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DOL Release Warns About Cryptocurrency in 401(K) Plans

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EXECUTIVE SUMMARY

The Department of Labor (DOL) recently issued a Release that warns about cryptocurrency use in 401(k) plans. The Release raises a number of concerns, including troubling implications for fiduciary duties with respect to brokerage windows and whether it is appropriate for DOL to target specific asset classes.

The risks and rewards of cryptocurrency and its role in investment portfolios are currently being hotly debated in many arenas. That debate has now come to the forefront with respect to cryptocurrency as an investment option in 401(k) plans.

On 9 March 2022, President Biden issued an "Executive Order on Ensuring Responsible Development of Digital Assets" (the Executive Order).[1] The Executive Order sets out policy objectives to (1) protect consumers, investors, and businesses in the United States, (2) protect the United States and global financial stability and mitigate systemic risk, (3) mitigate the illicit financial and national security risks posed by misuse of digital assets, (4) reinforce United States leadership in the global financial system, (5) promote access to safe and affordable financial services, and (6) support technological advances that promote responsible development and use of digital assets.

One day after President Biden issued the Executive Order, DOL issued Compliance Assistance Release No. 2022-01, on 401(k) Plan Investments in "Cryptocurrencies" (the Release).[2] In the Release, DOL takes the unusual step of signaling its disfavor with a particular asset class, cryptocurrency, as a plan investment. Normally, DOL stays neutral with respect to particular asset classes as a whole,[3] with the understanding that a fiduciary has a duty to evaluate investment options prudently depending on the particular facts and circumstances. While the Executive Order's policy objectives seek to balance consumer protection and risk mitigation with ensuring the benefits of financial innovation are enjoyed equitably by all Americans, the Release takes a much more one-sided approach.

The Release goes through a number of risks and challenges that cryptocurrency may pose to retirement account participants, such as its speculative and volatile nature, complexity, valuation difficulties, custodial and recordkeeping concerns, and evolving regulatory environment. These risks are not necessarily unique to this asset class. The Release fails, however, to balance the discussion of risks with an acknowledgment that a fiduciary may also consider possible benefits to a retirement investor of a portfolio that has a small allocation to cryptocurrency.

The Release mainly cautions fiduciaries about offering cryptocurrency as an investment option in a 401(k) plan's investment menu. However, DOL also cautions fiduciaries responsible for allowing investments in cryptocurrency through brokerage windows[4] that they should expect to be questioned about how they can square their actions with their duties of prudence and loyalty. The reference to brokerage windows raises additional concerns. A plan fiduciary has duties to prudently select and monitor a brokerage window provider, in the same way it is required to prudently select and monitor any plan service provider. However, while a plan fiduciary has duties to prudently select investment options known as "designated investment options" that form the main menu of investments available through the plan, investments through a brokerage window are not considered "designated investment options"[5] and a plan fiduciary typically has only limited duties with respect to such investments.

Plan fiduciaries considering cryptocurrency in 401(k) plans should proceed with care and, consistent with evaluating any asset class, plan fiduciaries should ensure they use a prudent process in their decision-making, including identifying the relevant information to consider (including the risks and challenges described in the Release), considering the relevant information, consulting experts when necessary, and documenting their process.

DOL's targeting of a specific asset class as it does in the Release raises a number of concerns. ERISA sets the legal standard for a fiduciary to determine whether any particular investment is appropriate for a specific plan. In addition, the implications of the Release with respect to brokerage windows are troubling. It is untenable, and contrary to existing guidance, for plan fiduciaries to be held responsible for investments made through brokerage windows. We expect industry pushback on the Release.

[1] Executive Order on Ensuring Responsible Development of Digital Assets. Although ERISA and retirement plans are not explicitly mentioned in the Executive Order, the Secretary of Labor is included among the other agency secretaries with respect to the need for interagency coordination in implementing the Executive Order. The Executive Order provides that within 180 days of the Executive Order, the Secretary of the Treasury, in consultation with the Secretary of Labor and the heads of other relevant agencies, shall submit a report to the President on the implications of developments and adoption of digital assets and changes in financial market and payment system infrastructures for United States consumers, investors, businesses, and for equitable economic growth.

[2] Compliance Assistance Release No. 2022-01, 401(k) Plan Investments in "Cryptocurrencies"

[3] We note that DOL did recently express its views on private equity strategies in defined contribution plans in a similar manner to the Release, cautioning that plan-level fiduciaries are not likely suited to evaluate the use of private equity investments in designated investment alternatives in individual account plans except in a minority of situations. U.S. Department of Labor Supplement Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives

[4] ERISA does not define a "brokerage window." However it is generally understood to be an investment option in a participant-directed 401(k) plan that gives participants the capabilities to buy and sell investment securities through a brokerage platform.

[5] DOL attempted to classify certain brokerage window investments as “designated investment options” via sub-regulatory guidance found in Field Assistance Bulletin 2012-02. However, after intense industry pushback, DOL removed the controversial guidance.

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