more beneficial share classes?

- Do you understand the management style (active or passive) and asset class of your chosen investment?

- Do you have a complete set of documents? It can be surprisingly difficult to obtain full documentation, and a notable number of fiduciaries and even investment professionals never ask for more than the initial disclosure document, even when a private placement memorandum or collective trust fund fact sheet states prominently that it is subject to the terms of a separate governing document. Fiduciaries should always request full documentation and should insist that their professional advisers conduct a thorough review.

- Do you understand how and when you can exit the investment? If the investment is illiquid, are there protections in the event of key-person departures? If payment might be made in kind, are appropriate safeguards available?

- Do you understand how the investment will operate, who makes investment and administrative decisions, and what sort of governance protocols and safeguards are in place?

- Do you understand the investment vehicle's or manager's policies on securities lending and associated fees?

- What sort of potential exists for conflicts of interest, and how are those addressed?

- Do you understand the economics of the investment? This analysis needs to include management fees, anticipated returns, risk factors, other compensation to the manager, anticipated fund expenses, anticipated plan expenses associated with making and overseeing the investment, taxes, and any other relevant costs and data.

- Is the investment subject to direct regulation by ERISA (*i.e.*, is the investment fund considered to hold "plan assets"), and if so, is it designed to comply with ERISA? If not, what happens if the fund subsequently becomes subject to ERISA?

- If the investment is a foreign vehicle, has local counsel confirmed that the vehicle is duly formed? Are there forum selection clauses or other provisions that would result in the need to litigate abroad in the event of a dispute?

- Will the investment endanger other plan assets, or is the plan's liability limited to its original purchase price or commitment? Are indemnity provisions that obligate the plan appropriately limited to comply with ERISA and to protect other plan assets against liability for claims generated by this investment?

- Will you have access to sufficient financial and valuation information in a timely fashion?

- What are the Form 5500 and tax reporting implications of the investment? Are the logistical obligations acceptable to the plan's staff?

- What sort of information does the plan or plan sponsor need to provide to the investment vehicle, and are the fiduciary and plan sponsor comfortable with meeting this obligation? Will the investment vehicle keep information provided confidential?

- Have you completed the subscription documents and investment management agreements correctly? In this regard, bear in mind that preprinted subscription documents may not line up with your plan's fiduciary governance structure, so be sure the proper entity is named in the document as the plan's fiduciary.

- Do you have appropriate contracts in place with any vendors involved in making or servicing the investment arrangement?

When it comes to investments, benefit plans have many choices. Fiduciaries need to do the research and spend the time necessary to make the right choices for their plans.

NOTES

1. An exception applies for investments in employer securities by defined contribution plans, under 29 U.S.C. § 404(a)(2).

2. *See, e.g., Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996).

3. 29 U.S.C. § 407.

4. 29 U.S.C. § 404(b).

5. Marlene Y. Satter,"Retirement Assets Rise to $24.7 Trillion," *BenefitsPro,* March 25, 2015, *http://www.benefitspro.com/2015/03/25/retirement-assets-rise-to-247-trillion* (last accessed May 14, 2016) (citing Towers Watson study for the $22.1 trillion institutional retirement plan figure and an Investment Company Institute study for figures including IRAs and other noninstitutional assets). This article focuses on private-sector plans subject to ERISA.

6. New regulations issued by the Department of Labor on April 8, 2016, expanded the circumstances in which a person is considered to be offering "investment advice" of the type that can give rise to fiduciary status under ERISA. The new regulations,

which become applicable from April 10, 2017, delete the previous requirements that the advice be offered on a "regular basis" and that the advice be the "primary basis" for investment decisions. Briefly, a person generally qualifies as offering fiduciary investment advice if he, she, or it (1) receives a fee or other compensation; (2) acknowledges fiduciary status, renders advice based on the understanding that the advice will be based on the particular needs of the recipient, or directs advice to specific recipients; and (3) makes a recommendation regarding acquisition, holding, or disposition of plan assets, investments to be made following a rollover or distribution of plan assets, or the decision to take a rollover or distribution, or management of plan property (including selection of an investment adviser or investment manager). However, mere provision of general investment and market information, including objective performance and benchmarking reports requested by a plan fiduciary, does not fall into the fiduciary category. Although the new regulations strive to reduce the number of situations in which plan fiduciaries believe they have hired a fiduciary 3(21) adviser and the investment professional believes that it has not accepted fiduciary responsibility and is simply providing information and carrying out instructions, it is still important for plan fiduciaries to insist on express documentation of their investment professionals' roles and responsibilities, and to discuss any questions regarding applicability of fiduciary liability with their counsel and the investment professional in detail.

7. Naturally, the questions surveyed in this article also do not represent an all-inclusive list even as of the date of publication and, conversely, the questions included may not be relevant in all cases. The needs of a particular plan, the preferences and concerns of particular fiduciaries and investment managers, the characteristics of particular investments, and other factors will affect the investment analysis, and the fast-evolving investment world and ongoing developments in ERISA regulation and litigation will continue to add to and modify this list.

8. *See* "Mutual Funds," SEC Fast Answers, December 14, 2010, *http://www.sec.gov/answers/mutfund.htm,* (last accessed May 14, 2016). *See also* "Investment Companies," SEC Fast Answers, July 9, 2013, *http://www.sec.gov/answers/mfinvco.htm* (last accessed May 14, 2016), for an overview of open-end investment companies, closed-end investment companies, and unit investment trusts.

9. 29 U.S.C. § 2510.3-101(a)(2).

10. *See, e.g., George v. Kraft Foods Global, Inc.,* 641 F.3d 786, 791–792 (7th Cir. 2011).

11. In this regard, it is worth noting that new SEC regulations requiring restrictions on liquidity in certain conditions will take effect for money market funds (other than those that qualify as "government" funds) on October 14, 2016.

12. Fiduciaries should work with their investment professional to be sure they are familiar with market norms as well as the written terms of investment. In an earlier decision in the *Tibble v. Edison Int'l* litigation recently addressed by the Supreme Court, the district court and the Ninth Circuit faulted the fiduciaries for failing to investigate the possibility of better share classes and to request waivers that were routinely granted when sought. *Tibble v. Edison Int'l*, 711F.3d 1061 (9th Cir. 2013).

13. *See, e.g., Tussey v. ABB, Inc.* 746 F.3d 327 (8th Cir. 2014); *Spano v. Boeing Co.*, 633 F.3d 574 (7th Cir. 2011).

14. "Exchange Traded Funds," SEC Fast Answers, November 8, 2013 *http://www.sec.gov/answers/etf.htm* (last accessed May 14, 2016).

15. *See* Trang Ho, "The Debate over ETFs in 401(k) Plans," *Institutional Investor*, April 11, 2014, *http://www.institutionalinvestor.com/article/3330107/asset-management-*

indexing-and-etfs/the-debate-over-etfs-in-401k-plans.html (last accessed May 14, 2016). However, as the article notes, Charles Schwab has rolled out an ETF 401(k) platform, and Betterment LLC is seeking to use ETFs to offer a cost-effective 401(k) platform. *See* Anne Tergesen, "Betterment to Offer ETF-Only, Online 401(k) Plan," *The Wall Street Journal,* September 11, 2015.

16. *See* 29 C.F.R. 2510.3-101(a)(2). A plan investing in a registered investment company or publicly offered security is treated as owning its shares of the registered investment company or public company, but not the underlying assets of that company.

17. 2015 *Investment Company Fact Book*, Appendix A, Investment Company Institute, 2015, *http://www.icifactbook.org/fb_appa.html* (last accessed May 14, 2016).

18. *See* 29 U.S.C. § 2510.3-101(h)(i) and (ii).

19. Various exemptions to the prohibited transaction rules often mean that compliance is fairly simple for large, professionally managed collective trust funds. However, the fiduciaries need to be sure they understand what information the trustee will need to meet its compliance obligations and that they are comfortable providing that information.

20. 29 U.S.C. § 2550.408b-2, particularly subsections (c)(1)(iv)(E) and (F) (investment provider and recordkeeper obligation to disclose); 29 U.S.C. § 2550.404a-5 (obligation for fiduciaries to provide information to participants).

21. Halonen, Doug. "DOL Urges Valuation Objectivity," *Pensions & Investments,* (August 18, 2008), *http://www.pionline.com/article/20080818/PRINT/690354140/dol-urges-valuation-objectivity* (last acessed May 14, 2016) (citing a letter from the Boston office of the Department of Labor discussing valuation obligations).

22. Often, a single trust will offer different "pools" with different investment strategies. For example, a single trust might have an investment pool focusing on large cap equity, one on small/mid cap, and one on bonds. Each pool has a separate portfolio and tracks gains and losses separately.

23. If a collective trust fund does not impose restrictions of this type, the fiduciaries should be sure they are comfortable that the fund's portfolio can accommodate potential withdrawals by large investors without undue disruption to remaining investors, in case the plan finds itself still in the fund after a large withdrawal by another investor. Because the fund's portfolio and investor population will change over time, this issue should be revisited periodically.

24. *See* 29 U.S.C. § 2510.3–101(h)(iii).

25. *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav.Bank*, 510 U.S. 86; 114 S. Ct. 517; 126 L. Ed. 2d 524 (1993).

26. "De-risking" by annuitizing a significant portion of a plan's obligations has been gaining increasing attention amid large annuity purchases in recent years. Typically, these transactions are initiated by a directive from the plan sponsor, as the entity setting a defined benefit plan's funding policy, and the authority of a plan sponsor to make this decision without fiduciary responsibility has been recognized by at least one court. *See Lee v. Verizon Communications., Inc.*, 623 Fed. Appx. 132 (5th Cir. 2015), *petition for cert. filed sub nom. Pundt v. Verizon Communications, Inc*. However, the fiduciaries are then obligated to implement the decision in accordance with ERISA's fiduciary standards. States have also expressed interest in regulating these transactions via insurance laws.

27. 29 U.S.C. §§ 2550.404a-4 (defined contribution plans) and 2509.95-1 (defined benefit plans, requiring "safest available provider" standard in most cases).

28. "Insurance Company Products Offered to Employee Benefit Plans," AICPA Employee Benefit Plan Audit Quality Center, December 2011 *https://www.raffa.com/resources/documents/aicpa_ebpaqc_topix%20primer_insurance%20company%20products_dec%202011.pdf* (last accessed May 14, 2016).

29. 29 U.S.C. § 2550.404c-1 provides that in order for plan fiduciaries to avoid liability for the consequences of individual participant direction decisions, plans that allow participants to select their own investments must offer an array of at least three *diversified* investment funds (emphasis added). It is important to note, of course that the Department of Labor takes the position that fiduciaries are relieved of liability only to the extent that the investment options made available to participants are generally prudent in the first instance.

30. The decision to offer a brokerage window under a participant-directed defined contribution plan requires consideration of various factors, including the cost, the likely usage, the available recordkeeper support, and the types of investments that ought to be made available. Fiduciary oversight responsibilities for investment offerings available under a typical brokerage window are less than the responsibilities applicable to the plan's "core" investment array, because fiduciaries cannot reasonably supervise thousands of mutual fund and individual securities offerings. However, the Department of Labor has indicated that it is potentially problematic for a plan to offer *only* a brokerage account, unaccompanied by a core array overseen by the plan fiduciaries, and that fiduciaries must act prudently and in the exclusive interests of plan participants when establishing and administering brokerage window. *See* Department of Labor Field Assistance Bulletin 2012-02R (July 30, 2012), Q&A #39.

31. Investment managers and other fiduciaries are subject to specific compensation disclosure requirements under 29 U.S.C. § 2550.408b-2, and other providers (such as brokers) may be subject to these regulations as well. If the regulations apply, the fiduciaries need to verify that all required disclosures are received. Even if the regulations do not, however, fiduciaries should be asking for similar information to ensure that the plan is paying no more than reasonable compensation and is receiving the desired services in exchange.

32. Studies indicate that fewer investment options can encourage participants to enroll in the plan, by reducing perceived complexity. *See* Marlene Y. Satter, "Fewer DC Investment Choices Equal More Savings, *BenefitsPro*, *http://www.benefitspro.com/2016/01/04/fewer-dc-investment-choices-equal-more-savings* (January 4, 2016) (last accessed May 14, 2016); Gary R. Motola and Stephen P. Utkus, "Can There be Too Much Choice in a Retirement Savings Plan?" Vanguard Center for Retirement Research (June 2003), *http://www.403bwise.com/pdf/vcrr_choice_study.pdf* (last accessed May 14, 2016).

33. In both H.E.B. Investment & Retirement Plan, H.E. Butt Grocery Company, SEC No-Action Letter (May 18, 2001), *https://www.sec.gov/divisions/investment/noaction/heb051801.htm* (last accessed May 14, 2016) and Invesco Advisers, Inc., SEC No-Action Letter (April 8, 2014), *https://www.sec.gov/divisions/investment/noaction/2014/invesco-advisers-040814-403b.htm* (last accessed May 14, 2016), the SEC discussed the implications of "generic" investment options in retirement plans and the ability of these options to count as a single "investor" for purposes of investor limits on Section 3(c)(7) funds in which the plans invested, and noted it had reached a consistent conclusion for investments in Section 3(c)(1) funds.

34. *See* 17 U.S.C. § 4.5; information regarding filing for the exemption is available at *http://www.cftc.gov/IndustryOversight/Intermediaries/CPOs/cpoctaexemptionsexclusions* (last accessed May 14, 2016).

35. ____ U.S. ____,134 S. Ct. 2459, 189 L. Ed. 2d 457 (2014).

36. *See, e.g.*, *In re Citigroup ERISA Litigation*, 2015 U.S. Dist. LEXIS 63460 (S.D. N.Y. May 13, 2015). (Rejected claims alleging that stock was excessively risky for the plan since risk was factored into market price); *c.f., Gedek v. Perez*, 66 F. Supp. 3d 368 (W.D. N.Y. 2014) (Kodak fiduciaries acted imprudently in retaining Kodak stock as Kodak slid towards bankruptcy; mere fact that stock price reflected valuation did not render stock prudent investment for retirement plans).

37. *See Tatum v. R.J.R. Pension Inv. Comm.,* 761 F.3d 346 (4th Cir. 2014).

38. *See, e.g.*, *Harris v. Amgen, Inc.*, 788 F.3d 916 (9th Cir. 2015). The Supreme Court reversed and remanded on January 25, 2016, for further consideration of whether the plaintiffs' claims adequately alleged that the fiduciaries could have taken action to protect the plan without violating securities laws. The Supreme Court reversal should be comforting to fiduciaries but does not eliminate all risk from holding company stock.

39. *See, e.g.,* Simon Mead, "Defined Contribution Plans Gain Access to Private Equity," *Institutional Investor,* April 13, 2015, *http://www.institutionalinvestor.com/article/3443994/asset-management-hedge-funds-and-alternatives/defined-contribution-pensions-gain-access-to-private-equity.html* (last accessed May 14, 2016); "Alternative Assets: The Next Frontier for Defined Contribution Plans," September 2013, *http://www.aon.com/human-capital-consulting/retirement/investment-consulting/bin/pdfs/IDF_Alts-Assets-in-DC-Plans.pdf* (last accessed May 14, 2016). However, defined contribution plan fiduciaries should understand the risks associated with alternative investments. *See* Jo-El J. Meyer, "Intel 401(k) Participants Sue Over Hedge Fund Losses," *Pension & Benefits Daily,* October 30, 2015. Fiduciaries of well-funded, and particularly overfunded, defined benefit plans still need to be sensitive to the special issues posed by alternative investments, but have more protection against liability for investment losses under current law (*see, e.g., Harley v. 3M*, 284 F.3d 901 (8th Cir. 2002) and also face fewer administrative complications in working with alternative investments.

40. Fiduciaries should not only be sure that the fund is properly formed as a limited liability vehicle (*e.g.*, a corporation, limited partnership or limited liability company) but they should also review any indemnity and guarantee provisions to be sure they understand the extent to which the investment fund or any party dealing with that fund might have recourse to other plan assets. Generally, absent wrongdoing or default by the plan, an investment should not provide for such recourse. Fiduciaries should, however, bear in mind that certain types of assets, such as real estate, prevent special limited liability risks.

41. The fund may qualify for exemption on the grounds that investment by "benefit plan investors" (*i.e.,* ERISA plans and IRAs) is "not significant" (*i.e.,* less than 25 percent of any class of equity, disregarding non-benefit-plan ownership by management and entities under management control), or as an "operating company," a "venture capital operating company," or a "real estate operating company."

42. Funds differ in their policies on "most favored nations" rights. Some decline to grant special arrangements at all and thus render the issue moot, some grant most favored nations rights automatically, at least to investors the same size or smaller, and some will grant most favored nations rights only on limited topics and in specific circumstances.

43. Offshore investments and other foreign funds raise the question of how the plan can comply with the requirement of 29 U.S.C. § 404(b) that the "indicia of ownership" of plan assets remain within the jurisdiction of the U.S. district courts. The Department of Labor has not issued formal guidance on how to address this concern for investments whose "indicia of ownership" consist of a subscription agreement, but the common practice is for plans to consider this requirement satisfied if the

subscription documents are held in the U.S. *See* George M. Gerchstein, "Investing in China: An ERISA Perspective," *Tax Management Compensation Planning Journal,* January 1, 2016, pp. 3–13, particularly pp. 7–8. If the investment vehicle itself is considered to hold "plan assets" and thus is subject to ERISA, the plan's fiduciaries should ensure that the fund's custody arrangements comply with 29 U.S.C. § 404(b).

44. *See* Department of Labor Advisory Opinion 99-16A (December 9, 1999), *http://www.dol.gov/ebsa/programs/ori/advisory99/99-16a.htm* (last accessed May 14, 2016).

45. Although it is less common than with collective trusts and pooled separate accounts, some alternative investment funds will make a Direct Filing Entity filing with the Department of Labor to simplify the investing plans' reporting obligations.