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Are ESOPs Risky Retirement Plans?

Perhaps the most common question about ESOPs is also the most politically important: are they too risky to be a good retirement tool for employees? ESOPs inherently concentrate retirement assets in a single security—company stock—and critics contend that this reduced diversification makes ESOP too risky. Even worse, employees depend on the same company for both their paychecks and their retirement accounts.

This is an understandable concern, but it rests on an assumption that turns out to be mostly incorrect. The diversification argument assumes that employees are making a choice between safely diversified assets versus the same amount in a single asset. For the very large majority of cases, however, the real choice is between non-ESOP participants, who have diversified assets, versus ESOP participants who have roughly the same amount in diversified assets, but who have an additional amount in company stock. Let's look at some of the other research findings that influence the riskiness of ESOPs.

ESOPs Are More Likely to Offer Secondary Retirement Plans Than Other Companies Are to Offer Any Plan

In a 2010 project funded by the Employee Ownership Foundation, the NCEO did an extensive analysis of ESOP companies using data from the U.S. Department of Labor Form 5500 reports. We looked at every ESOP company for which data are available compared to all retirement plans. The study found that ESOP companies are more likely to offer a second defined contribution (DC) plan than non-ESOP companies are to offer any DC plan at all.

ESOPs Cover More People

By law, ESOPs include all employees meeting minimum rules whether they defer any income or not. 401(k) plans, the most common retirement plan, usually only cover employees who defer into the plan. What they get then depends on what they defer, typically a 50% match up to about 6% of pay. So younger, lower-income employees not only are more likely to be uncovered entirely, but also are getting a lower percentage of their pay contributed by the company than higher income employees. In an ESOP, by contrast, all employees get the same percentage of pay.

What Is at Risk Is Rarely Employee Money

The vast majority of ESOPs are funded entirely by the company. ESOP participants often accumulate very large account balances,

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Thank you to everyone who made the **2014 Employee Ownership Conference** a great *(and sold-out)* success! We look forward to seeing you next year, when the conference will be in **DENVER, APRIL 20–23, 2015.**