

Cryptocurrency and Defined Contribution Plans: Action items for Plan Sponsors



May 10th, 2022

Overview

Cryptocurrency (or “crypto”) is coming whether we like it or not. That doesn’t mean it has to be in your retirement plan today, or, perhaps, any time soon – or ever. Crypto is a term used to describe “digital assets” including “tokens,” “coins,” “crypto assets,” and other derivatives. It can be a useful tool and diversification mechanism for investing, but it may not yet align with fiduciary obligations under the Employee Retirement Income Security Act (ERISA) and guidance from the Department of Labor (DOL). While some plans may only be regulated by state law, it is recommended to follow DOL guidance and ERISA as a best practice, particularly in this quickly evolving area of the law.

The DOL has recently issued two key pieces of guidance:

1. [Compliance Assistance Release No. 2022-01](#), released on March 10th, 2022, which “cautions plan fiduciaries to **exercise extreme care** before they consider adding a crypto option to a 401(k) plan’s investment menu for plan participants.”
2. [Follow-up letter from the Compliance Assistance Release written to Senator Tuberville](#) on April 20th, 2022, which re-enforces its position in the Compliance Assistance Release and provides:
 - a. That the DOL is not “taking a novel position by asserting that ERISA imposes obligations on fiduciaries of plans with self-directed brokerage accounts or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan” and
 - b. The Compliance Assistance Release is limited to digital assets.

As a reminder, it is important to listen to the DOL given that it is the regulator that investigates retirement plans and service providers to those plans.

In plans covered by ERISA, the DOL reminds plan sponsors of their duty to prudently select designated investment alternatives. In simpler terms, this means the fund line-up available to participants (also known as DIAs or Designated Investment Alternatives) must be selected using a process in which plan fiduciaries follow these steps:

1. Use a framework such as an Investment Policy Statement (IPS).
2. Gather information such as qualitative and quantitative factors about an investment option.
3. Evaluate the investment option objectively using the criteria in the IPS.
4. Decide to include the investment option in the fund line-up (or not).
5. Review this investment option on an ongoing basis and continue to determine if it should be retained in the fund line-up.

Although it may seem paternalistic, the DOL makes it clear the role plan sponsors have to protect participants from themselves when it comes to crypto and other risky asset classes, noting it is their responsibility to “identify and avoid imprudent investment options” and not to “shift responsibility to plan participants.” The DOL cites the recent Supreme Court case of *Hughes v. Northwestern University*, stating that “even in a defined-contribution plan where participants choose their investments, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan’s menu of options.” Each investment option in the plan requires the five-step prudent process outlined above on an ongoing basis.

In addition to a prudent process, the DOL identified five areas of concern specific to crypto, warning

fiduciaries to **exercise extreme caution** when adding this asset class to a fund line-up. In the Compliance Assistance Release, the DOL states it will be questioning those fiduciaries who have utilized the brokerage window to add crypto. It is conducting these questions in order to better understand how the inclusion of this asset class can be “squared” with duties of prudence (i.e., the prudent process outlined above) as well as the loyalty owed to the plan sponsor’s participants. In the April 20 letter, the DOL further provides that the DOL is **not** taking a new position on brokerage windows and that fiduciaries are responsible not only for making the brokerage window available but also “for the decisions to make cryptocurrency investments available to plan participants and beneficiaries, whether as designated investment alternatives or through a self-directed brokerage account or similar arrangement.”

Notably, the five areas of concern for the DOL on crypto include the following:

1. Crypto has “been subject to extreme price volatility.” Extreme volatility doesn’t align with what’s in the best interest of participants, particularly those who are approaching retirement, where extreme account drops could have devastating impacts.
2. Crypto might appeal to the unsophisticated investor because it is promoted to “offer investors unique potential for outsized profits.” If it is made available in a retirement plan, it sends the sign that it is vetted by knowledgeable investment experts (i.e., plan fiduciaries). Given how different it is as an investment type and how difficult it can be to evaluate, it has the potential, at this time, to lead to large losses for participants.
3. Crypto presents many different custodial and recordkeeping concerns for plan fiduciaries including the threat of hackers and theft.
4. Crypto presents difficulty and concerns with the reliability of the valuation of assets.
5. The regulations for crypto may be evolving, and the DOL is concerned that some market participants may not be in compliance.

Next Steps for Plan Sponsors

Crypto is popular in the global marketplace, but at this time, the DOL is making clear that 401(k) plan sponsors should use extreme caution. Considering that position, plan sponsors may consider these action steps:

1. Review the recent DOL Compliance Assistance Release and April 20 letter.
2. Develop a communication strategy or talking points for participants who request crypto in the 401(k) plan. For example, determine how to help participants understand that the retirement plan may not be the most appropriate platform to invest in crypto (for the reasons discussed above) but point to the other benefits of the plan.
3. Continue to monitor the guidance from the DOL and other regulators as this is a landscape that is quickly evolving, and their guidance may change after the DOL inquiries are discussed in their future recommendations.

For plan sponsors considering adding crypto as an option (or who already have crypto in their plans), consider the following action steps:

1. Review the recent DOL Compliance Assistance Release and April 20 letter.
2. Review the framework or other selection processes for how you selected, documented, and monitored the inclusion of crypto assets in the plan. Be sure to focus on the DOL’s requirement in their guidance that fiduciaries should “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.”
3. Seek competent ERISA counsel who is specialized in this area of practice. This is uncharted territory that requires close attention to detail.

For additional information, reach out to your NWCM advisor to discuss this guidance and how service providers are handling this in your plan(s).

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