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Cryptocurrency in 401(k) Retirement Plans

Digital assets, which include cryptocurrencies, crypto-assets, or digital tokens, among others, are digital representations of value and are issued and transferred using distributed ledger or blockchain technology. Bitcoin, Ethereum, and Dogecoin are among the most well-known cryptocurrencies. A November 2021 Pew Research Center and a March 2022 NBC News poll found that around one-fifth of Americans indicated that they had invested, traded, or otherwise used cryptocurrency.

In recent months, policymakers have paid increasing attention to the prospect of defined contribution (DC) pension plan participants being able to invest in cryptocurrency. While some contend that cryptocurrency in retirement accounts could benefit participants, others have expressed concern about its appropriateness as an investment option.

Defined Contribution Plan Investments

In DC plans, of which the 401(k) is the most common in the private sector, workers are provided individual accounts funded by their own contributions, contributions from their employers, or both. The funds in the account may accrue investment earnings, which can then be used as a source of income in retirement. Most DC plans are *participant-directed* individual account plans. In these plans, plan sponsors (which are usually the employers in 401(k) plans) choose a number of investment options from the offerings of a financial services company, such as the Vanguard Group, Fidelity Investments, or BlackRock. Participants in participant-directed DC plans then choose their investments from among the options that plan sponsors have made available.

The investment options usually include mutual funds with varying characteristics such as index funds (which mirror the performance of a stock market index such as the S&P500), small and large cap funds (which invest in small or large firms as measured by market capitalization), bond funds (which invest in debt obligations), real estate funds (which invest in real estate), and target date funds (which change the investment mix between bonds and stocks as an individual gets closer to retirement).

In addition to mutual fund investments, about one-quarter of private-sector DC plans allow participants to invest via a *brokerage window*. A brokerage window allows plan participants to invest in options beyond those provided by the plan, such as individual stocks and a wide variety of mutual funds. Some plans place restrictions on participants' investments within brokerage windows, such as limiting the percentage of an individual's account balance that can be invested in the brokerage window or prohibiting investments in the stock of the employee's company.

Cryptocurrency in Private-Sector DC Plans

Until recently, cryptocurrency was not available as an investment option for DC plan participants. In 2021, FORUSALL announced that it would be the first financial services company to offer plan sponsors the option to adopt cryptocurrency as an investment for participants. Participants whose plan sponsors adopt FORUSALL's investment platform can invest up to 5% of their account balances and direct 5% of their contributions to cryptocurrency through its brokerage window. In April 2022, Fidelity announced its intention to allow 401(k) participants whose plan sponsors adopt it as an investment option to invest up to 20% of their account balances in Bitcoin.

Fiduciary Choices

Most of the investment options provided by a plan sponsor in participant-directed plans are *designated investment alternatives*, which Department of Labor (DOL) regulations define as "an investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts." When making decisions about which designated investment alternatives to include in a plan, plan sponsors are fiduciaries under the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406) and must act with *prudence* ("with the care, skill, prudence, and diligence" that a prudent person would take) and with *loyalty* ("solely in the interest of the participants" for the purpose of providing benefits). In addition, fiduciaries have an ongoing duty to monitor plan investments to ensure they continue to satisfy fiduciary obligations.

Plan sponsors' fiduciary responsibilities regarding digital currency in retirement plans may depend on the channel through which the investment choice is offered to participants. For example, while Fidelity is offering plan sponsors the choice to include digital asset investments as part of their investment menus (alongside mutual funds, for example), FORUSALL is offering digital asset investments through its brokerage window.

While plan sponsors have a duty of prudence and loyalty when choosing the designated investment alternatives to be included in their plans, these duties do not necessarily apply to the investments that participants choose in a brokerage window. DOL regulations specifically exclude brokerage windows from the definition of designated investment alternatives. In 2012, DOL issued guidance that indicated that plan sponsors might have an obligation to treat an investment in a brokerage window as a designated investment alternative if a certain number of participants selected it. However, three months later, DOL removed that guidance.

Responses

Responses from Advocates

Advocates for including cryptocurrency as an investment option in retirement plans provide several reasons for why it is an appropriate investment option. They note that it is a widely-used asset class outside of retirement plans. In addition, cryptocurrencies may provide diversification benefits to an investment portfolio, potentially reducing a portfolio's risk without necessarily harming the portfolio's return. Advocates also claim that younger individuals may be more likely to participate in workplace retirement plans if investment choices include cryptocurrency.

March 2022 DOL Guidance

On March 10, 2022, DOL released a Compliance Assistance Release, *401(k) Plan Investments in "Cryptocurrencies,"* in which the department expressed "serious concerns" about plan fiduciaries' decisions to allow DC plan participants to invest in cryptocurrencies. The release identified a number of areas of concern. The concerns included the potentially speculative nature of cryptocurrency investments, the difficulties individuals might have in evaluating whether to—or how much to—include in their investment portfolios, recordkeeping challenges, valuation concerns, and the regulatory environment.

The release indicated that DOL planned to conduct an investigative program aimed at plans that offer such investments and that plan fiduciaries could expect to be questioned by DOL about their decisions. Subsequently, a DOL official noted that plans that allow their participants to invest in cryptocurrency will not be automatically subjected to an audit.

Industry Response and FORUSALL Lawsuit

In response to DOL's Compliance Assistance Release, 11 trade associations wrote to DOL on April 12, 2022, requesting that it be withdrawn and that guidance be developed via the rulemaking process. In addition, on June 2, 2022, FORUSALL filed suit seeking to vacate the Compliance Assistance Release on the grounds that the guidance violated the Administrative Procedure Act.

Selected Responses from the 117th Congress

In a May 4, 2022, letter, Senators Elizabeth Warren and Tina Smith asked Fidelity to respond to several questions regarding its decision to add Bitcoin to its 401(k) investment menu. The Senators asked about the reasons Fidelity "ignore[d]," the letter said, DOL's concerns regarding cryptocurrency in DC plans; Fidelity's assessment of the risk Bitcoin presents to its customers; the fees that customers will incur; and Fidelity's earnings and potential conflicts of interest arising from its involvement in cryptocurrency mining. Fidelity responded that it looked forward to having a respectful dialog with policymakers and that it would respond directly.

The Financial Freedom Act of 2022 (S. 4147, introduced by Senator Tommy Tuberville, and H.R. 7860, introduced by Representative Byron Donalds) would, among other

provisions, prohibit regulations that would constrain or prohibit the type of investments that could be offered through a brokerage window in a DC plan.

A provision in S. 4356, introduced by Senators Kirsten Gillibrand and Cynthia Lummis, would require the Government Accountability Office (GAO) to examine the use of cryptocurrency and digital assets in retirement plans. Separately, Representative Richard Neal asked GAO to examine the use of cryptocurrency in retirement plans in a June 15, 2022, letter.

Brokerage Windows and DC Plan Investments

As a result of the possibility of 401(k) plan participants' investments in cryptocurrency, broader policy issues surrounding brokerage windows have resurfaced. Brokerage windows are not designated investment alternatives. While plan sponsors might have a duty to monitor the brokerage window provider, plan sponsors do not have a duty to monitor participants' investments purchased through a brokerage window. This could lead to participants paying high fees for investments chosen through a brokerage window.

A 2021 report from DOL's ERISA Advisory Council noted the issues associated with brokerage windows in DC plans. Brokerage windows can allow sophisticated investors to construct investment portfolios more appropriate to their individual circumstances than they could by using a plan's designated investment alternatives. For example, a brokerage window might allow participants to invest in mutual funds that have environmental, social, and governance (ESG) goals, faith-based goals (such as those based on Christian or Sharia principles), or in individual stocks. However, participants with less sophisticated investment knowledge could make investments that would be inappropriate for their circumstances.

For Further Information

CRS Report R47152, *Private-Sector Defined Contribution Pension Plans: An Introduction*

CRS Report R46208, *Digital Assets and SEC Regulation*

Compliance Assistance Release No. 2022-01 401(k) Plan Investments in "Cryptocurrencies," <https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/plan-administration-and-compliance/compliance-assistance-releases/2022-01.pdf>

Understanding Brokerage Windows in Self-Directed Retirement Plans, ERISA Advisory Council, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2021-understanding-brokerage-windows-in-self-directed-retirement-plans.pdf>

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