Offering Crypto In A 401(k) Plan Is A Bad Bet

By Ary Rosenbaum, Esq.

When you're young, you can be adventurous within a limit. When you're a 401(k) plan sponsor, you can't be as adventurous. Being a 401(k) plan sponsor takes some responsibility and it's not a job to be stylish. Being a 401(k) plan sponsor, you can get into a lot of trouble by being stylish. One way of being too stylish is focusing on the "flavor of the week" and the newest flavor seems to be Bitcoin and other crypto currencies. As a trusted legal advisor, I'm not going to sugarcoat it, but offering it is a bad idea, right now.

What is crypto?

Cryptocurrency, sometimes called cryptocurrency or crypto, is any form of currency that exists digitally or virtually and uses cryptography to secure transactions. Cryptocurrencies don't have a central issuing or regulating authority, instead of using a decentralized system to record transactions and issue new units. This means crypto currencies are not regulated. The most well-known crypto currency is called Bitcoin. Bitcoin has gained popularity because it was around $5,600 a coin in March 2020 and its all-time high is over $69,000. I know as a crypto investor with two crypto wallet accounts.

Why the interest in Crypto for 401(k)?

Remember in 1998 and 1999, when everyone was going to be crazy investing in Beanie Babies and Internet stocks? Well, what is hot is what people are talking about. I have lived through enough fads such as Atari 2600, Cabbage Patch Kids, Trivial Pursuit, Beenie Babies, and fidget toys. I'm not trying to say that crypto is a fad, but it is extremely popular. In terms of investing, it does make sense that people are talking about Crypto. Up until recently, the returns on these coins were exorbitant. We've seen many companies such as Coinbase and Crypto.com spending millions in advertising for the Super Bowl. Crypto.com bought the naming rights for the home of my Los Angeles Clippers. With more awareness and previous great returns for crypto, more people have become aware of crypto and are more interested in investing in it.

The DOL issues guidance

With much interest in offering Crypto in 401(k) plans and providers considering it as an investment option for plan sponsor clients, the Department of Labor (DOL) decided to weigh in on the issue. Like the old E.F. Hutton commercials, if the DOL talks, plan sponsors and plan providers should listen. In March, the DOL issued Compliance Assistance Release No. 2022-01, which showed their issues with 401(k) crypto offerings and some warnings for plan sponsors and fiduciaries who would make these crypto investments available to plan participants. Ali Khawar, acting head of the DOL Employee Benefits Security Administration, indicated that the agency found 401(k) plan investment in cryptocurrency "very troubling" because of the volatility and lack of transparency of crypto investments. The DOL reiterated that plan fiduciaries must follow duties of prudence and loyalty under ERISA. Plan fiduciaries have to select and monitor each investment option made available to plan participants under the Plan. The DOL guidance claims that the extreme price volatility of crypto is because of uncertainties in valuation, speculative conduct, fictitious trading, theft/fraud, and other factors. The DOL also stated that the volatility in Crypto may attract participants who expect high returns without understanding and appreciating the risks. As someone in the business for the past 24 years, I can recall plan participants running after large returns by investing in technology mutual funds. As we know, the Internet stock crash hurt many plan participants who then eventually locked in their losses by selling off these investments. The difficulty in offering crypto is exacerbated when participants think that offering crypto in a 401(k) lineup is a plan fiduciaries' endorsement of those investments. From a security standpoint, the DOL cautioned that unlike traditional retirement plan assets that are held in retirement plan trust or custodial accounts that are readily and easily available to pay retirement benefits and expenses, cryptocurrencies only exist as computer code lines in a digital wallet, that is prone to fraud and theft, Unlike Internet stock and technology funds, there is no regulation of cryptocurrency, which may change. As a result of this laundry list of issues with cryptocurrency, the DOL states that any 401(k) plan fiduciaries that allow plan participants to invest in cryptocurrencies and related products, may expect a future audit as part of an investigative program aimed at protecting participants and beneficiaries of plans that offer such investments. As an ERISA attorney, I will tell you that I wouldn't recommend crypto currency in a 401(k) plan even as a crypto investor with my private money. What I do with my money is my business a plan sponsor as a plan fiduciary doesn't have that luxury. This DOL guidance is a dire warning and I would never recommend a plan sponsor client do something that invites a plan audit.

Fidelity begins a Crypto offering

With the DOL issuing this troubling guidance, most of us in the industry expected that any provider would put the brakes on a 401(k) crypto offering. Yet Fidelity, one of the 800-pound gorillas in the 401(k) space thought otherwise. Fidelity announced that later this year, they will enable participants for the 401(k) plans they administer to put up to 20% of their retirement money into Bitcoin — if their employers want to allow it. Fidelity holds more than $2.4 trillion in 401(k) assets, which is more than a third of the entire 401(k) market. For plan sponsors that want to offer this option, Fidelity will offer a digital asset account to hold Bitcoin. The digital account fee will be between 0.75 percent and 0.90 percent of assets, depending on several factors including the employer and the amount invested. An additional trading fee will also be added. People think that Fidelity has lost their mind by coming out with this announcement right after the DOL's guidance. Being a student of 401(k) history, I understand Fidelity's position. They are the biggest 401(k) plan provider and if anyone could get the DOL to change their mind, it would be them. Remember over 20 years ago, several retirement plan providers were converting defined benefit plans to cash balance plans. The Internal Revenue Service said they were a cutback in benefits until the law was changed to formally allow cash balance plans. Since the DOL guidance isn't a section of ERISA or a regulation, Fidelity thinks they have time to sway the DOL's position, especially if the government issues some sort of regulation of crypto investments. The only other issues here are timing and timing is everything. I think Fidelity's announcement would have garnered more fans if Bitcoin wasn't more than 50% off its all-time high.

My take

They often say that in business, there are two types of people: the quick and the dead. That doesn't hold for plan sponsors. As a plan sponsor and plan fiduciary, it's better to be slow to adopt Bitcoin into your 401(k) lineup without guidance from the DOL that it's OK. While I'm not saying Bitcoin is like Beanie Babies, I do remember people losing their shirts by trying to run after exorbitant returns. I love crypto investing, but it's not for everyone, especially 401(k) plan participants, who are prone to make too many costly investment decisions. Coupled with the volatility of crypto currency offerings, this 401(k) Bitcoin is a solution looking for a problem. Offering an unregulated asset in a heavily regulated 401(k) plan is a bad bet. Patience is a virtue and a necessary virtue for 401(k) plan sponsors. This article may be a cold take, years down the line, but right now, it's better to be slow in adopting this option into your plan until the DOL gives the green light to it.

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