WHAT YOU NEED TO KNOW

Cryptocurrency & ERISA/DC Plans

Cryptocurrency is a topic dominating financial headlines, but what is it and is it worth exploring with your advisor? Here we explain Cerity Partners' position as it relates to incorporating Cryptos in a qualified retirement plan — specifically a defined contribution ("DC") plan.

WHAT IS A CRYPTOCURRENCY?

A cryptocurrency ("Crypto") is a virtual (read non-tangible) currency that is designed to act as a medium of exchange (similar to other currencies) for goods and services.

The appeal of this type of currency is that it theoretically exists and operates outside the control of any one person, group, or government. This gives it a "sovereign" quality that may make it less susceptible to manipulation. Additionally, this type of currency doesn't require a third party for the brokerage of a transaction, and therefore eliminates the need for centralized banking, which is why it is often referred to "decentralized" currency.

The most popular Crypto today is the Bitcoin. Bitcoin has garnered a lot of attention due to its growing adoption as tender for goods and services, as well as its extreme investment performance over the last decade or so. However, Bitcoin is not alone: there are more than 19,000 different cryptocurrencies in circulation, according to Forbes.

Because Crypto is a form of currency, investment professionals and market participants are arguing about its legitimacy as an asset class or investment in a diversified portfolio.

WHAT HAS THE DEPARTMENT OF LABOR ("DOL") COMMUNICATED?

On March 10, 2022, the Employee Benefits Security Administration ("EBSA") of the DOL delivered a compliance assistance release to the public. This notice cautioned retirement plan sponsors and fiduciaries to exercise extreme care before considering Crypto in defined contribution plan investment menus.

The DOL made direct references to core fiduciary principles of prudence and loyalty while clearly noting the high volatility and elevated trading costs that Crypto has demonstrated over time. The department also suggested caution related to recordkeeping concerns involving these assets given the challenges faced by defined contribution plan custodial platforms. There was also mention of self-directed brokerage account ("SDBA") windows and it is not yet clear if retirement plan sponsors will need to provide additional communications or reporting for Crypto being held in these accounts.

In April 2022, the DOL Acting Assistant Ali Khawar told the Wall Street Journal he had "grave concerns" with the news that a large DC plan will allow Crypto investments in its plans later this year. Khawar said he views Crypto as speculative and that it could risk the retirement security of plan holders. "We are not talking about millionaires and billionaires that have a ton of other assets to draw down," he said.

IS THERE AN INVESTMENT CASE?

Cryptos have a market price, established in a similar supply and demand dynamic, and are traded on exchanges specifically built for Cryptos (e.g. Coinbase, Kraken, etc.). However, unlike traditional asset classes like equity and fixed income, Cryptos do not have an intrinsic value. In other words, they do not derive their price from concepts like earnings per share, or coupon payments. Rather, they're worth whatever the current bid price is for them on the exchanges they trade, and those bids are primarily coming from retail investors, speculating on the value of the Crypto.

This does not mean Cryptos are worthless or a "scam." It only means that we cannot apply empirical, or fundamental means of valuation to this investment.

The investment case for Crypto has shifted over time. Originally, Cryptos were viewed as a more efficient means of transactions and might therefore replace global banking as we know it today. Today, however, the investment thesis lies more in the sovereignty of the currency. In other words, if Cryptos cannot be manipulated by banks, governments, or captured interest groups, investors can have greater confidence in the value and stability of the currency.

To date, Cryptos have been extremely volatile. Bitcoin, the most popular Crypto, has seen incredible appreciation, along with incredible volatility, or risk. This makes it an unsuitable investment for the non-professional or well-educated investor.

THE CERITY PARTNERS POSITION

Due to our fiduciary responsibility to select prudent investments for DC participants, we do not currently recommend Crypto for DC plans. We have come to this conclusion due to two primary reasons: The DOL has strongly cautioned against it, and the investment merit of Crypto is still largely unclear.

Please contact your Cerity Partners advisor if you have questions.

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