welcome to brighter

crypto in DC plans

a cautionary tale?

Cryptocurrency and crypto-related assets have become an increasingly frequent topic of conversation for defined contribution (DC) plan sponsors and fiduciaries.

While cryptocurrencies have been in existence for over a decade, a small DC plan administrator brought it to the forefront for participant-directed retirement plans in 2021 by making cryptocurrency accessible in several small plans it administered. At that time, some of the largest DC plan administrators decided not to follow suit, but that has now changed and soon many more plan sponsors will have the option to offer participants access to cryptocurrency.

Currently, Mercer does not view cryptocurrency or crypto-related assets as being a suitable standalone investment option in the core menu of a DC plan (we do not contemplate access through brokerage windows in this paper). As we stay abreast of the ever-changing investment opportunity-set and, in particular, crypto- and digital-related assets, it is possible that in the future our position may change, but there are numerous circumstances that contribute to our current view.

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Regulatory environment

On March 9, 2022, President Biden signed an Executive Order laying out a national policy and instructing federal agencies to study and report on digital assets (including cryptocurrency). Some key areas of focus in Executive Order include consumer protection, privacy, illicit finance, financial stability, environmental impact, and maintaining national security. The very next day, the US Department of Labor issued a Compliance Assistance Release outlining their concerns around the inclusion of cryptocurrency in 401(k) plans, specifically commenting that "at this early stage in the history of cryptocurrencies, the Department has serious concerns about the prudence of a fiduciary's decision to expose a 401(k) plan's participants to direct investments in cryptocurrencies, or other products whose value is tied to cryptocurrencies.[1]" The Department of Labor cited multiple concerns, such as the speculative and volatile nature of cryptocurrencies and valuation concerns.

We believe plan fiduciaries should be mindful of this sub-regulatory guidance when determining whether offering cryptocurrencies or crypto-related assets as a core investment option is a prudent investment for all plan participants.

[1] https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/compliance-assistance-releases/2022-01

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Volatility

Cryptocurrencies have a history of high volatility. Looking at the current largest cryptocurrency (see Figure 1), Bitcoin, we have seen significant swings in value over short time periods. The annualized standard deviation of monthly returns of Bitcoin over the period from 2015 to 2020 was approximately 80%. This is at least four times the volatility of publicly traded equities.

The chart below (see Figure 2) shows calendar year returns of Bitcoin, which further illustrates the volatility; in the past seven calendar years, the range of returns has been -72% to +1,271%. Over the most recent six-month period ending April 25, 2022, Bitcoin had lost 34.2%[2]. While some participants may understand the nature of and be able to withstand high volatility, we believe most participants in DC plans may not have the ability to absorb such volatility or the expertise to truly understand the drivers of cryptocurrency performance. It is also important to highlight that while some have argued that crypto-related assets serve as a diversifier, we have seen correlations with traditional assets spike during market selloffs.

Given DC plans serve as long-term savings vehicles that employees increasingly rely on for their primary source of retirement funds, providing investment options with more consistent, less volatile return patterns can support savings behaviors and possibly enhance the long-term outcomes of participants.

Figure 1. Top 10 Cryptocurrencies[3]

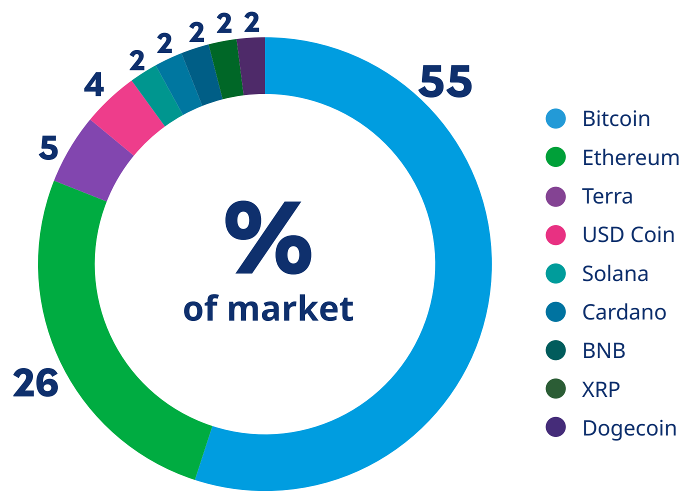
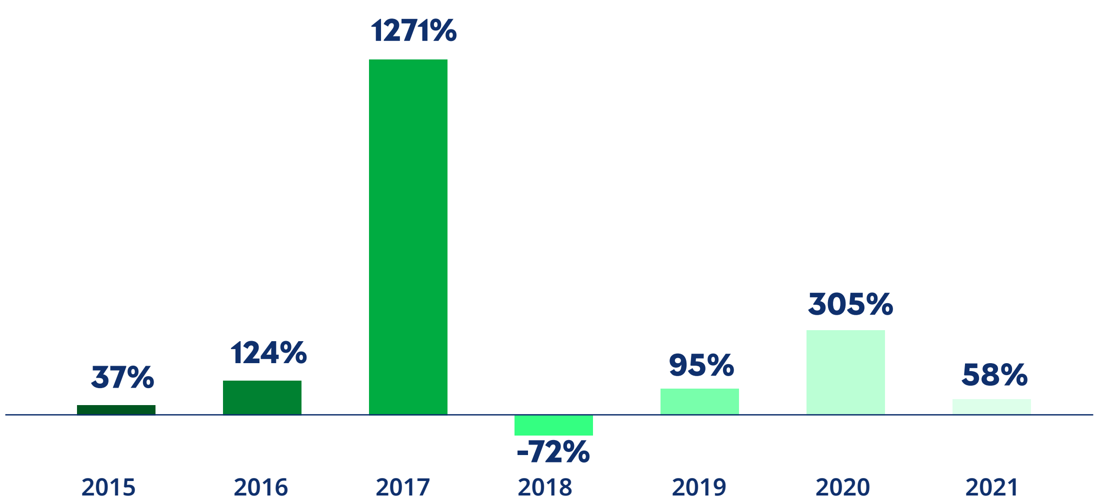


Figure 2. Bitcoin (BTC) Calendar Year Returns[4]



[2] Source: Coindesk
[3] Source: CoinMarketCap, April 26, 2022.
[4] Source: MarketWatch. Bitcoin, USD.

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Participant education and role in portfolio

Crypto-related assets have received a lot of attention in the news and on social media platforms, which has made them feel more mainstream in many ways. However, we question whether most DC participants have the resources or information needed to make educated investment decisions when it comes to investing in cryptocurrency or crypto-related assets. Based on Mercer's inquiries to some of the largest DC plan administrators, educational information on how to build a portfolio inclusive of cryptocurrency has been extremely scarce. Further, being able to distill facts about crypto-related assets can be time consuming and difficult when looking to resources available on social media or other more consumer-oriented platforms.

When we think about providing building blocks to create a portfolio for long-term retirement savings, we generally do not recommend including sector specific funds — and consider a crypto-related asset to have characteristics that align with more niche or sector-type funds. We find that the potential for concentration risk, volatility and, in some instances, high fees, are greater with niche or sector specific funds. Generally, focusing on well-diversified investment options with fees deemed to be reasonable relative to performance expectations will provide better components for DC plan participants to build long-term portfolios aligned with their individual retirement goals.

Our comments here are not all-inclusive but intend to point out a few areas of concern for adding standalone exposure to cryptocurrency or crypto-related assets for DC plans.

There are numerous other concerns that Mercer currently believes outweigh the benefits associated with crypto-related investments. We contemplate these, along with the benefits, in some of our previous papers, Cryptoassets update – Worth buying? and Gold & Bitcoin – birds of a feather or chalk and cheese? We will continue to monitor developments in DC plan administration, cryptoasset valuation and regulation, as well as investment implications. Plan sponsors who wish to explore the addition of cryptocurrency or crypto-related assets, or who are concerned with exposure through brokerage windows, should consult with legal counsel to further understand implications and the extent of their fiduciary responsibility. And for those sponsors looking to provide diversification opportunities to DC participants, we suggest exploring other well-established implementations, such as other diversified real asset investment strategies.

For more information

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