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FORUM

Bitcoin in Your 401k?

**Doesn't Matter, Cyber-Thieves Are
Going to Hack and Drain it Anyway**

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Bitcoin in your 401(k)?

Doesn't Matter, Cyber-Thieves are Going to Hack and Steal it Anyway

- U.S. Retirement Plans
- What Does ERISA Cover
- Fiduciary Liability Under ERISA
- Cryptocurrencies as Investments

What are Cryptocurrencies

Essential Attributes: Protection Against Fraud and Theft

How Does this Work from Users Perspective

- Cybersecurity & Retirement Plans
- Safeguards & Remedies
- Questions

U.S. RETIREMENT PLANS



U.S. Retirement Plans

- \$28 Trillion in U.S. Retirement Plan Assets
- Heightened area of class action litigation/gov't audit
- Defined Benefit Plans (traditional pension plans)
 - Jurisdiction – DOL, IRS, PBGC
 - Employer funded
 - Investments rules (ERISA/IRC/DOL)
 - Guaranteed by PBGC (ERISA)
 - Controlled Group Liability (IRC)

U.S. Retirement Plans

- 401(k) Plans
 - Jurisdiction – DOL & IRS (no PGBC guarantee)
 - Employee contributions – employer may match
 - Investment options set by employer – must monitor fees
 - Employee chooses & monitors investments
 - Increased class action litigation over 10 years

U.S. Retirement Plans

- IRAs
 - Jurisdiction – DOL & IRS (no PBGC guarantee)
 - Traditional v. Roth
 - Individual contributions
 - Alternative investment options permitted (e.g., real estate, private mortgages, private company stock, IP)
 - Employee chooses & monitors investments
 - Area of growing interest by plaintiff's bar/government



WHAT DOES ERISA COVER

What Does ERISA Cover?

- All pension and health/welfare plans are subject to ERISA unless:
 - “Church” plans
 - Government-related plans
- ERISA preempts state law
 - What about federal/state cybersecurity laws?
 - What about federal securities and blue sky's laws?
- Does not address cryptocurrency as investment
- What about Internal Revenue Code?

What Does ERISA Cover

- ERISA and “Plan Assets” (ERISA s. 3)
 - Plan “data” considered a protected plan asset by courts
 - What are permitted investments in retirement plans (IRC/ERISA)
- 2016 Report by Advisory Council on Employee Welfare and Pension Benefit Plans “Cybersecurity Considerations for Benefit Plans”
 - Ensure process to identify risks
 - Develop program to protect data
 - Develop response plan

What Does ERISA Cover

- Review service provider contracts to lower/mitigate costs to retirement plan if cyberattack
- Understand how service providers store and protect data
- Understand notification to participants/government (PBGC?)
- Cyber-insurance?
- Have written response plan

FIDUCIARY LIABILITY UNDER ERISA



Fiduciary Liability Under ERISA

- **Who is a Fiduciary? (ERISA 3(21)):**
 - Exercises discretionary authority or control over plan management/administration
 - Exercises discretionary authority or control over management or disposition of plan assets
 - Provides investment advice for direct/indirect fee

Fiduciary Liability Under ERISA

- Fiduciary status – derived from plan function performed regardless of title
- Functional/de facto test – anyone can be a fiduciary when performing ERISA fiduciary functions (even individual employees)
- Person/entity that has power to appoint, retain or remove a plan fiduciary has discretionary authority over management/administration of plan and is a fiduciary

Fiduciary Liability Under ERISA

Fiduciary Duties (404(a) ERISA)

- Undivided Loyalty - exclusive purpose of providing benefits. Must act “solely in interests of plan participants” (SIPP)
- Duty of Prudence – Exercise *“the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”*

Fiduciary Liability Under ERISA

Fiduciary Duties

- Whether duty of prudence has been breached depends largely if fiduciary can show it engaged in procedural due diligence before taking action questioned. In other words, focus is on “process” for making fiduciary decisions
- Potential liability for co-fiduciaries:
 - knowingly participates in breach
 - conceals
 - does not act to correct

Fiduciary Liability Under ERISA

Fiduciary Duties

- Duty to monitor
 - selection of service providers
 - establish a formal review process at reasonable intervals
- Continuous duty of oversight
 - *Tibble v. Edison*, U.S. Supreme Court, 2015

Fiduciary Liability Under ERISA

Fiduciary Duties

- ERISA s. 409 - Personal liability under ERISA for fiduciary breach by board of directors, CEO, CFO, VP HR etc. (e.g., their house and personal savings...)
- ERISA prohibits fiduciary indemnification by plan (different than ERISA bond)
- D&O coverage often doesn't cover or low limits of coverage

Fiduciary Liability Under ERISA

Fiduciary Duties

- What are duties regarding cryptocurrency as investments?
- Do fiduciaries have duty to ensure procedures in place to secure online data from cyberattacks?
 - What about ensuring TPAs have procedures & protections
 - Duty to review, monitor and test (“benchmark”)
 - Operational burdens? Record-keeping, reporting, communications
 - Small plan independent audit requirements (5% non-qualifying assets)



CRYPTOCURRENCIES AS INVESTMENTS

What Are Cryptocurrencies

- Bitcoin defines cryptocurrencies as new forms of money that use cryptography to control the creation of currencies and transactions in them, rather than a central authority
- Idea is to create limited pool of identifiable units and then track transactions in those units using a distributed database protected by cryptography
- Several different kinds of crypto-currencies. Bitcoin was the first, and arguably the most popular, cryptocurrency



Essential Attributes: Protection Against Fraud and Theft

- Underlying theory behind Bitcoin is concept of triple-entry accounting
- Each transaction tracked not only by the participants in that transaction but also every other person with a copy of the database
- Makes use of a distributed database where other people transacting in Bitcoins have a copy of the ledger
- Owners of Bitcoins use their private “key” to authorize transactions in their own Bitcoins, and those transactions are then reflected in the public ledgers



How Does This Work From User's Perspective

- Each user has a Bitcoin “wallet”
- Each wallet stores a necessary private key that is used to unlock
- Once another person obtains the private key, that person potentially controls the Bitcoins in the wallet
- Transactions and Bitcoins are effectively irrevocable because there is no central authority to reverse transactions



Cryptocurrencies as Investments

• ERISA/IRC

- IRC prohibits certain investments
- ERISA s. 407
- Fiduciary standards (prudent?)
- SIPP?

Pension

(Defined
Benefit Plans)

No

401(k)

(Defined
Contribution
Plans)

No

IRAs,
HSAs
(Other Plans)

YES
But ERISA
standards

Cryptocurrencies as Investments

- ERISA, DOL, PBGC – silent
- IRC
 - 2014 guidance – virtual currency treated as property like real estate asset class. Property is not a qualifying plan asset
 - Self-directed brokerage accounts in 401(k) - can custodian take “custody” of cryptocurrency?
 - Prohibits certain investments in IRA’s – e.g., artwork, stamps, collector coins, metals

Cryptocurrencies as Investments

- Will IRS restrict cryptocurrencies?
- What about funds that track Bitcoin? No SEC approval (yet)
- Other countries?
 - Canada – yes
 - Australia – yes
 - Iceland - yes
 - China – very restricted

CYBERSECURITY & RETIREMENT PLANS



Cybersecurity & Retirement Plans

- Types of data breaches:
 - Plan participant – inadvertently provided information
 - Plan sponsor – data hack/inadvertent leak
 - Third party administrator (TPA) – data hack/inadvertent leak
 - Data thieves – remember \$28 trillion in assets
 - Growing target – future of class action litigation (remember, personal liability)

Cybersecurity & Retirement Plans

- Who is responsible for loss?
 - Plan Participant?
 - Did employer provide adequate safeguard training?
 - Employer policies specific?
 - Plan Sponsor?
 - Fiduciary breach under ERISA?
 - Co-fiduciary liability (ERISA s. 405)
- Third Party Administrator (TPA)
 - What does contract with plan sponsor provide?
 - If sub-delegation, co-fiduciary liability?
 - Indemnification provisions?



SAFEGUARDS & REMEDIES

Safeguards & Remedies

- **Review** - Undertake a retirement plan cybersecurity review to limit exposure
- **Written Plan** - Develop a retirement program cybersecurity plan
- **Paper** - Document action/procedure in Board or pension committee minutes
- **TPA Contracts** - Review all third party service provider contracts for cybersecurity breach language, notice requirements, indemnification,
- **Governing documents** - Review and amend plan/SPD/statement of investment policies & goals etc.

Safeguards & Remedies

- **Delegation** – Board/committee considerations for exposure
- **Monitor** - Monitor investment strategies
- **Inventory** - Inventory plan data
- **Training** – duty of care in hiring/monitoring providers
- **D&O** - Have D&O coverage reviewed:
 - ERISA carve-outs
 - Monetary limits
 - Who is covered

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Areas of Practice

ERISA
Employee Benefits
Executive Compensation
Cybersecurity

Social Media

[LinkedIn Profile](#)



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Areas of Practice

ERISA
Employee Benefits
Structured Finance
Cybersecurity

Social Media

[LinkedIn](#), [Twitter](#)

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Robin Nunn represents clients in complex commercial, corporate, litigation and regulatory matters. Her practice includes counseling clients on bank and consumer regulatory matters, particularly representing companies in legal counseling, regulatory proceedings, and defending corporate and individual clients in matters initiated by federal and state government regulators, as well as in class action litigation and internal investigations. She is co-head of the Supervision, Enforcement and Litigation group.



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Kim Richardson is an accomplished lead counsel and certified data privacy and security professional. She has extensive experience counseling businesses on data privacy and security law and compliance, as well as intellectual property and licensing, commercial agreements, and e-commerce and advertising. Ms. Richardson currently serves as Sr. Director Worldwide Privacy Counsel for Herbalife. She also serves as an adjunct Professor at Loyola Law School in the Cybersecurity concentration program. Prior to Herbalife, Ms. Richardson was Vice-President of Legal Affairs for Universal Studios Hollywood and Universal CityWalk Hollywood theme park and entertainment center. Ms. Richardson held several positions at the Walt Disney Company, including acting as the Assistant General Counsel for Disney's Data Privacy Group, Executive Counsel for Disney Consumer Products, and Counsel for Walt Disney Feature Animation. Ms. Richardson received her J.D. from Harvard Law School. She received her B.A. in Communications (mass media emphasis) with a Specialization in Business Administration from UCLA, *magna cum laude*, *Phi Beta Kappa*. Ms. Richardson is also a Certified Information Privacy Professional (CIPP/US) and is licensed to practice in California.



QUESTIONS?