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## 401k Account Holders have the Responsibility – What they Need is the Power

The Enron debacle has generated much debate about the need for further legislation regarding employee 401k plans. No distinction is being made between legislation of employee investment choice and employer 401k responsibility. The former is an attempt to regulate “good investing” while the latter is largely to prevent fraud and remove the hurdles for employees attempting to create retirement wealth by choosing their own level of investment risk.

Why are 401k plans popular among both employers and employees? The traditional defined benefit plan (a pension) created liabilities for the employer. The employer guarantees the employee an annuity, bearing the investment risk inherent in this guarantee. The employer runs the risk of an under-funded pension plan if investment results are not as projected, or an over-funded pension plan creating a fat target for corporate raiders. As a result, traditional pension money is invested very conservatively, and becomes a low risk, low return proposition for the employee, regardless of their particular risk tolerance. With the passing of ERISA laws in 1974, the concept of a defined contribution plan (401k, profit sharing plans, SEPs, etc.) was born. The employer sheds both the investment risk liability and the risk of an over- or under-funded pension while still getting the tax deduction. The employee can choose the level of risk they wish to embrace rather than having it chosen for them by the employer.

The key concept is that *employees choose the level of risk* – not the employer, and certainly not the government. The account holder of the 401k, as well as most other qualified retirement plans, bears complete responsibility for investment risk. This is not an opinion – it’s the law and the central tenant of the defined contribution plan. The problem arises when employers put hurdles in the way of the employee – giving them the responsibility but not the power. Hurdles include things such as limited investment choices, black-out periods, and high holding requirements for employer stock.

Companies have every right to make their matching contributions in company stock – but have no right to force employee tax-deferred contributions into company stock and/or force them to hold a certain percentage of company stock. Why do employers do this? Forcing employees into holding large amounts of company stock creates an additional demand that aids in propping up the stock price. This is a huge hurdle that prevents employees from having the power to set their own risk level – and an affront to the concept of the defined contribution plan. Extended black-out periods, during which an employee’s ability to make investment decisions are suspended, also take away power from the employee. While there may be special circumstances that create short-term black-outs for new contributions, there is no reason that existing contributions, already within the plan, should ever be unavailable to account owners. Legislation should make it so.

By law an employer must offer at least three investment choices in a 401k. Any limitation of investment choice reduces the power of the account holder. 401k's should be opened up, by law, to the same laundry list of investment choices as any qualified plan. An IRA account holder can choose to invest in any mutual fund, individual stock, bond or REIT that is traded on the major markets. So can account holders of SEPs, SIMPLEs, and profit-sharing plans, all plans offered by many employers as a substitute for a 401k. By attempting to legislate "good investing" by offering very limited investment choices, the opposite actually occurs. With limitations there is less control of investment risk and an intelligent, well-informed investor is forced into limited choices that are often sub-optimal. "Dumbing down" investment choices hurts far more employees than it helps -- the small percentage of folks who don't think it's imprudent to put *all* their money in company stock.

401k account holders are no less intelligent investors than owners of IRA's, SEPs, SIMPLEs, and many other qualified plans. Why then assume they need special legislation to keep them from making bad investment decisions? America is about having choices, and by creating legislation that reduces the hurdles, rather than reducing the choices, 401k holders will finally have the power to go along with the responsibility of investment risk that has been theirs all along.