AI Investment Risk Demands Vigilance by 401(k) Plan Managers

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The stock market's reliance on a handful of major technology companies highlights the importance of the role of fiduciaries tasked with managing retirement plans and protecting participants against a potential downturn.

Americans with retirement accounts allocated in public markets are increasingly invested in major technology companies boosted by the artificial intelligence boom, whether participants realize it or not, benefits attorneys said. That has sparked concerns that retirement savings could be at risk if any AI bubble bursts, causing the market to drop.

A historic tech selloff prompted by speculation about the impact of the Nov. 3 election resulted in new caution around AI-related stocks this month.

Fiduciaries must ensure they are following the required process under the Employee Retirement Income Security Act to monitor plan investments and document their efforts in order to guard against potential lawsuits, benefits attorneys said. They should diversify a plan's holdings, if needed, to protect participants against market volatility, according to experts.

"Just by investing in the public markets right now, a lot of our savings may be riding on the success of a handful of technology companies," said Erin Cho, leader of Mayer Brown's ERISA fiduciary practice. "A hot topic in the ERISA space is whether private market asset classes are appropriate for pensions, particularly for 401(k) plans."

Market Uncertainty

Major technology and AI giants — including Nvidia Corp., Amazon.com Inc., Meta Platforms Inc., Apple Inc., and others — account for roughly one-third of the entire S&P 500 index. The Nasdaq 100 is heavily composed of tech-related stocks, while Apple, Nvidia, Alphabet Corp., and Microsoft Corp. are among the companies that are part of the Dow Jones Industrial Average.

The stock market responded to the midterm election results with turbulence, driven by the performance of AI stocks. The market dipped, then recovered in the day after Democrats won majorities in both chambers of Congress. Then came a Nov. 5 rout as tech stocks dropped the most

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since 2020. The Nasdaq fell 6.4% after voters expressed opposition to data centers, and companies prepared for more intense oversight and regulation from a Democrat-led Congress.

The spotlight will remain on the role of tech stocks in the market with AI company Anthropic PBC's upcoming initial public offering.

The savers most at risk are 401(k) participants who may only be a few years from retirement, said Harold Ashner, a partner at Wagner Law Group and a former attorney at the Pension Benefit Guaranty Corporation. A market wipeout similar to 2000 or 2008 could upend when or whether someone later in their career is able to retire, he said.

Some financial strategists have downplayed fears of a bubble, pointing to public concerns about the sustainability of the AI boom. Both the S&P and Nasdaq rebounded on Nov. 6.

"The market goes up and down and we have these cycles, they happen," said Michael Kreps, a principal at Groom Law Group.

Fiduciary Responsibilities

Many participants are invested in target-date funds and index funds, where concentration in a particular sector can build up. Plan fiduciaries need to "look under the hood" to address potential overexposure, Ashner said.

"Fiduciaries aren't required to predict whether AI is a bubble, and they shouldn't try," he said. "ERISA requires a prudent process and appropriate diversification, not an ability to call the top of the market. The right question isn't 'Is this a bubble?' It's 'If it is, have we prudently addressed that risk?'"

Kreps said a lesson from the Great Recession and the dot-com bubble is that plan sponsors and fiduciaries need to have an investment strategy and stick to it, and consider a communication strategy with participants.

"You can do that in a fiduciary capacity or you can do it in an educational capacity, which is how most sponsors will do it, working with record-keepers and other providers to make sure participants understand that retirement's a long-term game and that you can't time the market," Kreps said.

He said fiduciaries should "do a little bit of a refresher" to figure out which investments would be most impacted by a downturn.

Fiduciaries must also ensure they're following proper process under ERISA, which holds those managing retirement plans to high legal standards of care. Those overseeing plans must monitor the investments in certain funds and sectors, be aware of any restraints on liquidity in the event of a

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downturn, and document their decision making to guard against litigation risk, attorneys said.

“ERISA doesn’t require that an investment manager or fiduciary guarantee investment returns, but fiduciaries need to have processes in place and should document their process,” Cho said.

Certain plan sponsors have been adopting multi-asset class funds that include an allocation to private assets which could be a way to increase diversification and hedge against the risk of a downturn in public markets, Cho said.

The Labor Department is close to finalizing a regulation that would make it easier for fiduciaries to include alternative assets on 401(k) plan menus by providing legal cover if they satisfy six factors when considering whether to include alternatives.

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