Near-Retirees and Retirees

"While all participants will feel the impact of inflation, it's the near-retirees and retirees who are the most vulnerable and are the most inflation-sensitive group," Verdeyen says. "They have nonexistent or little opportunity for wage growth and a short time horizon before they start spending."

In some cases, advisers might want to talk to plan sponsors about steering older workers toward multi-asset portfolios or suggest one with a higher allocation to Treasury inflation-protected securities or real estate, Verdeyen says.

"Plan sponsors just want to think about how the current investment options affect their specific participant population," she says.

Most 401(k) menus tend to focus more heavily on equity funds than fixed income, with equity dominating by a margin of three to one, according to Janus Henderson Investors.
Given today's inflationary environment and the unique challenges it poses for fixed income, it might be worth taking a closer look at the fixed-income portion of the plan menu, Rivera suggests.

> **"We've been talking about market volatility, but inflation is new for both advisers and clients."**

That said, the recent interest rate increases were widely expected, and most fixed-income fund managers had baked them into their strategy, says David Eichorn, CEO and head of investment strategies at NISA Investment Advisors LLC, in St. Louis. "While there have been price losses in bond funds, they're actually generating meaningful income for the first time in a while," Eichorn says. "So, they're attractive, and, as interest rates go up, that drives institutional flows into fixed income for the higher yield, so we're seeing them as a more attractive asset class."

Building Blocks Remain the Same

While rising interest rates, higher inflation and stock market volatility pose new challenges for asset managers, the key components of a successful plan menu have not changed, Beck says. For him and his team, those building blocks include: broad market coverage; high diversification potential, including negatively correlated options; sufficient choice; and a straightforward design that is easy to use.

In this market, though, he says, advisers must also work with plan sponsors to conduct thorough due diligence on the asset managers they select within that framework.

"Manager due diligence is even more critical in these times because the dispersions of returns may be higher in certain asset classes," Beck says. "There's an opportunity to pick winners and avoid losers. So there's an opportunity for plan sponsors to not only get the asset allocation and the offering right, but also to select the right manager."

Setting Expectations

Even if no changes are necessary, advisers might take this as an opportunity to level-set expectations with plan sponsors, Collinson says.

"You want to make sure that plan sponsors have a basic understanding of inflation and what the potential implications of inflation are, so they are sufficiently knowledgeable and can be asking good questions and making informed decisions about the plan," she says.

Then, advisers can take a closer look at the lineup with their sponsor client to make sure it understands the potential performance of the investments that might be susceptible to inflation—and can communicate that to plan participants, if necessary.

Despite current market conditions, plan sponsors that work with Alight Solutions largely have not been making big changes to their investment lineup, says Winfield Evans, the recordkeeper's vice president of investment solutions and strategy in New York City. "Roughly 10% or less of our clients have used a dedicated fund that offers investment protection," Evans says. "And we have not seen an upsurge in plan sponsor interest. What investors really need in their plan is an all-weather portfolio."

Tagged: Fixed income, inflation, investment menu

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Fool's Gold for 401(k)s?

The DOL's guidance on cryptocurrency causes much confusion.

By Michael Katz

Art by Mar Hernández

In early March, the Department of Labor's Employee Benefits Security Administration warned retirement plan fiduciaries to "exercise extreme care" before they considered allowing their participants to invest in digital assets.
In a March 10 Compliance Assistance Release, EBSA wrote that cryptocurrencies "present significant risks and challenges to participants' retirement accounts." It was issuing the warning, the regulator said, after recently becoming aware that companies were marketing crypto investments as potential additions to 401(k) plan menus.

"Under ERISA [Employee Retirement Income Security Act], fiduciaries must act solely in the financial interests of participants and adhere to an exacting standard of professional care," EBSA wrote. "A fiduciary's consideration of whether to include an option for participants to invest in cryptocurrencies is subject to these exacting responsibilities."

Yet, the agency took the guidance further and said it will launch an investigative program aimed at retirement plans that offer investment in digital assets. It said fiduciaries that are responsible for overseeing such investment options, or that allow them through brokerage windows, "should expect to be questioned about how they can square their actions with their duties of prudence and loyalty."

It is this part of the guidance that has raised concerns and questions among plan providers, legal experts and politicians. In a letter to EBSA Acting Assistant Secretary Ali Khawar, the U.S. Chamber of Commerce expressed concerns that EBSA was attempting to regulate through investigation and asked that the guidance be rescinded. The organization said the guidance effectively prohibited certain investments and mandated fiduciary responsibility for brokerage window investments without any public input.

"If regulation is needed in this area," wrote Chantel Sheaks, head of retirement policy for the chamber, in Washington, D.C., "it should be done through formal rule-making under the Administrative Procedures Act, rather than through investigations." Sheaks added that EBSA should seek the input of the regulated community by first issuing a request for information to gather more facts on the issue and possible solutions.

Carol Buckmann, an employee benefits and ERISA attorney, and a partner in Cohen & Buckmann PC in New York City, agrees with Sheaks. She says the process of developing law through investigation "bypasses the important element of public comment and can leave many in the dark about what the actual legal standards are."

The language in the release is "very broad and imprecise," Buckmann says, adding, "[it] potentially makes even indirect cryptocurrency investments through funds presumptively imprudent." She says EBSA should defer implementing any investigation program until it considers and evaluates the feedback from the release.

'Only Sub-Regulatory Guidance'

However, the guidance's bark may be worse than its bite as, Buckmann says, the courts may give it less deference as a regulation—it is sub-regulatory guidance, which "doesn't have the status of an advisory opinion or regulation."

Amid the criticism and the confusion, EBSA has defended the release. In a response letter to Senator Tommy Tuberville, R-Alabama, who had written to Labor Secretary Martin Walsh, objecting to the release, Khawar said EBSA had not taken a "novel position" with the guidance.

"The department has long indicated that fiduciaries have responsibilities with respect to brokerage windows," Khawar wrote. He cited Field Assistance Bulletin No. 2012-02R (1), issued by EBSA in 2012, that said fiduciaries of plans with self-directed brokerage accounts are still bound by ERISA's duties of prudence and loyalty to the participants and beneficiaries. "It's reasonable," Khawar wrote, "to expect plan fiduciaries to be able to respond to questions about their decisions to make cryptocurrency investments available to plan participants and beneficiaries whether as designated investment alternatives or through a self-directed brokerage account or similar arrangement."

But he also noted that the guidance is limited to cryptocurrency investments and "focuses on the need for ERISA fiduciaries to exercise extreme care at this stage of cryptocurrency's development. It does not, and should not, be read to address other types or classes of investments."

Unpersuaded by Khawar's letter, Tuberville introduced a bill that would prevent the DOL from issuing rules or guidance that limits the type of investments self-directed 401(k) plan participants may choose through a brokerage window.

"The federal government has no business interfering with the ability of American workers to invest their 401(k) plan savings as they see fit," Tuberville wrote in an op-ed on CNBC's website. "The Labor Department should not be able to limit the range or type of investments retirement savers may select." He said requiring plan fiduciaries to assess investments offered through a brokerage window and then to restrict options would be a "massive new regulatory burden" for retirement plans, which would "be at risk for heavy-handed enforcement actions." Like the Chamber of Commerce, he also criticized EBSA for issuing guidance "without announcement," adding that the agency "skirted the notice and public comment process put in place by Congress that agencies are required to follow."

Undeterred by EBSA's warning, just a month after the guidance was issued, Fidelity Investments announced the launch of an offering that will allow participants to invest a portion of their 401(k) in bitcoin. Fidelity said the offering is a custom plan account that holds bitcoin and short-term money market investments to provide liquidity.

> **… he sees cryptocurrencies as akin to early-stage investment in tech companies and other venture capital investments.**

Fidelity was rebuked by U.S. Senators Elizabeth Warren, D-Massachusetts, and Tina Smith, D-Minnesota, who wrote in a letter to company CEO Abigail Johnson that "investing in cryptocurrencies is a risky and speculative gamble, and we are concerned that Fidelity would take these risks with millions of Americans' retirement savings."

Fidelity has drawn considerable attention with its decision since being the first to announce its intention to allow crypto investments in its plans. Last June, financial advisers at retirement investment platform ForUsAll also announced a platform called Alt401(k) that will enable retirement plans to offer cryptocurrencies.

ForUsAll co-founder and Chief Investment Officer David Ramirez acknowledges that cryptocurrency has the potential to be risky and volatile, which is why, he says, the company has capped crypto investments at 5% of a participant's portfolio. ForUsAll also closely monitors allocations, and it alerts employees when their overall cryptocurrency allocation exceeds 5% of their portfolio; that way, they can rebalance into more traditional mutual funds.

"Certainly, plan sponsors have questions about the statements from the DOL, and we want to make sure they understand all of the built-in safeguards we've put in place," Ramirez says. "Our program really was designed to address specifically the concerns that were raised by the DOL, and we're confident we can hold up to that."

Ramirez says his firm engaged with the department before creating the Alt401(k) and received feedback that was incorporated into the offering. He says he expects the platform to be available during the second quarter of this year.

Education, Guidance and Guardrails

"It's more than just providing access," Ramirez says. "I think the question is: How can you provide access thoughtfully? We're focused on ensuring that access is coupled with education, guidance and guardrails."

But why allow participants to invest any of their funds in an asset class that many consider to be risky and speculative? For Ramirez, a big reason is "financial inclusion," as he sees cryptocurrencies as akin to early-stage investment in tech companies and other venture capital investments.

"Venture capital as an asset class has been out of reach for the vast majority of everyday Americans," he says. "Technology companies are staying private longer, meaning that Americans are not able to invest in those companies during some of their highest growth periods." He says he also believes allowing cryptocurrencies in 401(k) plans will attract younger plan participants, who, he says, often see retirement plans as increasingly irrelevant.

Still, Buckmann says, the threat of an EBSA investigation will scare off many sponsors and advisers from offering digital asset investments in their lineups. "Even fiduciaries that feel they can justify limited crypto exposure as prudent will not want to become part of an EBSA investigation," Buckmann says. "Unless the EBSA guidance changes, I would not expect many plans to sign up for the Fidelity program."

If plan fiduciaries decide to dabble in crypto, she says, they should keep in mind that there are different routes to exposure, with different risk profiles, and they should limit the percentage of a participant's account that may be exposed.

Safe custody is also key to consider, she says. Plan advisers and sponsors might want to look into a method called cold storage, which is intended to control risks such as accounts being hacked or lost because of a missing password, she explains. With cold storage, a digital wallet is stored on a platform that is not connected to the internet; the platform protects the wallet from vulnerabilities.

"It will be very hard to justify direct investments under" the EBSA guidance, Buckmann observes.