TOP 5 MYTHS ABOUT 401(K)S

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Back in the old days Pension plans were the default way that American's secured their retirement. Employees received a fixed sum of money for life after they retired. Unfortunately a lot of things have changed since then. It's rare that someone spend their entire career with one firm. Pension plans are expensive and have largely been phased out. Today, the most common way Americans save for retirement is through a 401(k) or 403(b) plan – where employees are required to save their own money on a voluntary basis.

While these types of plans can be extremely effective at preparing you for retirement, there are, unfortunately, a lot of myths about them. Don't let the myths hold you back from participating and maximizing the chances that you will have a comfortable retirement.

Myth No. 1 | Deferring Just Enough to Get the Employer Match is Enough

An employer match is a great tool. It's free money for your retirement and it can help you build your account balance at a much faster rate. However one trend we see too often is employees only deferring enough to get that maximum employer match. Most often this will not be enough to secure your retirement.

In many cases, an employer match only goes up to 4% or 6% of your income, and it might only be a 50% match. Even if you max out your employer match, you might not be saving enough money each month to meet your retirement goals. Let's look at a 50% match up to 6% as an example. You put in 6% and your employer contributes 3% in match, so you saved a total of 9%. That's good, but it won't be enough to get you to the suggested 15%.

Review your retirement needs, and then be realistic about how much you're saving with the employer match. You might need to bump up your contribution in order to reach your goals.

Myth No. 2 | You Need to Know How to Invest to Participate in a 401(K) Plan

The number one reason participants don't participate in their 401(k) plans is due to a fear of investing. This does not have to be the case. Most modern day 401(k) plans offer a variety of ways to invest. If you are comfortable building a portfolio, then your plan should offer you a suite of funds to choose from. If you are looking for an auto-pilot solution, your plan should offer you Target Date Fund, a Risk Based Fund or even a managed option. Any of these choices allow you to set it and forget it.

Your plan should offer you assistance in selecting your investment allocation. Don't be afraid to ask for assistance if you don't understand your options.

Myth No. 3 | 401(k)s are Expensive

Recently, there has been a lot of talk about how expensive 401(k)s are. While there are some plans that come with high fees, the reality is that many plans are quite affordable. There are costs associated with running a 401(k) plan, but your employer is responsible for insuring those costs remain reasonable. The majority of plans do this.

Your plan provider or your employer should be able to explain to you, in simple terms, how much your plan costs, and what those fees are allocated to. It's also important to realize that none of the fees collected from your 401(k) plan go back to your employer. They go to pay required 3rd party vendors who work on your plan and invest your assets.

Myth No. 4 | A 401(K) Loan is a Benefit

401(k) plan loans are often seen as a benefit of a plan. In reality, they are quite the opposite. 401(k) loans can be really attractive – there is no credit check and often the rate is lower than a credit card. However, there are several ways that 401(k) loans can significantly damage your retirement savings.

More than 50% of all loans into 401(k) plans are never paid back. When a 401(k) loan is not paid back, it is distributed as taxable income. This means you will pay taxes on the outstanding balance of the loan, plus a 10% early withdrawal penalty. Ouch.

In addition, while you are using the proceeds from the loan, they aren't being invested and earning you money in your retirement account.

Myth No. 5 | You Don't Need to Worry About Tax Planning

Because a 401(k) is a tax-deferred account, many people forget about the tax planning. After all, you get a tax deduction now. What else is there to worry about?

A lot of the tax planning with 401(k)s happens on the other end, when it's time to withdraw and use the money. When you withdraw, you pay taxes at your regular marginal rate. You will need to plan for taxes then.

Whether or not you participate in a 401(k) plan, it's always a good idea to see a financial professional about coordinating your withdrawals with other benefits, like Social Security. Also, if you have a spouse, you will need to coordinate withdrawals from his or her retirement account and plan around those Social Security benefits as well.

Tax planning with a professional is always a good idea, now and in the future. Don't assume that just because you have a 401(k), you don't need it.

The Bottom Line | The 401(k) plan can be an excellent tool for building your retirement nest egg, but it can't be used in isolation. Take the time to learn about your 401(k) plan and consult with a financial professional about your tax and retirement savings plans.

For more information, please call **407.585.1160**