Putting Too Much in Company Stock

A classic mistake that can come back to haunt you.

Presented by Benedict A. Mitchell Jr.

Have you invested too much of your 401(k) in company stock? This can happen – and you may not be fully aware of it.

Back when corporations offered traditional pension plans, the federal government watched out for this tendency. In 1974, the Employee Retirement Income Security Act (ERISA) made it illegal for pension plans to invest more than 10% of their assets in company shares. These days, the employee-directed 401(k) is the default workplace retirement plan – but ERISA doesn't limit the amount of 401(k) assets that can be directed into company stock.[1]

If the stock flops, how big a hit will you take? Pre-retirees with too much of their nest egg in company stock may recognize the risk. The debacles at Enron, Tyco and WorldCom are still fresh in the memory. Even so, recognition may not prompt them to diversify their portfolios.

What factors promote this problem? Psychology plays a role. After years of working for a large company, employees come to believe in its stability – it should continue to do well, it should be around for years to come. (Past success is interpreted as an indicator of future performance.) This optimism may be the biggest reason why 401(k) plan participants overweight their portfolios in company stock.

Employer encouragement – however overt or subtle – is another factor. At the end of 2011, the Employee Benefits Research Institute (EBRI) and the Investment Company Institute (ICI) took a snapshot of 401(k) asset allocations and found that 58% of businesses with 5,000 or more employees offered their workers company shares as a 401(k) investment option. Some corporations even match employee 401(k) contributions with stock shares.[1,2]

Breaking the surveyed 401(k) programs down further, the survey determined that about 6% of plan participants had more than 80% of their 401(k) assets invested in their employer's stock. About 5% of plan participants aged 40-49 had 31-40% of their 401(k) assets invested in company shares; about 6% of plan participants aged 60-69 had 21-30% of their plan assets invested in company stock.[2]

The classic maxim is to avoid putting more than 20% of your retirement plan assets in company stock at any time, especially if that weighting amounts to more than 20% of your overall retirement savings.[1]

What do you do if you're overweighted? First, you want to determine if you are – and you may own more of your employer's stock than you initially think. Employer matches, stock options, and even mutual funds that invest in the company may increase your exposure.

A financial professional can help you look at metrics that could give you a picture of the fundamentals, volatility and risk surrounding the stock. If you do find that you hold too much of it for comfort, it is time to diversify – but make sure you are aware of any restrictions on selling the shares before you take the next step.

Remember the virtues of diversification. As you get older, you have less time to make back portfolio losses, and so there is less wisdom in investing heavily in a single stock. Allocating your retirement assets across different types of investments may help you to "insulate" more of your retirement savings in the event of a downturn or a particularly volatile market. Lessening the amount of company stock in your portfolio has another potential plus: it reduces the potential correlation between your financial future and the future health of the company.

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Citations.

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