

ALERTS

DOL Compliance Guidance on Plan Investments in Digital Assets

March 16, 2022

On March 10, 2022, the U.S. Department of Labor (“DOL”) released guidance titled 401(k) Plan Investments in “Cryptocurrencies” (Compliance Assistance Release No. 2022-01 [the “Release”]). In the Release, the DOL expressed “serious concerns” about exposing 401(k) plans and their participants to both direct investments in cryptocurrencies (which the DOL defined as including a wide range of digital assets) and to indirect exposure through products whose value is tied to cryptocurrencies. The DOL further cautioned plan fiduciaries to use “extreme care” before offering such direct and indirect investments as part of a 401(k) plan’s investment menu. Participants self-directing their investments in 401(k) plans and the plan fiduciaries directing investments in defined benefit plans need to be mindful that if an investment in cryptocurrencies and related products do not work out well, it is likely to draw the attention of the DOL and class action plaintiffs lawyers.

The great majority of 401(k) plans are self-directed and typically offer plan participants an extensive range of investment choices from which to choose, often including a “brokerage window,” which allows participants to invest in an even broader range of choices in addition to the set “menu” offered under the plan. This design is intended to allow plan fiduciaries to avoid responsibility for how an individual plan participant invests the assets in his or her account under the plan. In this Release, the DOL reminds plan fiduciaries that the law requires that the investment options offered under a 401(k) plan must be prudently selected and monitored, which includes that any imprudent options be removed, citing a recent U.S. Supreme Court ruling that held that plan fiduciaries must

independently evaluate and monitor each investment option, and that the failure to remove imprudent options is a fiduciary breach.

The DOL noted six specific reasons that caused it to have “serious concerns” with exposing plan participants to an option to invest in cryptocurrencies and related products. In the DOL’s view, such investments present significant risks and challenges to participants’ retirement accounts, including, fraud, theft and loss. The reasons specifically cited include: the speculative and volatility nature of the asset; the challenge faced by inexperienced plan participants to understand the investment and its risks; the lack of traditional asset custody and the ease in which assets can be lost due to loss of a password, hacking and theft; the difficulty in obtaining an accurate and reliable valuation of the assets; and the evolving nature of the regulatory environment surrounding cryptocurrencies. In this regard, the DOL expressed its belief that participants may be operating outside of existing regulatory frameworks or simply not complying and that, as a result, law enforcement agencies could shut down or restrict the use of platforms and exchanges. The DOL stated that plan fiduciaries must consider all of these issues before offering direct and indirect cryptocurrencies as a plan investment option. Fiduciaries cannot simply shift to plan participants the responsibility to identify and avoid imprudent investment options.

The DOL went on to indicate that it has the same concerns if a 401(k) plan’s investment platform includes a brokerage window that allows plan participants who established a brokerage account to invest in cryptocurrencies and related products. We note that DOL rules already permit plan fiduciaries to bar certain investments without losing the protections they enjoy when participants are allowed to self-direct the investment of their account. The DOL concluded the Release with an announcement that the Employee Benefits Security Administration will conduct investigations of fiduciaries who oversee plans offering cryptocurrency and related products as investment options, warning that such plan fiduciaries should be prepared to be questioned as to how they can square offering such options with their duty of prudence and loyalty taking into account the risks described above. Plan fiduciaries should consider limiting the availability of investments including crypto funds, either directly on a 401(k) plan menu, or through a 401(k) plan’s brokerage window, where plan participants do not have a practical understanding of how the investments work, the risks inherent in such investments, and

how such investments may work in conjunction with their plan's other investments.

The Release does not mention the fiduciary responsibility of trustees of defined benefit plans if they choose to invest in cryptocurrencies and investment products tied to cryptocurrencies. The DOL issued written compliance guidance several years ago, however, concerning the fiduciary responsibility of pension plan fiduciaries that choose to invest in highly and complexly structured financial products. That guidance provides that the plan fiduciaries must understand the investment product and be capable of monitoring the investments in such a product. Although the Release focuses on the risks presented to non-expert plan participants when they are offered cryptocurrencies and related products as investment options, the DOL's prior written guidance with respect to investing in complicated financial products, as well as the issues raised in the Release, are equally applicable to non-expert plan trustees should they choose to invest the assets of a defined benefit plan in cryptocurrencies and related products.

Call to Action:

1. Review the 401(k) plan's investment menu and determine whether each investment option continues to be prudent.
2. If the 401(k) plan offers direct or indirect investments in digital assets, review whether the plan should continue offering such options in light of the DOL's guidance.
3. If the 401(k) plan has a self-directed brokerage window, consider whether the plan fiduciaries will impose any limitations on permissible investments.
4. Please contact any one of the individuals listed below if you would like to discuss the structure or operation of your 401(k) or other qualified employee benefit plan.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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