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Employee Benefit Plan Review

401(k) Plans and Crypto

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Due to the growing popularity of and attractive returns on cryptocurrencies ("crypto"), 401(k) participants are urging plan fiduciaries to permit these investments.[1] However, investment in crypto can be an unpredictable ride. In April 2022 alone, it is estimated that the crypto market lost $800 billion in value.[2] In May 2022, crypto offered through TerraUSD (UST) suffered a complete meltdown wiping out billions of dollars of value in the process.

The EBSA guidance reminds fiduciaries of their responsibility to act solely in the financial interests of their participants.

Whether this volatility can be squared with fiduciary duties imposed by the Employee Retirement Income Security Act of 1974 ("ERISA") needed clarification. ERISA's fiduciary duties have been described as the "highest known to the law." Fiduciaries wrestle with related issues including: Should crypto be part of the core investment menu available to all plan participants? Do fiduciaries have an obligation to limit crypto investment even in a plan's self-directed brokerage option?

In an attempt to clarify these complex issues, the Employee Benefits Security Administration ("EBSA"), issued Compliance Assistance Release No. 2022-01.[3]

This column answers three questions:

- What does the guidance provide?;
- Why is it controversial?; and
- What are opponents doing about it?

The EBSA Guidance

The EBSA guidance reminds fiduciaries of their responsibility to act solely in the financial interests of their participants. The guidance included a stark warning that it "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."

Specifically, according to the EBSA, crypto presents significant risks for the following reasons:

- *Crypto is a Speculative and Volatile Investment*
  - The Securities and Exchange Commission characterizes crypto as "highly speculative."
  - EBSA's concerns include wide press coverage of fictious trading, theft and fraud.

  - This "extreme volatility can have a devastating impact on participants, especially those approaching retirement and those with substantial allocations to cryptocurrency."
- *Concerns About Plan Participants Making Informed Investment Decisions*
  - Due to crypto claims of "outsized profits," participants will not be able to sort out "the facts from the hype."
  - By allowing crypto, plan fiduciaries have signaled, or at least implied, that crypto is a prudent investment regardless of a participant's investment sophistication.
- *Custodial and Recordkeeping Concerns*
  - Unlike traditional plan assets, crypto exists as computer code in a digital wallet.
  - Crypto is especially vulnerable to hackers and theft.
- *Valuation Concerns*
  - Crypto valuation is complex and challenging and is difficult to do reliably and accurately.
  - Crypto valuation presents unique issues when compared with more traditional investment products.
  - These valuation issues make it especially difficult for plan fiduciaries to meet ERISA duties.
- *Evolving Regulatory Environment*
  - Evolving securities laws related to crypto currency may expose plan fiduciaries to liability and "plan participants to the risks of inadequate disclosures and the loss of investor protections."
  - Crypto promoters may operate outside or fail to abide by existing regulations.

In short, the guidance "cautions plan fiduciaries to exercise extreme care before they consider adding a cryptocurrency option to a 401(k) plan's investment menu for plan participants."

The Controversy

The Opposition

The total amount contained in all 401(k) plans is estimated to be $7.3 trillion.[4] Being effectively denied access to the vast 401(k) market is "at best putting a chilling effect on such investments and at worst condemning them."[5]

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U.S. Senator Tuberville summarized the opposition concerns as follows:

> The Biden administration has taken it upon itself to dictate what assets are viewed worthy of retirement investment, taking the decision away from individual investors by issuing regulatory guidance targeting cryptocurrency. This is government overreach at its finest.[6]

A letter requesting withdrawal of the guidance, details industry concerns[7]:

- EBSA's new cryptocurrency position is inconsistent with current law and was adopted retroactively without notice, comment, or proper regulatory review.
- The "extreme care" standard imposed by the guidance is inconsistent with ERISA's "prudence" standard.
- The EBSA should issue guidance on which investments are inherently appropriate or inappropriate.
- "Guidance" should not be used as a substitute for the formal rulemaking process.

The Supporters

Many organizations (including the AFL-CIO) representing investors, consumers, workers, and retirees, wrote to the EBSA with their "strong support" for the guidance.[8]

Their position is:

- The guidance is entirely consistent with fiduciary duties under ERISA.
- They agree with the five specific concerns the guidance outlines (as detailed above).
- Crypto markets are pervaded by so many uncertainties that providing participants with this option is "particularly challenging" for plan fiduciaries' ability to meet the ERISA prudence standard.
- It is entirely appropriate for the EBSA to caution plan fiduciaries to exercise "extreme care."

Plaintiffs' attorneys also support the guidance as it provides a new basis for lawsuits against plan fiduciaries. These suits, even if not ultimately successful, are extremely expensive in both effort and money.

The argument goes something like this: The EBSA has essentially made it a fiduciary violation to offer crypto. Your plan offers crypto. Therefore, the plan fiduciaries are in clear violation of the standard of care.

This threat of class action lawsuits will have a further chilling effect on the willingness of 401(k) plans to offer crypto as an investment option.

Actions by Opponents

The Financial Freedom Act

The first official response to the guidance from Congress is Financial Freedom Act. The Act aims to protect sponsors from regulatory scrutiny and allows investors to choose their own path when it comes to crypto investments. If passed, it would amend federal benefits law to ensure fiduciaries are permitted to select "any particular type of investment alternative" for their menu of options if they provide the 401(k) participant an opportunity to choose from a broad range of investment alternatives. It also would ensure that no investment is considered either "favored or disfavored" for any other reason than its risk-return characteristics – a clear shield for cryptocurrency in light of EBSA's guidance.

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Further, it prohibits EBSA from issuing any regulations or guidance constraining or prohibiting the range or type of investments that may be offered through a typical brokerage window.

It appears unlikely to gain traction in the current Congress. Moreover, it is unlikely that ERISA would be amended in such a broad manner in a dispute over cryptocurrency. After all, as written, the Financial Freedom Act would go much further than protecting crypto investments.

The bill is a clear signal that some in Congress, and the larger business community, are in favor of more flexibility when it comes to the use of cryptocurrency as an investment vehicle. This bill may be revisited if there is a change in congressional leadership for 2023.

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The ForUSAll Lawsuit

ForUSAll, a crypto provider, alleges in a lawsuit against the EBSA that the guidance is an "arbitrary and capricious" attempt to restrict the use of cryptocurrency in retirement plans. ForUsAll argues that the EBSA violated the Administrative Procedure Act ("APA") by issuing guidance without following the correct notice and comment procedures. Those procedures, argued ForUsAll, would have required the guidance to go through a time-consuming rulemaking process, which could have taken months, if not years. By that time, of course, the regulatory landscape of crypto would be significantly different as there is a frequent meme in the crypto world that one week in crypto can feel like the equivalent of a year, if not more.

Key allegations from the complaint include:

- The EBSA rushed out the Guidance and deliberately circumvented the APA's rulemaking process because it feared that the bevy of crypto Super Bowl commercials would encourage employees to put their retirement savings in crypto. ForUsAll alleges that the rushed Guidance was the EBSA's attempt to get ahead of this potential influx of new crypto investors supposedly wanting to put their taxed advantaged retirement dollars into crypto.
- The EBSA's Guidance is in direct contradiction to President Biden's Executive Order, which directed several federal agencies, including the EBSA and Treasury Department, to begin focusing their efforts on the growing cryptocurrency field and evaluate how to move crypto forward through appropriate regulation. The complaint alleges that no other agency responded to the Executive Order in the same manner as the EBSA.
- Neither the Guidance nor statements by EBSA officials offer any coherent rationale for how a duty would exist to select and monitor investments in a brokerage window if those investments are cryptocurrency but not if they are any other type of investment.
- There was a strong demand to add cryptocurrency to retirement plans through ForUsAll's program prior to the release of the Guidance, with many plans still having interest. Since the release of the Guidance, however, approximately one-third of the plans ForUsAll has discussed the matter with have indicated that they do not intend to proceed further at this time given the position taken by the EBSA.
- ForUsAll wants the court, among other relief, to vacate and set aside the EBSA's crypto Guidance, prevent the EBSA from acting to implement the Guidance, and prohibit investigations outside the scope allowed by the Employee Retirement Income Security Act.

Conclusion

Plan fiduciaries are in a precarious position-stuck between the demand of participants and the ESBA guidance. Fiduciaries who choose to include cryptocurrencies or other digital assets in their 401(k) investment menu should keep EBSA's scrutiny in mind. Plan sponsors and other plan fiduciaries have a duty to monitor plan investments and remove from the menu any investment options that are imprudent. Employers that include crypto in their 401(k) menu should ensure they have a robust monitoring process in place because they may end up being audited by EBSA.

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Nonetheless, the controversy serves as more direct evidence that there is an increasing demand from the workforce to have access to crypto products. While several financial experts expect that crypto may eventually have a place in 401(k) offerings, the time period for this adoption and the parameters for such inclusion remain to be seen. We expect this debate to continue. In the meantime, employers and fiduciaries should continue to monitor these developments, as well as guidance from the EBSA, in order determine what makes the most sense for their business and their workforce.

Notes

1. In this column the term "crypto" refers to all versions of currency existing digitally or virtually using cryptography to secure transactions. As the issues discussed generally apply to all crypto investments, we do not distinguish between the countless varieties available.
2. *https://www.reuters.com/business/finance/crypto-assets-shed-800-bln-market-value-month-2022-05-10/.*
3. *https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/compliance-assistance-releases/2022-01.*
4. *https://www.ici.org/faqs/faq/401k/faqs_401k.*
5. *https://www.uschamber.com/retirement/comments-to-dol-on-compliance-assistance-release-no-2022-01-401k-plan-investments-in-cryptocurrencies.*
6. *https://www.tuberville.senate.gov/newsroom/press-releases/new-tuberville-legislation-promotes-financial-freedom-for-401k-investors/.*
7. *https://www.napa-net.org/sites/napa-net.org/files/JointLtrDOLCrypto20220412.pdf.*
8. *https://consumerfed.org/wp-content/uploads/2022/04/Groups-Support-DOL-Guidance-Regarding-Crypto-Assets-in-Retirement-Plans-4.26.22.pdf.*

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