



The Law and Economics of Company Stock in 401(k) Plans

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Abstract

Full Text



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Some 11 million participants in 401(k) plans invest more than 20 percent of their retirement savings in their employer's stock. Yet investing in the stock of one's employer is risky: single securities are riskier than diversified portfolios, and an employee's human capital typically is positively correlated with the company's performance. In the worst-case scenario, workers can lose their jobs and much of their retirement wealth simultaneously. For workers who expect to work for a company for many years, a dollar of company stock can be valued at less than 50 cents after accounting for risk. However, employees still invest voluntarily in their employer's stock, and many employers insist on making matching contributions in stock. We provide evidence that employees underestimate the risk of owning company stock, while employers overestimate the benefits associated with employee stock ownership. We then analyze the likely effects of current and proposed regulations in this context.



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