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Client Alert

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DOL Expresses Extreme Skepticism About Allowing 401(k) Plan Participants to Invest in Cryptocurrency

On March 10, 2022, the U.S. Department of Labor (the "DOL") issued Compliance Assistance Release No. 2022-01 (the "Release") regarding 401(k) plan participant-directed investments in cryptocurrencies. The Release "cautions plan fiduciaries to exercise extreme care before they consider adding a cryptocurrency option" to the investment menu of a self-directed 401(k) plan, and even calls into question the availability of cryptocurrencies through a plan's brokerage window.

Significant Risks and Challenges to Participants. The Release expressly identifies decisions about whether to "include an option for participants to invest in cryptocurrencies" as subject to ERISA's prudence and loyalty obligations. The DOL expresses "serious concerns" about the prudence of allowing 401(k) plans to offer cryptocurrency based on the "significant risks and challenges" the DOL associates with cryptocurrency and notes that the inclusion of *any* imprudent investment option in a menu can constitute a fiduciary breach, even if participants have other prudent options available to them. The Release highlights five reasons behind the DOL's concerns:

- ***Speculative and Volatile.*** The DOL cites Securities and Exchange Commission ("SEC") staff bulletins labeling "investments in cryptocurrency . . . highly speculative." As a relatively new asset class, cryptocurrency has been "subject to extreme price volatility", the DOL says, with "widely published incidents of theft and fraud." Volatility is a heightened concern for participants approaching retirement and for those participants "with substantial allocations to cryptocurrency."

- ***Participants Cannot be Assumed to Have Necessary Investment Expertise.*** Due to the novelty and complexities of cryptocurrency, typical plan participants may not be able to fully appreciate the risks related to such investments. According to the DOL, plan fiduciaries who "choose to include a cryptocurrency option on a 401(k) plan's menu . . . effectively tell the plan's participants that knowledgeable investment experts have approved the cryptocurrency option as a prudent option."
- ***Custodial and Recordkeeping Issues.*** Cryptocurrency may be difficult to custody. Many plan custodians/trustees may not be equipped to address issues related to a digital wallet. Losing or forgetting a password may result in permanent loss of the assets in a given wallet. Other methods of holding cryptocurrency could make the asset vulnerable to theft.
- ***Valuation.*** The DOL is concerned that valuation of cryptocurrency is "complex and challenging", especially as compared to traditional equity and debt assets. Further, cryptocurrency market intermediaries may not have adopted consistent accounting treatment or reporting methods.
- ***Evolving Regulatory Environment.*** The DOL instructs plan fiduciaries considering whether to include a cryptocurrency investment option to analyze how to comply with evolving regulatory requirements concerning cryptocurrency, especially in the SEC's realm. The Release also cites as a concern the possibility that law enforcement agencies may shut down or restrict platforms and exchanges, or restrict the use or trade of cryptocurrencies, in connection with investigations of illegal activities.

Promised Investigations. The DOL intends to launch an investigative program aimed at fiduciaries of defined contribution plans who choose to include cryptocurrency within the investment menu (whether directly or indirectly, through products whose value is tied to cryptocurrency) or permit investment in the asset through a brokerage window. "[P]lan fiduciaries responsible for overseeing such investment options or allowing such investments through brokerage windows should expect to be questioned," the DOL says, "about how they can square their actions with their duties of prudence and loyalty in light of the risks described above."

Action Items. The DOL obviously considers cryptocurrencies an exotic investment by current standards and hopes to discourage new investments in cryptocurrencies with the promise of investigations into the fiduciaries of those plans that already offer cryptocurrency as an option or through a brokerage window. This Release marks a significant departure from the DOL's standard position by indicating that an entire asset class should be viewed skeptically. ERISA, however, does not prohibit 401(k) plans from offering such investments. Including cryptocurrencies as a 401(k) plan investment option may or may not make sense for a particular plan depending on myriad factors.

Nonetheless, the DOL has now provided some guidance that fiduciaries must heed. Plan fiduciaries of 401(k) plans should consider whether any investment options permit participants to invest directly or indirectly in cryptocurrency. In addition to examining whether there is a direct investment option, plan fiduciaries should review brokerage window restrictions and consider whether digital assets should be added to the list of prohibited investments. If the plan and its investment policy statement allow participants to invest in cryptocurrency, even through a brokerage window, we recommend that the plan fiduciary consult with its business and legal advisors to assess and mitigate fiduciary risk.