

Lessons Learned from Enron

Diversify.¹ If there is one lesson to be learned from the Enron bankruptcy, it is the importance of making sure your 401(k) retirement plan has a diversified investment portfolio. A diversified portfolio helps provide stability, enabling you to better ride out the natural up and down business cycles that occur over time.

According to many published reports, Enron employees watched in disbelief as their 401(k) retirement plans, many of which held only Enron stock, steadily and precipitously decreased in value as the company's share price slid from \$90 in 2000 to less than a dollar at the close of 2001. In January of 2002, the company was delisted from the New York Stock Exchange. In all, about 18,000 – 20,000 employees lost an estimated \$1.3 billion.

One employee's plight was fairly typical. A 61-year-old woman had spent 15 years with the company amassing close to \$500,000 in her 401(k) plan by the winter of 2000. She was contemplating retirement. Today, she is out of work and her nest egg is worth just \$22,000 and retirement is out of the picture.

Enron employees may have the sorriest tale, but they are not alone. Employees at other large companies have seen their retirement plans decrease dramatically in value when their company's stock took a nosedive. Many employees, for a variety of reasons, routinely invest heavily in their own companies, unaware of the potential pitfalls. Benefits consulting firm Hewitt Associates estimates that as of October 31, 2001, almost 30% of the \$7.1 billion in assets in the nation's 1.5 million 401(k) plans were invested in the stock of the sponsoring company. Enron employees, for example, had 62 percent of their 401(k) plans in company stock.

The Enron debacle brought calls for retirement plan reform front and center in Washington. As a result, the Pension Protection Act of 2006 was signed into law by President Bush on August 17, 2006. One provision of the PPA is that employers must now allow plan participants to diversify out of company stock after a period of three years of service. Regardless of what happens in the legislative halls, there are steps most 401(k) plan participants can take today to make sure they have enough diversity in their plans to help withstand a steep plummet by their employer's stock.

As any financial professional will tell you, an undiversified investment is a risky, and not particularly smart, investment.

1. **Make sure your portfolio is well diversified**, using the plan's fixed account, as well as a mixture of stock and bond funds. Should one of your funds take a sudden hit, you'll be able to absorb it more easily.
2. **Limit the amount of your employer's stock in your plan.** Most big companies match part of each worker's 401(k) contribution in company stock, which often can't be moved into other investments until you have three years of service with the company. When you are able to do so, shift some of that stock into other investments.
3. **Discuss all the provisions of the plan with your company's benefits experts**, and don't be afraid to ask questions.

In the end, employers can only go so far in educating 401(k) participants on the advantages of diversification and ultimately employees must judge the financial strength of their own company when deciding how much of their 401(k) money to invest in company stock. It's your responsibility.

While increased diversity in 401(k) plans is one silver lining from the Enron mess, an ominous black cloud may be that people will begin to contribute less to, or even abandon, their 401(k) plans and ultimately be less financially prepared to retire.

In an article in the December 11, 2001 issue of DC Plan Investing, a retirement industry newsletter, R. Theodore Benna, president of the 401(k) Association and the individual

¹ Diversification cannot ensure a profit or guarantee against market loss.

generally credited with developing the 401(k) idea more than 20 years ago, states if systemic problems are not addressed, , "We could see significant erosion of employee confidence, which could result in lower contributions. And that's bad for everybody."

A survey conducted in September, 2001, indicates the shrinkage of participants' 401(k) accounts could cause them to change the way they invest. Almost half of the 1,000 consumers surveyed by Cigna Retirement and Investment Services said they would pursue new investment strategies if their retirement plan balance were lower at the end of 2001 than it was in January. The most alarming response was that 11% said they would stop contributing to their 401(k) accounts.

That would be a huge mistake. For all the potential disaster of having a plan too full of one company's stock, the benefits of participating in a well-diversified 401(k) plan remain overwhelming.

If you are reassessing your personal retirement strategies, here are a few simple rules to consider.

1. **Participate in your company's 401(k) plan.** Don't let some examples of extreme failure scare you away from participating in a well-structured, disciplined retirement plan. Since 401(k) contributions use pre-tax dollars, a good piece of the money you invest would be taken out in taxes anyway. Most company plans offer some sort of matching, so you're also getting money for free. Always invest enough to get the full company match. The money is there. Don't leave it on the table.
2. **Diversify.** It bears repeating. The Enron employees who were hurt the most were the ones who had 100% of their 401(k) money in Enron stock. As mentioned above, keep a limited (or whatever you judge to be prudent) amount of your company's stock in your plan.
3. **If you leave your job, roll your money over into another tax-deferred investment.** If you leave, just move the money to your new employer's plan or if you don't have a new job, you can usually put it in a tax-deferred IRA.
4. **Invest according to your age and goals.** You can generally afford to be more aggressive with your investments when you're younger. As you get closer to retirement, you may want to move your money into safer, more conservative investments, depending on your particular situation.
5. **Take responsibility for your plan.** Remember, you are ultimately accountable for the investment decisions and the money in your 401(k) account. Keep on top of your options.

Today in the wake Enron's collapse, many people are meeting with their financial professionals to make sure their 401(k) plans are properly diversified.