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Deep Dive

Your Employer Will Decide the Fate of Private-Market 401(k)s

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- President Donald Trump's executive order paves the way for companies to consider offering private market, cryptocurrency, and other off-market investments in retirement plan menus.
- The order seeks to overcome deep-rooted employer skepticism by easing regulations outlining investment oversight duties under the Employee Retirement Income Security Act.
- According to Ruth E. Delaney, a K&L Gates LLP ERISA partner, "this is a departure from the precedent employers are used to," and employers will have to weigh the risks of alternative investments.

The success of the Trump administration's mission to modernize workplace 401(k)s with alternative private investments hinges on risk-averse employers that have steered worker assets almost exclusively into stocks and bonds for decades.

President Donald Trump's executive order on Thursday paves the way for companies to consider offering private market, cryptocurrency, and other off-market investments in retirement plan menus.

The order seeks to overcome deep-rooted employer skepticism fueled by the strict, personal liability companies already face under federal benefits law by easing regulations outlining investment oversight duties.

The White House instructed the US Labor Department to review and consider loosening fiduciary constraints on 401(k) plan sponsors picking and choosing investments under the Employee Retirement Income Security Act. Both the government and individual investors can sue a fiduciary for failing to live up to ERISA's standards.

Alternative investments are usually considered high-risk, high-reward products, unsuitable for the more stable, long-term strategies typical in defined-contribution retirement plans. Actively managed off-market investments are often more expensive than their public counterparts and they're usually highly illiquid, posing flexibility challenges for 401(k)s.

Pooled funds offer some relief, but Trump's new policy says "every American" deserves access to a product line for which employers can be held personally liable.

"This is a departure from the precedent employers are used to," said Ruth E. Delaney, a K&L Gates LLP ERISA partner in Los Angeles. "We're in uncharted territory here."

Litigation accusing fiduciaries of putting costly funds in their plan lineups is already on the rise, and major financial players like BlackRock Inc. and Empower are actively rolling out private-market products tailored to the \$12.5 trillion industry.

But pressure from Washington, Wall Street, and enthusiastic plan participants pitching private-market and crypto-heavy 401(k)s will face off against the already persistent threat of legal exposure in Trump's new vision for American retirement portfolios. It will be up to companies to weigh the risks and the complicated nature of multi-asset funds.

"An executive order can wipe out legal issues, but it can't do away with the perceived threat private equity poses to employers, especially for assets that they don't really feel they understand," said Hilary Wiek, a senior strategist at Morningstar's PitchBook Data Inc., a public and private capital market research platform.

Alternative Playbook

First up on the White House's agenda to overcome employer pressure will likely be to do away with Biden-era guidance that cautioned fiduciaries against the risk of private equity in 401(k)s.

The policy is "low-hanging fruit" for the Labor Department's Employee Benefits Security Administration as it executes Trump's order, said Andrew Oringer, partner and general counsel at the Wagner Law Group LLC, a boutique firm specializing in ERISA.

The first-term Trump administration laid out a strategy for eliminating perceived fiduciary risks in an information letter that established guardrails plans could use to add unconventional investments that satisfy fiduciary oversight requirements. The Biden guidance supplemented that letter with counter-arguments against alternative investing and cautioned about the high level of expertise fiduciaries may need to suss out suitable private-market products.

Trump's new executive order instructs the Labor Department to clarify fiduciary duties as they pertain to alternative investments and hints at a safe harbor specific to those kinds of investment products.

Safe harbors under ERISA protect against enforcement and litigation when fiduciaries can prove they followed the department's regulatory guidance. But they've never been used to broadly green light a specific type of investment, because the DOL usually takes a passive stance on what types of investments are permissible under ERISA, said Delaney.

It's also unclear whether a DOL safe harbor would protect against private-sector litigation or just government-led enforcement.

Swaying Employers

But image matters, and a permissive subregulatory tone combined with new legal carveouts could be enough to sway employers that are on the fence about alternative investments, said Hersh Shefrin, an economist and professor of consumer financial psychology at the Santa Clara University Leavey School of Business.

Plus, employers are bound to face immense pressure from Wall Street's private-equity firms, which stand to gain new capital investment streams and lobbied the Trump administration heavily for Thursday's executive order.

"Wall Street sells the same way drug companies sell," Shefrin said. "You get visited by representatives that look at ways to make you feel good. There will be conferences to go to that are lavishly funded. Then employees will start asking for it."

That combination could be enough to overcome even the most litigation-weary employer, but it will depend on regulatory agencies coming up with workable, practical solutions for inserting alternative investments into 401(k)s unfamiliar with cutting-edge investing tactics, said Oringer.

The Securities and Exchange Commission can play a role redefining accredited investors and adjusting qualified purchaser status, he said. But, it will always ultimately be up to employers to pull the private-market trigger, Shefrin insisted.

"At the end of the day, this kind of judgment is made more at an intuitive level than an analytical one," he said.

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