RETIREMENT NEWS

MARCH 15, 2018 / 7:17 AM / A DAY AGO

How bitcoin IRA investments bypass U.S. fiduciary protections

Reuters Staff

(The opinions expressed here are those of the author, a columnist for Reuters.)

A Bitcoin (virtual currency) coin is seen in an illustration picture taken at La Maison du Bitcoin in Paris, France, June 23, 2017. REUTERS/Benoit Tessier/Illustration

By Mark Miller

CHICAGO (Reuters) - Bitcoin in an IRA? You might think holding a volatile, unregulated investment like cryptocurrency in a retirement account would violate the U.S. Department of Labor's fiduciary rule, which took effect last summer.

But despite the risks, the "bitcoin accepted here" shingle is hanging proudly in the Wild West of retirement investing - self-directed Individual Retirement Accounts.

Cryptocurrency is a digital - or virtual - currency that uses cryptography for security. Market-leader bitcoin racked up astonishing gains of more than 1,300 percent in 2017, but lost over half its value earlier this year. (reut.rs/2Fyp5jg). This week, it is trading around $9,000 - a stomach-churning drop from its 52-week high just short of $20,000 in December.

"As we've seen recently, it can drop like a stone, instantly," said Ed Slott, who educates financial advisers on IRAs and publishes the Slott Report.

Traditional IRA accounts hold mutual funds, equities and bonds; the custodial firms that hold these accounts will not touch cryptocurrencies like bitcoin or other alternative investments, such as precious metals or real estate.

But in a self-directed IRA, you can invest in just about anything. Under the Internal Revenue Service Code, the only prohibited investments are life insurance, collectibles (such as coins or precious gems), or commingling personal assets (such as a home you own). A marketplace of small custodial firms specializes in these accounts.

IRA investments are the main focus of the fiduciary rule, because most of the assets in them are rolled over from 401(k) plans, which enjoy the protection of the Employee Retirement Income Security Act of 1974. One of the main aims of the rule is to protect investors from high-cost, risky investments when they move assets to IRAs.

Self-directed IRAs are covered under the rule, although their proponents argued that they should have been exempted during the debate about its creation. “They tried to argue that if people wanted to gamble with their own money, we should let them,” said Phyllis Borzi, who led the fiduciary initiative as assistant secretary for Employee Benefits Security in the U.S. Department of Labor during the Obama administration.

“I wasn’t convinced by that argument, because self-directed IRAs are the least-regulated segment of the retirement account market.”

Self-directed IRA custodians are not acting as fiduciaries as long as they refrain from giving specific advice about investments. They can charge fees to facilitate fairly complex account setups; they also may provide education about the rules and regulations through books, pamphlets or videos.

A NON-FIDUCIARY ROLE

Consider Adam Bergman, author of “How to Use Retirement Funds to Purchase Cryptocurrencies in a Nutshell.” Bergman heads Miami-based IRA Financial Group, which acts as a custodian for self-directed IRAs. His company’s services are not limited to cryptocurrencies - most of the self-directed IRAs held at his firm are invested in real estate, he said.

Bergman, an attorney, is well aware of the rules against providing specific advice. “We are non-fiduciary custodians,” he said. “We don’t sell financial products - we take great pains to make sure we are not fiduciaries. We just facilitate. There’s no way on God’s green earth I’m going to give people investment advice.”

Fair enough. Yet on Bergman’s website, you can watch a video where he discusses clients who have had “huge gains” investing in cryptocurrency in the past few years - and paid no tax because they used Roth IRAs as the investment vehicle. “They may otherwise have three or four hundred grand in taxes they would have to come up with.”

But the worries do not end with taxes. Aside from their volatility, cryptocurrencies trade on unregulated online exchanges. Many have been plagued by technical problems and hacks, and

the Commodity Futures Trading Commission warned investors to be wary of fraudulent "pump and dump" schemes (reut.rs/2FyYxOP). The Wall Street Journal reported recently that the U.S. Securities and Exchange Commission has issued dozens of subpoenas as part of a broad investigation of the cryptocurrency industry (reut.rs/2Ip2kft).

Self-directed IRAs are a small niche market, holding about $50 billion in assets, according to a report last year by the U.S. Government Accountability Office (GAO). By comparison, the overall IRA market represented $8.5 trillion at the end of the third quarter last year, according to the Investment Company Institute.

In its report, GAO focused on the additional responsibilities shouldered by investors in alternative assets, and recommended that the IRS improve the guidance offered to account owners on how to monitor their tax liability and determine fair market value of unconventional assets. The IRS agreed with the recommendations, but to date has only partially implemented the reforms, according to the GAO (bit.ly/2pbO150).

The appeal of using an IRA to invest in alternatives is simple. "For most people, it's where their assets are concentrated," said Tim Steffen, director of advanced planning at Robert W. Baird & Co.

But Slott thinks retirement investors should consider the broader merits of alternative investments, and cryptocurrency in particular. "If a client asked me about this, I'd say - 'Do you understand it? If you don't know what you're investing in, then why would you do it?'"

Sometimes that understanding is lacking. Said Steffen: "We even had one client who wanted to hold the physical coin itself."

Editing by Matthew Lewis

Our Standards: The Thomson Reuters Trust Principles.