Testimony on Michigan House Bill 4510 (2025)

Prepared for: Michigan House Committee on Economic Competitiveness

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Chairman Hoadley and members of the committee,

I am the senior managing director of the Pension Integrity Project at Reason Foundation, a national nonpartisan think tank. Our project has played a key technical assistance role in dozens of bipartisan pension reforms across the states over the last several years, including Michigan, and we have over a dozen years of experience in public pension research, actuarial modeling, and pro bono plan design consulting. Thank you for the opportunity to submit technical comments regarding House Bill 4510.

Among the many technological revolutions we are currently experiencing is the emergence of cryptocurrency and digital assets, and public sector trust funds like pension systems are just beginning to explore if and how they are going to invest in this emerging sector, making this proposed legislation very timely.

Overall, this bill represents a prudent and appropriately cautious first step toward incorporating digital assets into Michigan's public pension portfolios. Our research indicates that digital assets like Bitcoin and Ethereum can serve as credible investments for return and diversification, but given the inherent volatility and associated risk, we believe that such investments should occur within a disciplined, rules-based fiduciary framework. HB4510's approach to establishing clear guardrails for entry into this emerging asset class is a positive step in protecting both beneficiaries and taxpayers and is well-aligned with a risk-managed entry strategy.

We are currently finalizing a forthcoming report outlining a set of best practices for public pensions and other trust funds and would offer the following observations on the two key provisions of HB4510.

The first key provision would restrict Michigan's public investment to cryptocurrencies with a market capitalization of at least $250 billion. This would limit investment to only the largest, most mature digital assets, which today are Bitcoin ($1.84 trillion market cap) and Ethereum ($404 billion). This aligns with our best practice recommendation that public trusts should generally avoid most alternative cryptocurrencies due to governance risk, regulatory uncertainty, technological obsolescence, and near-zero recovery value in failure scenarios. By contrast, Bitcoin is the oldest and most mature digital asset, relatively speaking, and the financial industry is embracing it as an investment return and diversification instrument whose limited supply drives its value as an inflation hedge. Additionally, the use of a market

capitalization threshold (versus explicit approval of specific assets themselves) is a prudent approach that will allow additional cryptocurrencies and stablecoins to become eligible investment opportunities over time as they mature.

The second key provision would require that digital assets be held only through an exchange-traded product (ETP) issued by a registered investment company. We believe this is a prudent provision to mitigate operational and security risks associated with direct custody. Since being first approved in 2024, SEC-approved spot Bitcoin ETFs (a type of ETP) have improved institutional access, custody, and compliance frameworks and make crypto more accessible for large institutional investors via regulated vehicles.

While the provisions of HB4510 constitute the foundation of a prudent approach, we suggest that the legislature also consider additional policy guardrails to complement the provisions in HB4510:

- First, we recommend the adoption of an **explicit allocation cap for digital assets**, recommending that total digital asset exposure be capped. For Bitcoin specifically, we recommend a limit of up to 5% of total assets under management, and for other digital assets, we recommend a limit up to 2% of total assets under management.
- Second, any cap imposed on digital assets' share of the total portfolio needs to be paired with guidance regarding the approach and method of **rebalancing over time**. For example, one could adopt a periodic rebalancing regime with monthly or quarterly rebalancing, for example. Alternatively, a policy could establish explicit "drift bands" around the target allocation (e.g., ±2 percentage points around a 5% Bitcoin target), or a dual-threshold structure, with one cap for initial allocation (e.g., 3%) and a higher cap for maximum allowable appreciation (e.g., 5%).
- Third, we recommend that exposure to digital assets be **sourced from existing alternative asset allocations** (e.g., private equity, hedge funds, private debt, real estate, etc.) so as to avoid increasing aggregate portfolio risk.
- Lastly, the legislature should adopt **enhanced risk management protocols**, including crypto-specific stress testing (e.g., for 80-100% drawdowns) and a required, planned exit strategy.

Thank you very much for the opportunity to submit testimony. We stand ready to respond to any questions the committee may have related to this subject.

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