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**ALERT ▪ Executive Compensation & Employee Benefits**

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# Cryptocurrency and 401(k) Plans: DOL Implores Fiduciaries to Exercise Extreme Care

On March 11, 2022, the U.S. Department of Labor (DOL) published Compliance Assistance Release No. 2022-01 (CAR 2022-01) in order to provide guidance for 401(k) plan fiduciaries who are considering plan investments in cryptocurrencies. The strongly worded statement reveals the agency's heightened level of concern surrounding cryptocurrency as plan investments, with the DOL cautioning fiduciaries to "exercise extreme care" before they consider adding a cryptocurrency option to a 401(k) plan lineup for plan participants. Although CAR 2022-01 was released just one day after President Biden signed an Executive Order outlining a whole-government strategy to ensure responsible innovation in digital assets, the use of cryptocurrency in 401(k) plan lineups has been on the DOL's radar at least since the summer of 2021. At that time, there were statements from the Acting Assistant Secretary for the DOL's Employee Benefits Security Administration (EBSA) that the agency viewed the use of cryptocurrencies in the retirement plan context as a "very troubling" development given its high volatility and limited transparency.[1]

According to CAR 2022-01, the DOL's 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 stem from the significant risks of fraud, theft and loss that have been endemic to these asset classes at least as of this early stage in their evolution. CAR 2022-01 elaborates on several aspects of cryptocurrencies that are at the heart of the DOL's apprehensions:

- **Cryptocurrencies' highly speculative and volatile nature** – CAR 2022-01 cites investor education materials prepared by SEC staff that describe how cryptocurrencies have been subject to extreme price volatility, which may be due to the many uncertainties associated with valuing these assets, speculative conduct, the amount of fictitious trading reported and widely published incidents of theft and fraud, among other factors.

- **Difficulty for participants to make informed decisions** – As the DOL explains, cryptocurrencies are substantially different from typical retirement plan investments, and it can be extraordinarily difficult—even for expert investors—to evaluate these assets. The DOL is concerned that participants will be less likely to have sufficient knowledge about these investments or will lack the technical expertise necessary to make informed decisions about investing in them. Moreover, CAR 2022-01 describes how a fiduciary's decision to include a cryptocurrency option on a 401(k) plan's menu may be misconstrued by participants as an endorsement of these asset classes as prudent options for plan participants.

- **Custodial and recordkeeping issues presented** – Unlike traditional plan assets that are held in trust or custodial accounts, readily valued and available to pay benefits and plan expenses, cryptocurrencies generally exist as lines of computer code in a digital wallet. In that sense, it is unclear how ERISA's indicia of ownership and trust requirements can be satisfied with these assets, because with some cryptocurrencies, losing or forgetting a password can result in permanent loss of the assets, and other methods of holding cryptocurrencies can be vulnerable to hackers and theft.

- **Valuation concerns** – CAR 2022-01 also describes the difficulty of generating accurate and reliable valuations for cryptocurrencies. In particular, the release mentions how there is expert disagreement about important aspects of the cryptocurrency market, noting that none of the proposed models for valuing cryptocurrencies are as sound

[1] Ted Godbout, "Khawar: Cryptocurrency Guidance on the Horizon" National Association of Plan Advisors, July 28, 2021, available at https://www.napa-net.org/news-info/daily-news/khawar-cryptocurrency-guidance-horizon.

as traditional discounted cash flow analysis for equities or interest and credit models for debt. Furthermore, cryptocurrency market intermediaries may not adopt consistent accounting treatment, and they may not be subject to the same reporting and data integrity requirements with respect to pricing as other intermediaries working with more traditional investment products.

- **Evolving regulatory landscape** – According to the DOL, the current regulatory landscape governing the cryptocurrency markets is rapidly evolving, and some participants may be operating outside of existing regulatory frameworks or not complying with them. CAR 2022-01 makes clear that the DOL expects fiduciaries who are considering whether to include a cryptocurrency investment option to analyze 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. Moreover, given the widespread use of Bitcoin and other cryptocurrencies in illicit activities, fiduciaries must take into consideration the real possibility that law enforcement agencies could shut down or restrict the use of platforms and exchanges, thereby limiting or shutting off the ability to use or trade Bitcoins.

## Key Takeaways

CAR 2022-01 concludes by indicating that EBSA expects to conduct an investigative program aimed at plans that offer participant investments in cryptocurrencies and related products, and to take appropriate action to protect the interests of plan participants and beneficiaries with respect to these investments. Furthermore, as part of this probe, the DOL will examine how plan fiduciaries responsible for overseeing such investment options or allowing such investments through brokerage windows are satisfying their duties of prudence and loyalty under ERISA in light of the significant concerns the DOL articulates in CAR 2022-01.

While there has been increasing demand on the part of individual investors to add cryptocurrency exposure to their retirement accounts,[2] the DOL's unequivocal position in CAR 2022-01 on the riskiness of cryptocurrencies as plan investment options will likely have a chilling effect on this nascent market. That said, CAR 2022-01 focuses on the use of cryptocurrencies in 401(k) plans—how exactly the agency's position will apply to the defined benefit plan space is unclear. Additionally, the guidance appears to home in on a 401(k) plan fiduciary's decision to expose participants to direct investments in cryptocurrencies. Whether some of the agencies' concerns can be mitigated by indirect investments in funds that have cryptocurrency exposure—perhaps even minimal exposure that would be subject to a strict cap—is also unclear at this time.

While the DOL has not created a flat prohibition on offering 401(k) participants exposure to cryptocurrency and digital assets, in light of the DOL's strong wording and warning of new investigative efforts, plan fiduciaries who remain interested in pursuing these investment options are advised to exercise a very high level of care in all decision-making, and to produce sufficient documentation of that decision-making process.

If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney contacts.

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[2] Anne Tergesen, "Saving for Retirement? Now You Can Bet on Bitcoin," Wall Street Journal, June 25, 2021, available at https://www.wsj.com/articles/saving-for-retirement-now-you-can-bet-on-bitcoin-11624613435.