Cryptocurrency in small bytes: Bitcoin in your 401(k)? A byte that may bite

Cryptocurrencies are attracting the interests of many sort of speculative investors, but more recently are also being considered by retirement plan sponsors.

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IT WAS INEVITABLE, THE WILD GAINS in certain cryptocurrencies have recently caught the interest of retirement plan sponsors and participants as a potential investment boom to 401(k) accounts, IRAs, and traditional pension plans. With approximately $28 trillion in U.S. retirement plan assets, the potential - and risks - are staggering.

But are retirement plans even permitted to invest in these unregulated "currencies" under applicable legislation? If so, would it be a prudent investment? What are the risks to plan sponsors? Is it true that officers, directors, and other employees may have personal liability under the Employee Retirement Income Security Act (ERISA) for making these decisions? Here are some things to ponder as you gaze out into the Ethereum...

Investment by a retirement plan in cryptocurrencies is not a per se violation of ERISA. No specific regulation or guidance has been provided under ERISA or the Internal Revenue Code regarding whether pension and other retirement plans can properly invest in cryptocurrency.

The matter, however, is certainly one that both the DOL and IRS are concerned about, especially since IRAs and other retirement vehicles are moving toward embracing some forms of investment in cryptocurrencies. The IRS has advised that for federal tax purposes, virtual currencies will be treated as property and certain self-directed IRAs have embraced cryptocurrencies as investments. But since IRAs are not subject to ERISA, it provides little comfort for 401(k) and pension plans.

Many questions remain to be answered by the regulators regarding cryptocurrencies as a proper investment

in retirement plans. For example, are they domestically situated "property" within the reach of U.S. courts? Are they a security? Is there sufficient "indicia of ownership" such as through U.S. cryptocurrency exchanges or crypto "wallets"?

It's worth noting that those individuals who exercise discretionary authority or control over a retirement plan are considered fiduciaries under ERISA and have a duty to act prudently and in the best interest of plan participants. Could a decision to invest in cryptocurrency violate those duties - notwithstanding a push by plan participants to permit such investment opportunities? Absolutely. And that exposure under ERISA is a personal liability of the fiduciaries - meaning the personal assets of each board director, CEO, CFO, and other employees involved in administering the plan or its assets are at risk. That risk is something the retirement plan can't indemnify against - and often, outdated D&O insurance doesn't cover or cover sufficiently.

While cryptocurrencies seem certain to play some sort of increasing role in the domestic and world economies, retirement plan sponsors and participants need to be wary of these products - at least until the regulators provide further guidance. To do otherwise may personally expose corporate officers, directors, and other employees to fiduciary breach claims under ERISA. ■