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HEADLINE: How's Your 401(k) Today?

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HIGHLIGHT:
Lawyers are starting to draw a bead on plans that may not put your needs and interests first

BODY:

The sagging stock market hasn't yet scared the 35 million workers who contribute to company 401(k) plans. You keep making regular investments to your plan's various mutual funds. Large numbers of you also own company stock through the plan-often in substantial amounts. That's something to take another look at. You're gambling with your future, at doubtful odds.

OK, some stocks will post terrific records over the long term. But others will dive and not recover, or not recover for many years. If you own company stock in your plan and it slides to a lower price, the 401(k) could be hollowed out. What's going to happen when workers wind up on the losing end?

I predict that they'll call the lawyers in. They'll sue their companies for running imprudent plans. A few unhappy employees have already taken their complaints to court. These have been unusual and spotty battles, but you can smell the powder in the air.

The jackpot: To me, the big issue is going to be the excessive amounts of company stock in many 401(k)s. So far most employees have loved their stock. By the tens of thousands, they've hit the jackpot and retired well. Oh, to have had half your money in Cisco or General Electric for the past 10 years.

But that's hindsight. Going forward, you have no idea which stocks will be successful and which will disappoint. The more you depend on a single stock, the greater the risk of a ruinous loss.

Consider Cendant Corp., the consumer-finance firm. After a merger in 1997, phony accounting came to light. The stock price was promptly chopped in half~sad for those near retirement who had chosen it for their 401(k)s. And consider IBM, whose stock price plunged by two thirds in the years after the 1987 crash. A planner told me about a client, an IBM retiree, who used to take walks past the house he'd planned to buy but could no longer afford.

By law, employee retirement plans can hold as much company stock as they want. Your regular contributions might be matched with stock, or you might buy it with the money you put in.

The consulting firm Hewitt Associates keeps track of the "house stock" held in big-company 401(k)s. Currently, it averages 22 percent of the plans' investments. That's lower than it was last year, suggesting that some companies and employees are wising up.

Still, some plans are more than 50 percent invested in company stock. At Coca-Cola it's a whopping 83 percent. In firms with Employee Stock Ownership Plans, all of your money typically goes into the stock.

That's incredibly imprudent by any normal investment standard, says Norman Stein, law professor at the University of Alabama in Tuscaloosa. The company thinks you'll work harder if you feel like an owner. But what's good for the company isn't always good for you.

Here's where the 401(k) issue gets interesting. On the one hand, employers have the right to pick the investments for the plan. On the other hand, they have a duty toward their employees. They're supposed to put your interests first. If they don't, and you lose money, they could be liable.

There's not much law in this area yet. Most 401(k)s have done so well that workers have nothing to gripe about. They head for court, however, if they think they've gotten a rotten deal. For example:

Failing companies. Courts have said that you can sue if your company was failing and the plan let your money languish in the losing stock.

Self-dealing. Courts are looking at this tricky question now. What does it take to show that a company twisted its 401(k) to serve its own corporate interests? Two cases are currently testing the waters, both brought by the Washington, D.C., law firm Sprenger Lang.

One case involves 45,000 workers whose firm was merged into SBC Communications, the nation's largest local phone company. In their previous 401(k), these workers had owned stock in AirTouch Communications. But SBC competes with AirTouch and~not surprisingly-didn't want that stock in its plan. Anyway, that's the reason one manager gave for selling the workers out. They received SBC shares instead. The company says that the sale was routine; none of its savings plans include direct ownership of other companies' shares.

As luck would have it, AirTouch soared and SBC fell. So the workers screamed. I doubt they'd have screamed if AirTouch had tanked, but that's the point. Employees go nuts when they lose gains they think they should have had. Among other things, the lawsuit asks whether SBC had a legal reason to sell the shares.

The second case involves the First Union Corp., a major bank based in Charlotte, N.C. First Union manages its own 401(k) as well as a number of 401(k)s for outside firms. The lawsuit alleges that the captive, in-house plan is forced to pay higher fees than comparable outside plans. What's more, the in-house plan offers only First Union mutual funds-mediocre funds that benefit the bank more than the employees, Sprenger attorney Eli Gottesdiener claims.

First Union's attorney, Gregory Braden of Alston Bird in Atlanta, denies the charges and says First Union's funds were chosen "with the primary goal of maximizing performance."

Rarely won: So far suits against 401(k) plans have been rare and rarely won, says David Wray, president of the Profit Sharing/401(k) Council of America in Chicago. Most of the plans have been well run. Nevertheless, it's smart to reassess your risks.

Best advice for employees: If your employer matches your 401(k) contribution with company stock, invest your own money in something else. In fact, switch out of most of the stock if the plan allows.

Best advice for companies: Match your employees with cash, not stock. If you use stock, let them diversify into something else. If they own too much stock voluntarily, explain the risk. And offer a smart mix of low-cost investments. Lawsuits are rare today-- but if the market turns, watch out.

Reported by Temma Ehrenfeld