Mutual Funds

8 ways to check for 401(k) plan abuse

The 401(k) is a wonderful retirement savings tool, but dishonest employers can make it a nightmare. Here's how to look for signals the plan is not being run on the up and up.

By Timothy Middleton

Your mid-year 401(k) statement should arrive within a week or two. Don't just toss it in a drawer.

Outright looting of 401(k) money by dishonest bosses is rampant. The U.S. Department of Labor documented more than 1,000 cases last year of companies pocketing 401(k) employee contributions. Another thousand committed less egregious abuses. Experts suspect far more cases haven't come to light yet.

"Take an active role in managing your finances and protecting your assets," counsels J. Steven Cowen, a financial adviser in La Jolla, Calif. In most instances, the Labor Department only acts after employees complain.

And the statement you're about to receive can be the key to unlocking your plan's secrets. If you don't receive one, beware -- thieving bosses aren't eager to pay postage on proof of their own guilt. If you do get it, read it carefully. The signs of abuse, if present, can be easy to spot.

But you have to know where to look. This is the fifth in a series of columns designed to sharpen your pension vision. The 401(k) system is a well-intentioned but deeply flawed retirement scheme. It is needlessly expensive and poorly policed.

And that's true when everybody involved is honest and competent. Often, they're not. Here are eight ways to judge the integrity of your plan. A single red flag might prompt you to write your boss a letter seeking an explanation. Multiple red flags should encourage you to contact the Department of Labor.

Check your account totals regularly

The Labor Department found the most blatant abuse of 401(k) plans was employers withholding employee contributions from paychecks but not depositing the money in the plan. In May, the agency sued the president of a defunct homebuilder, Rycenga Homes of Spring Lake, Mich., claiming he had diverted more than $1 million of 401(k) plan assets to pay company debts, in part by failing to remit contributions deducted from employees' paychecks.

Last month, the department sued a failed San Francisco-area engineering firm, GKO & Associates, charging that it withheld nearly $116,000 of employee contributions.

Compare your pay stubs to your statement, says Ray E. LeVitre, a planner with Net Worth Advisory Group in Midvale, Utah. "The amounts being deferred on the pay stubs should match the amounts going into the plan," he says. "Once the money reaches the (investment managers), the company can't touch it."

Make sure of the match

In June, Chicago Spectro Service Laboratory of Oak Park, Ill., agreed to restore more than $625,000 to the company's profit-sharing plan that it had failed to contribute.

Jeff Broadhurst, a financial adviser in Lansdale, Pa., says one of his former employers likewise failed to make a promised match of employee contributions. Such matches are common, and one of the most attractive features of 401(k) plans. "Their party line was that it was a mistake," he says. Whether intentional or mistaken, such lapses obligate the employer to make up for lost investment earnings, too.

Put your plan on your computer

Create a mirror version of your retirement-plan portfolio and check the performance of your investments yourself. That way you can compare that portfolio with your statements. "This takes time to do, but it's the only true way to understand how your account is performing," says Robert Gerstemeier, an advisor in Naperville, Ill. "When you break this out and track it over time, seeing any red flags pop up is pretty easy."

Watch out for slow payment

"Contributions need to be deposited by the 15th of the month following the month the moneys were withheld," says Kirk Hackbarth, a planner with Kabarec Financial Advisors in Palatine, Ill. "If moneys are not being deposited on a timely basis, that certainly is a red flag that requires immediate attention." The best place to check these numbers is on quarterly statements. Some companies also have online account statements that will list any account activity.

Watch for signs of outright fraud

"Red flags include loans that you did not authorize, reductions in account balances that do not track market activity, investment changes you did not authorize or any other discrepancies that you notice," says Hal Schweiger, a planner with Capital Financial Advisors in San Diego.

How's business?

"Problems with a company's retirement plan will most likely be due to issues in the underlying business of the company," notes Joseph P. Bedingfield Jr., a financial adviser in Birmingham, Ala. "Pay attention to changes you see around you at work. Red flags could be unexplained or poorly explained management and staff changes, which may include unusual turnover or reassignments."

In June, six of the 13 companies the Labor Department sued for pension-plan abuses had already gone out of business. They ranged from a computer-training school in Miami to a talent agency in Manhattan.

If you can get out of a bad 401(k) plan, do it

Michael Helffrich, a financial planner with PFP Advisors in Minneapolis, suggests rolling eligible 401(k) balances into individual retirement accounts. Two exceptions: If you might face legal judgments, as a physician might, 401(k)s are judgment-proof, but IRAs are not. And if you have to cash out a bundle of company stock, check with an accountant to make sure you don't create tax liabilities.

You can also escape a plan if you take a new job. Roll over the money from the former employer's plan. Besides protecting it, "You can usually lower your costs, tailor your investments to your exact needs and improve your investment choices," says Frank Armstrong, president of Investor Solutions in Coconut Grove, Fla.

If you're stuck with a bad plan at work, continue to fund the 401(k) up to the amount of the company's matching contribution, advises Lawrence H. Friedrichs, an advisor in Mesa, Ariz. After that, he says, "consider the use of a Roth IRA to fund for retirement needs, if possible, in addition to the 401(k) or instead of the 401(k)."

Watch co-workers' payouts

Chicago Spectro Service Laboratory allegedly falsified documents to cover up its failure to make contributions, but anyone who quit or retired and tried to roll the money over would have discovered the problem.

If all else fails, contact the Department of Labor's Employee Benefits Security Administration, which bears ultimate responsibility for regulating employee benefits, including pensions. EBSA's Web site gives instructions for making complaints, and offers several other tips on how to monitor your plan for abuse. You can also call the EBSA at 1-866-444-EBSA (3272).