Crypto Developments: The More Things Change, The More They Stay The Same?

A couple years ago, people gathered to watch the biggest football game of the season and found themselves bombarded by cryptocurrency ads. As one famous movie actor endorsed a particular cryptocurrency, he urged that "Fortune favors the brave." A lot has happened since then. President Biden issued a crypto-related executive order, the Department of Labor (DOL) followed with a compliance assistance release, and the crypto market endured a particularly rough patch. Nonetheless, the nation's largest recordkeeper confirmed it intended to proceed with a digital assets offering for its 401(k) plan participants, and another recordkeeper (unsuccessfully) brought suit to challenge the DOL's guidance.

Most recently, the Securities and Exchange Commission (SEC) approved several large investment firms' applications to offer bitcoin exchanged-traded funds (ETFs), which will make it easier for retirement plans to make crypto available to plan participants. What now? We may be best served by recognizing that if the DOL had made those crypto commercials, it may have urged that "Prudence favors the cautious."

Here's What You Really Need to Know:

1. On March 9, 2022, the Biden administration issued an executive order directing all relevant federal agencies to review and develop a crypto policy. The next day, the DOL issued Compliance Assistance Release No. 2022-01, (the DOL Release) which "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."

2. One recordkeeper filed suit against the DOL, asserting that the DOL Release was arbitrary, capricious, and otherwise not within the DOL's statutory authority. The court dismissed the suit on August 29, 2023, finding that the recordkeeper's suit had no merit.

3. What has changed? On January 10, 2024, the SEC approved 11 bitcoin ETFs, including one application from Fidelity. This immediately made it easier for some retirement plan recordkeeping platforms to make crypto available within a plan's lineup (pending the fiduciary decision to provide such an option).

4. What has not? The DOL Release remains good agency guidance. Accordingly, to the extent plan fiduciaries encounter renewed demand for crypto access within the plan, fiduciaries will be well-served to review the DOL's position and proceed with the recommended level of caution.

Let's Dive In...

Crypto is a digital currency through which a decentralized system uses cryptography to verify transactions and maintain records. This broad term is used to describe "digital assets" including "tokens," "coins," "crypto assets," and other derivatives.

DOL Guidance - General Fiduciary Obligations

When the DOL issued the DOL Release in 2022, it did so in the context of rising demand to make crypto available in retirement plans. As employers struggled in a competitive labor market, some began to entertain this notion as a way to curry favor with current or potential employees, particularly younger ones.

Notwithstanding those conditions, the DOL took us back to the basics. In a plan covered by the Employee Retirement Income Security Act (ERISA), the DOL reminded plan fiduciaries that they have a duty to prudently select designated investment alternatives. In English, this meant that fiduciaries must implement a process including the following steps when setting the fund line-up available to participants:

1. Use a framework such as an investment policy statement (IPS)
2. Gather information such as qualitative and quantitative factors about an investment option
3. Objectively evaluate the investment option using the IPS criteria
4. Reach a decision whether to include the investment option in the line-up, and
5. Review this investment option on an ongoing basis and continue to determine if it should be retained in the line-up

The DOL made very clear that plan fiduciaries bear the responsibility to "identify and avoid imprudent investment options," and not to merely "shift responsibility to plan participants." The DOL cited the Supreme Court's Hughes v. Northwestern University opinion, stating that "even in a defined-contribution plan where participants choose their investments, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options."

DOL Guidance - Concerns with Crypto

Within the DOL Release, the DOL made two strong statements specifically relating to a fiduciary's decision to include crypto in a plan line-up. First, it cautioned plan fiduciaries to exercise "extreme care" before considering the addition of a crypto option. Second, it emphasized that a fiduciary's consideration whether to offer a crypto investment option is subject to "these exacting responsibilities", which are considered to be the "highest known to the law." The DOL emphasized that it "has serious concerns about the prudence of a fiduciary's decision" to expose a plan's participants to crypto. The DOL expressed the belief that crypto investments present "significant risks and challenges" to participant accounts, including "significant risks of fraud, theft, and loss," for the following reasons:

1. Crypto is highly speculative and subject to extreme price volatility, which can have a devastating impact on participants.
2. Crypto might appeal to the unsophisticated investor because it is promoted to "offer investors unique potential for outsized profits." Moreover, the DOL suggested that fiduciaries' decision to offer a crypto option effectively tells the plan's participants that knowledgeable investment experts have approved crypto as a prudent option.
3. Crypto presents many different custodial and recordkeeping concerns for plan fiduciaries, including the threat of hackers and theft.
4. The DOL was concerned about the reliability and accuracy of crypto valuations.
5. The regulations for crypto may be evolving and some market participants may not be in compliance.

In the DOL Release's final paragraph, the DOL confirmed that it meant business. It announced the expectation of an investigative program aimed at plans that offer crypto options. In other words, the DOL tipped off fiduciaries to the following reality: if you ignore our objections to crypto, prepare for us to ask about the steps you took to protect participants' interests when deciding to make crypto available.

DOL Guidance - Brokerage Windows Aren't a Way Around

The final sentence of the DOL Release reflected the DOL's acknowledgement that some plan fiduciaries may attempt to avoid crypto-triggered fiduciary responsibilities by allowing crypto solely through a brokerage window. It has long been the DOL's position that plan fiduciaries have a duty to prudently select and monitor the provider of a brokerage window, but not the investment options chosen by participants through that window. Here, though, the DOL announced that it would be questioning fiduciaries who have utilized the brokerage window as a means to add crypto to the plan, as the DOL wants to better understand how that can be "squared" with duties of prudence and loyalty owed to their participants. More recently, the DOL later clarified in a 2023 Hearing that the DOL is focused primarily on fiduciaries' oversight and selection of designated investment alternatives and not specifically targeting brokerage windows (as may have been interpreted from the DOL Release).

Next Steps for Fiduciaries

The varieties and acceptance of crypto have continued to grow. The SEC's recent approval of bitcoin ETFs will further accelerate the availability of crypto within retirement plans. However, the DOL's stance remains: plan fiduciaries should exercise extreme caution. In doing so, fiduciaries should:

1. Go back and review the DOL Release. Pay attention to the DOL's strenuous objections to crypto.
2. Develop a communication strategy or talking points for participants who request plan access to crypto. For example, determine how to help participants understand that the retirement plan may not be the most appropriate plan to meet their needs at this time (for the reasons discussed above), but point to the other benefits of the plan.
3. Continue to monitor the guidance from the DOL and other regulators. This landscape is quickly evolving.
4. Continue to monitor guidance related to brokerage windows, if applicable to your plan, as the DOL has dropped multiple hints at a change of perspective related to brokerage windows.

And, for fiduciaries who are considering crypto to meet the needs of participants (or who already have crypto in their plans), consider the following action steps:

1. Review the DOL Release.
2. Review the framework or other selection process for how you selected, documented, and monitored the inclusion of crypto assets in the plan. Particularly be sure to focus on the DOL's requirement in its guidance that fiduciaries should "include in their analysis 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."
3. Seek competent ERISA counsel that specializes in this area of practice. This remains unchartered territory that requires close attention to detail.

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