AdviceIQ Trusted. Financial. Guidance.

Guidance
Find opportunities. Avoid traps.

The 401(k) Ignorance Factor

Submitted by Wayne Fourman on Tue, 09/30/2014 - 12:00pm

Too many Americans don’t understand how their 401(k) plans work, and how to take full advantage of this excellent retirement savings vehicle. Such neglect is very harmful to their long-term well-being.

In a defined contribution (DC) plan such as a 401(k), a chunk of money each year is invested for your retirement. You contribute a slice of your pre-tax pay to the plan, and some companies match your contribution full or in part. That arrangement has increasingly replaced the old pension system, known as defined benefit, where you were guaranteed a retirement payout based on your final pay and years of service.

Seems simple and it is definitely widespread. But lack of awareness or understanding is the main reason employees fail to join in to best use such a plan, according to Deloitte’s Defined Contribution Benchmarking Survey. As correctly noted in the survey:

“DC plans like the 401(k) were not intended to be the sole – or even primary – retirement [savings] vehicle of the American worker. However, as access to retirement income sources, such as employer-sponsored defined benefit plans continue to decline and Social Security benefits are not the sure thing they used to be, DC plans now represent the main source of future retirement income for a wide – and growing – majority of the workforce.”

A recent TIAA-CREF Financial Services survey also finds that respondents are not taking necessary steps to make sure they hold the right investments in a retirement account.

Market trends and life stages are factors triggering need for adjustments to your investment allocation. The survey finds, though, that 25% of workers never changed how their money is invested and 28% last changed investment allocations at least more than a year ago.

Among other TIAA-CREF findings:

- More than half (53%) of employees with company retirement plans were not automatically enrolled in company plans. Of those employees, more than a third (37%) waited six months or longer to enroll; almost one in four employees waited a year or more.
- More than half (57%) of workers did not increase plan contributions after their last raise, most often citing an immediate need to pay expenses. A quarter did not up contributions after the last pay hike because they already contributed the maximum annual amount to their plan; men (33%) were nearly twice as likely as women (17%) to contribute the maximum.

Maybe we need to apply what President Ronald Reagan said about the Russians' promise to reduce nuclear weapons: "Trust, but verify." Theoretically you can trust any properly implemented retirement plan – but you need to verify that yours heads in the proper direction.

Two of the biggest questions:

How do you become more involved in your company's 401(k) when most employers (and probably yours, too) communicate in a group setting with little one-on-one interaction?

- Tell your employer that like most humans you like personal contact.
- Seek out a qualified financial advisor. Many participants do not realize that financial advisors can explain most details of a 401(k).

How do you improve your overall retirement outlook?

- Take more interest in your retirement planning and don't shoot in the dark when it comes to planning. Again, find personal help.
- Coordinate your 401(k) with your Social Security, your health savings account and with other investments you use to save for retirement.

Follow AdviceIQ on Twitter at @adviceiq.

Wayne Fourman, with the May Financial Group in Greenville, Ohio, has served individuals and businesses with personal financial counseling since 1983 and provides 401(k) participant help.

Topic:
Investing
401K
Retirement Planning