

Tips on 401(k) Plans

What is a 401(k) plan?

It is a retirement savings plan sponsored by your employer and funded by you with money that is deducted from your pretax pay.

You will be responsible for making the investment choices in your 401(k). Usually, your employer's plan will offer you a number of investments from which you can choose.

Sometimes, you will be able to choose from a wider range of options that are offered through your plan's administrator.

At this time, you will need to do some research to decide how you want to invest your money – incorporating your risk tolerance and the time horizon in which you want to achieve your financial goals.

Reasons why you should participate in your 401(k) plan:

It's easy and convenient: The amount you choose to contribute is automatically deducted from your paycheck. You won't see the money, so you won't spend it! Payroll deduction will make it easy for even the most savings-challenged individuals!

Easy enrollment: If your employer offers a 401(k) plan, then consider yourself lucky – not everyone is offered a retirement plan at work. Since your employer provides all the enrollment materials to get you started on your savings plan, then all you have to do is pick up a pen, fill out the enrollment form, and you're on your way to saving! Do it!

You call the shots: With your 401(k) plan, you are the boss. You get to choose how much you want to contribute and where you want to invest your money. You also have the option of changing your contribution amount or transferring money among your investments if necessary. Your 401(k) statements will make it easy for you to track how much you are saving.

It will always be your money: Whatever money you contribute to a 401(k) plan is yours -- even if you leave your job. You may have to be vested to be entitled to your company match, but you can still always roll your money into a rollover individual retirement account (IRA) or your new employer's plan where it can continue to grow tax-deferred.

Get free money from your employer with a company match: To encourage more employee 401(k) participation, some companies will offer to do a company match. For example, a company may offer to put in another dollar for every dollar you save in the plan, up to 3 percent of your eligible pay. Then, it may add 50 cent for every dollar you put in after that up to 6 percent of your pay. That's like getting a 75 percent investment return!

You don't want to have any regrets 10 years down the line: Saving \$20 a week now may seem impossible, but the reality is that you cannot afford not to save. It will always seem challenging to put money aside for your future, but if you don't take advantage of saving even a little today, you may have to face the challenge of saving a lot later to make up for lost time and money! (See money saving tips below).

Compound interest - why it is bad to cash out your 401(k) plan:

Basically, the earlier you start saving, the more years your money has to earn interest.

Leaving your money to grow in a 401(k) plan or some other defined contribution plan lets you take advantage of compound interest – which is extremely important in building your retirement nest egg. Example: a 25-year old individual with a lump-sum distribution of \$3,500 from a 401(k) plan will have \$95,783 by the age of 67 (age of full Social Security benefits), assuming an 8 percent annual rate of return.

If you cash out your 401(k), you will have to pay federal and state taxes on the money you take out, plus a possible 10 percent withdrawal penalty on the money.

And more importantly, you lose the opportunity to increase the amount of money you have in a tax-deferred account.

Source: www.choosetosave.org