

Understanding 401k Plans

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A 401k plan is an employer sponsored retirement plan that allows you to save for retirement. This plan is usually a benefit that your employer offers when you begin your employment with them and may require that you wait a specified period of time until you can begin contributing to the plan.

How Does it Work

The 401k plan allows you to save money for retirement by using pretax dollars from your paycheck. By doing this, it lowers your overall gross income. Your contributions then grow tax deferred until you are ready to use them.

When you sign up, you determine how much you want to contribute to the plan. This also determines how much your employer will match, if your employer matches your contributions. You will also decide at that time how your contributions will be invested and who the beneficiary will be.

Withdrawals

Since a 401k plan was designed to be used for retirement, withdrawals are not allowed until the age of 59 ½ without penalty. Furthermore, withdrawals are required by the IRS no later than age 70 ½.

401k loans

Most 401k plans do allow a loan feature. However, because it is not required by law, it is based on the plan. If your employer is a small business, they may not be able to afford to offer a 401k loan feature. The 401k loan is attractive because there is no credit check and because generally the interest rate if very loan, usually 1 to 2% higher than prime. However, keep in mind, should you decide to take a loan from your 401k plan and then leave your employer, before you can rollover your 401k, the loan would have to be paid in full.

Choosing an Investment

Since a 401k plan is just a retirement vehicle, there are usually many investment options within the plan to choose from. Sometimes choosing which investment or investments that is right for you can be very tricky. Many 401k plans have an administrator that is a Financial Advisor. Ask to set an appointment with that person so that you can seek guidance from that person. Before you can choose an appropriate investment, it is important to understand the following:

- Your time horizon until retirement
- Your risk tolerance
- Have you ever invested before, if so, in what?
- How would you feel if the market dropped by 10 or 20%?

Summary

As you can see, 401k plans play a significant role in saving for your retirement and are a great place to start if you have no retirement plan. If you are unsure if your employer offers a 401k plan, see your Human Resources representative today!