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Wealth Management & Financial Planning Services

Will Crypto Make an Appearance in Your 401(k) Plan?

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In recent months, the debate surrounding digital asset investing has reached a fever pitch among media pundits, financial experts, lawmakers, and policy enforcers, partly due to the fact that cryptocurrency might soon be available in at least some 401(k) plans. If given the opportunity, should employer retirement plans offer crypto as part of their investment lineup? And if the option is available, should workers consider allocating a portion of their retirement savings to cryptocurrency? There is much to ponder before employers and workers answer those questions.

DOL's position gives reason for pause

Although cryptocurrency investments have been in the news for years, the hubbub surrounding retirement plans began in earnest in March 2022 when the Department of Labor (DOL) Employee Benefits Security Administration (EBSA) issued a compliance assistance release cautioning employers about offering crypto in their retirement savings plans. The release, which has since sparked outcry from industry watchdogs and even one lawsuit (as of this writing), reminded employers of their obligations to "act solely in the financial interests of plan participants and adhere to an exacting standard of professional care." These responsibilities are commonly referred to as an employer's fiduciary duties to its retirement plan participants.

The bulletin continued:

"Fiduciaries who breach those duties are personally liable for any losses to the plan resulting from that breach. A fiduciary's consideration of whether to include an option for participants to invest in cryptocurrencies is subject to these exacting responsibilities.... At this early stage in the history of cryptocurrencies, the Department has serious concerns about the prudence of a fiduciary's decision to expose a 401(k) plan's participants to direct investments in cryptocurrencies, or other products whose value is tied to cryptocurrencies."[1]

The DOL detailed five reasons for its concerns about the risks and challenges to participants' retirement accounts:

1. **Speculative and volatile investments.** "The Securities and Exchange Commission has cautioned that investment in a cryptocurrency is highly speculative.... Extreme volatility can have a devastating impact on participants, especially those approaching retirement and those with substantial allocations to cryptocurrency."
2. **Challenge for plan participants to make informed investment decisions.** "Cryptocurrencies are often promoted as innovative investments that offer investors unique potential for outsized profits.... it can be extraordinarily difficult, even for expert investors, to evaluate these assets and separate the facts from the hype.... When plan fiduciaries...choose to include a cryptocurrency option on a 401(k) plan's menu, they effectively tell the plan's participants that knowledgeable investment experts have approved the cryptocurrency option as a prudent option for plan participants." The DOL stresses that participants are less likely to have enough knowledge and expertise to make informed decisions, compared to other plan investment options, which could ultimately result in retirement account losses.
3. **Custodial and recordkeeping concerns.** "Cryptocurrencies are not held like traditional plan assets in trust or custodial

accounts, readily valued and available to pay benefits and plan expenses." The DOL cited the risks of lost passwords, which can wipe out a participant's access to the assets, and vulnerability to hackers and theft, among others.

4. **Valuation concerns.** "Experts have described the question of how to appropriately value cryptocurrencies as complex and challenging."
5. **Evolving regulatory environment.** "Fiduciaries who are considering whether to include a cryptocurrency investment option will have to include in their analysis how regulatory requirements may apply to issuance, investments, trading, or other activities and how those regulatory requirements might affect investments by participants in 401(k) plans."

Perhaps most alarming to employers and those in the retirement plan industry, the release concluded by saying that employer plans offering digital asset investments will be subject to an "investigative program," and that "plan fiduciaries responsible for overseeing such investment options or allowing such investment options through brokerage windows should expect to be questioned about how they can square their actions with their duties of prudence and loyalty in light of the risks described above."

A major firm opens the door

Approximately one month after the DOL issued Compliance Assistance Release 2022-01, the nation's largest retirement plan provider announced that it would begin offering bitcoin through a digital asset account in its 401(k) plans for employers that wish to add it to their retirement plans, with the potential for adding other cryptocurrencies in the future. In its press release, the organization noted the growing interest in digital assets among both employers and workers.[2] The organization later indicated that it would limit the amount that participants could invest in digital assets to 20% of account balances, but that employers could impose stricter limits.[3]

Industry pushes back

After the DOL issued the compliance release, several trade groups — including the Investment Company Institute, the Insured Retirement Institute, the Small Business Council of America, and the U.S. Chamber of Commerce — signed a joint letter to EBSA Acting Assistant Secretary Ali Khawar expressing their concerns. Although signers explicitly stated they took no position on whether it's appropriate to offer cryptocurrency in retirement plans, their points included the following.[4]

- The belief that the Department overstepped its authority by neglecting to develop guidance through an official notice-and-comment rulemaking process. Using such a process, the DOL would release proposed guidance and allow a comment period, during which industry experts and others could share their insights and opinions. After considering this feedback, the DOL would then release final guidance. In fact, the letter stated that the release may have actually run afoul of the Administrative Procedure Act, which likely led to one plan provider filing suit in June 2022.
- The guidance effectively extends an employer's fiduciary obligations to investments offered within a retirement plan brokerage window, which previous rulings had expressly determined was not the case.
- Will only direct investment in cryptocurrencies be scrutinized, versus mutual funds and exchange-traded funds that may invest in cryptocurrencies? The DOL guidance was unclear, merely referring to "cryptocurrencies and related products."
- The DOL's guidance that fiduciaries should use "extreme care" when it comes to cryptocurrency is "not the legal standard applicable to fiduciaries under ERISA," the law that governs employer-sponsored retirement plans, and will create confusion.
- There is no legal precedent establishing that the DOL may evaluate or determine the appropriateness of investments offered in a retirement plan.

Uncertain future

Since issuing the original EBSA compliance assistance release, Mr. Khawar has clarified that being an employer client of a financial services firm that offers cryptocurrency in its plans won't automatically trigger an investigation. In addition, DOL Secretary Martin Walsh indicated that the Department is considering using the official rulemaking process to develop regulation governing cryptocurrency in retirement plans.[5]

Although it appears cryptocurrency will indeed be offered to employers for their retirement plans, few have indicated a willingness to adopt the investment option for their plans. In fact, according to the Plan Sponsor Council of America, less than 4% of employers said they were considering adding cryptocurrency to their plans, but after the DOL published the compliance assistance release, only half said they will continue to do so.[6]

Whether digital assets eventually gain traction in the retirement plan industry remains to be seen; however, it bears repeating that cryptocurrency investing, in general, is still in its infancy. Although millions of people have dipped their toes in the crypto waters over the past decade (most in recent years), the digital asset market has been characterized as the "wild west" of the asset management industry. Employers and retirement plan participants may want to proceed with caution.

1 U.S. Department of Labor, March 2022

2 Fidelity press release, April 2022

[3] *The Wall Street Journal* , April 26, 2022

[4] Letter to Mr. Khawar, April 2022

[5] Bloomberg Law, May 2022, and Plan Sponsor, June 2022

[6] Plan Sponsor Council of America, March 2022

Cryptocurrencies are not traditional investments; they are highly speculative instruments, carry a significant amount of risk, and are not suitable for all investors. Cryptocurrencies typically are not subject to the same reporting and data integrity requirements that apply to more traditional investment products. The IRS is treating cryptocurrency as an asset subject to capital gains taxation rather than as a currency.

Since many digital assets are currently unregulated, you may not have the same level of investor protection you would have from traditional investments. There may be limited publicly available information about the operations, financials, or governance behind some digital asset investments. This lack of transparency can make these investments even more vulnerable to misinformation, rumors, or fraud. Take the time to learn as much as you can about a digital asset investment and look for warning signs of fraud.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.