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GETTING PERSONAL:

Investors Make Costly 401(k) Errors-Study

By Daisy Maxey

NEW YORK (Dow Jones)—Americans are making lots of costly mistakes with their 401(k) plans, and, sadly, those who can least afford it are making the biggest missteps, according to a new study that will be released Monday.

In addition to not saving enough and missing out on company matches available through 401(k) plans, many investors' 401(k) plans are not well diversified or are too full of their company's stock, an evaluation by registered investment advisory firm Financial Engines Advisors LLC found.

The firm, which was co-founded by Nobel Prize-winning economist William Sharpe, offers investment advice and is hired by companies to manage 401(k) plans for their employees. From March to June 2007, it assessed nearly one million 401(k) portfolios from 82 plan sponsors with more than \$50 billion in assets.

While some participants are taking full advantage of their plans, it found that those with lower salaries and lower plan balances and those who are closer to retirement tend to make the most costly mistakes.

The evaluation clearly shows that the do-it-yourself 401(k) isn't working very well for a large portion of investors, said Jeff Maggioncalda, president and chief executive of Palo Alto, Calif.-based Financial Engines.

"The Americans who will most rely on their 401(k)s for retirement are the ones who are benefiting the least from the 401(k)s," he said. "They're misusing it, and the mistakes that they're making will cost them potentially a lot of money in retirement."

The study found that some 33% of active participants fail to invest enough in their 401(k)s to ensure that they receive the full matching contribution from their employer, which means they're leaving free money on the table. And while 60% do save enough to receive the full employer match, they're still saving below the Internal Revenue Service or 401(k) plan limits, and only 7% of active participants save enough to come within \$500 of the IRS or plan maximum allowed, the study found.

"What's perhaps a little surprising is that one of the best features of a 401(k) plan is that it's pretax savings, yet nine out of 10 people fail to max out their 401(k) contribution," Maggioncalda said.

Still, many plan participants are saving at healthy rates; 25% of the entire sample were found to be saving 10% or more of

their salaries.

Not surprisingly, however, younger participants and those with lower salaries or lower account balances tend to save the least. Some 48% of those under 30 are failing to save enough to receive the full employer match, compared with 35% of those in their 30s, 31% of those in their 40s, 26% of those in their 50s and 28% of those over 60, according to the study.

Of those earning less than \$25,000 a year, 63% don't save enough to receive their employer's match, compared to 24% of those with annual salaries between \$50,000 and \$75,000 and 12% of those with salaries greater than \$100,000 a year, the study found.

That can take a large bite out of a nest egg.

If the average participant saving 1.9% of his salary - not enough to receive his employer's full match - and with a median account balance of \$5,872 continued contributing at the same rate and receiving the partial employer match, he's projected to have about \$46,800 after 20 years, Financial Engines said. However, if that investor increased his contribution to 6% of salary - enough to receive the full typical employer match in the report - he's projected to have about \$120,900 after 20 years, the advisor said. The most common employer match in the sample was 50 cents per dollar, up to 6% of pay.

High Levels Of Company Stock

Another troubling finding is that 69% of the 401(k) participants in the evaluation had inappropriate risk or inefficient portfolios. Of that 69%, 38% had very risk-inappropriate or very inefficient portfolios. Common problems include high money-market or stable-value concentrations, age-inappropriate portfolios or concentrations in a single asset class, Financial Engines said.

Again, participants with the lowest salaries were found to be most at risk. More than 53% of participants with annual salaries below \$25,000 have portfolios with very inappropriate risk and/or diversification, compared to 33% of those earning more than \$100,000 annually, the study found.

And such improper investments also can be costly. Portfolios with very inappropriate risk and diversification could expect to have 22% less projected retirement wealth after 20 years, compared to those with appropriate risk and diversification, given the same

balance and assuming no future contributions, Financial Engines said.

Those numbers highlight why advice is important, Maggioncalda said. If employers don't make advice available at the workplace, many, particularly the less wealthy, likely won't receive any help, he said. Employees are open to advice, he said, noting that when some companies have told their employees that Financial Engines will begin to manage their 401(k) plans unless the employees decline within 45 days, 60% have permitted the advisor to manage their accounts.

The advisor also found that despite recent company collapses and market volatility, many Americans still underestimate the high risk levels associated with holding high concentrations of company stock.

Some 36% of participants in plans with company stock as an investment option hold more than 20% of their portfolios in unrestricted company stock, the study found. Some 11% hold between 10% to 20% in company stock, and 53% hold less than 10% of their portfolios in unrestricted company stock, it found. And older participants - those with the least amount of time to recover if their company's stock takes a plunge - hold the most.

"The biggest employer reaction to Enron wasn't to restrict company stock, but to let people diversify if they want, but employees didn't do that," Maggioncalda said. "The reaction from employees was, 'Enron was defrauding investors; that's not my company. We're no Enron.'"

Nevertheless, he said, Financial Engines has diversified more than \$2.5 billion in company stock for its managed accounts over the last four years.

While it would be easy to see "gloom and doom" in the assessment, there is hope because the report provides a snapshot of the 401(k) plan in transition, Maggioncalda said. Thanks to the Pension Protection Act of 2006, which made automatic enrollment in 401(k)s and providing advice easier for employers, positive change is coming to the marketplace, he said.

"For about 30 years, we've basically said to employees, 'Look, you've got this 401(k), here are some choices; it's up to you to do it yourself.'" Maggioncalda said. "We're at a very interesting point where that era is ending and the era of the automatic 401(k) is beginning."

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