The New York Times

October 5, 2003, Sunday, Late Edition - Final

SECTION: Section 3; Page 1; Column 1; Money and Business/Financial Desk

LENGTH: 642 words

HEADLINE: MARKET WATCH;
Lopsided 401(k)'s, All Too Common

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BODY:

IN a ruling last week, Judge Melinda Harmon of Federal District Court in Houston put corporate executives on notice that they may be responsible if their employees' 401(k) plans are destroyed by fraud or mismanagement.

Here's hoping that the warning also pushes managers of 401 (k) plans to reduce the significant risks that still lurk in many of these plans.

The case before Judge Harmon relates to the Enron 401(k) plan, which had 60 percent of its assets invested in the company's stock. The former employees whose savings vaporized are suing Enron's top executives and the Northern Trust Corporation, the bank that administered the plan, contending violations of pension laws. The judge denied a motion to dismiss that case.

Unlike pension plans, 401(k) plans aren't insured. Winning the suit would be the only way for former Enron employees to recover some losses.

After Enron collapsed, Congress discussed limits on the amount of company stock that can be in a 401(k), but the issue died. Now, almost two years later, investors in many 401(k) plans remain dangerously overexposed to their companies' stock. Never mind that the bear market was supposed to have taught investors tough lessons about risk and diversification.

According to Hewitt Associates, which canvasses 1.5 million 401(k) plan participants, 28 percent of assets, on average, at the end of 2002 were held by workers in shares of their employers' stock. That is down from 42 percent in 2001, but still sky-high.

More troubling is the risk run by the employees with the lowest salaries. Workers making $20,000 or less annually have 23.2 percent of their retirement accounts in their companies' stock, Hewitt said. Employees earning more than $100,000 have 16.6 percent.

While those overseeing 401(k) plans at companies have a fiduciary duty to run the plans prudently, investing in a company's own shares is exempt from federal diversification requirements. And companies get such benefits from stashing their shares in 401(k) plans - the stock they contribute does not show up as an expense on the income statement ~ that it is no surprise the plans are still full of these shares.

"The law allows so much company stock in a 401(k) that over time the notion that the people running the plans are trustees, as opposed to corporate boosters, has gone," said Eli Gottesdiener, a lawyer in Washington representing Enron employees in the 401(k) suit. "The uncompensated risk is so enormous, and it is so outrageous that the legal structure allows it."

THE percentage of 401 (k) assets held in company stock fell last year in part because many of the shares performed poorly, illustrating perfectly why it is unwise to put all eggs in one basket. Intel's 401(k) lost $366 million in its company stock investment during 2002, or 28 percent of the plan's total investment

loss. At the end of the year, Intel shares totaled 10 percent of the plan's assets, down from 16 percent the year before. At Coca-Cola, where almost three-quarters of the plan assets are held in company stock, 401(k) holders lost $71 million last year, 43 percent more than the loss registered in the mutual funds offered as an investment choice to the employees.

Of course, many employees choose to put all their retirement funds into their companies' stock. But some companies force their own stock on employees by using the shares, as Coke does, to match workers' contributions to a 401(k) or by requiring workers to hold company shares until they reach a certain age.

This practice must change. Sure, the law protects employers from being sued for lack of diversification. But why can't companies be good corporate citizens and help their employees build solid retirement funds? Why is it so hard for companies today simply to do the right thing?

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GRAPHIC: Chart: "Banking on the Company"
Share of 401(k) plans invested in each company's own stock.

Coca-Cola
'01: 76%
'02: 73%

Dell
'01: 58
'02: 51

Intel
'01: 16
'02: 10

Microsoft
'01: 56
'02: 47

Motorola
'01: 14
'02: 11

Qwest
'01: 27
'02: 16

(Source by Company filings)