BUILDING FINANCIAL SECURITY

The ABCs of 401(k)s

One of the ways to save and invest for retirement may be right where you work, through a 401(k) plan. If you're in the government or a nonprofit, your plan might be called a 457 or 403(b). They all generally work the same way, but each has its own rules. Here's what you need to know about making the most of your retirement savings plan at work.

STEP 1: SIGN UP

The only way you benefit from the plan is to actually sign up for it. Since lots of people never get around to it, many employers automatically enroll employees into the plan. If you haven't signed up and weren't automatically enrolled, contact human resources to find out how to participate.

STEP 2: DECIDE HOW MUCH TO SAVE

Once you're a participant, decide how much of your pay to contribute, and the amount you pick will come right out of your paycheck into your 401(k) account. Aim to save at least 10% to 15% of your income. The later in your career you start, the more you'll have to save to build your retirement nest egg.

For tax year 2020, you can contribute up to $19,500. You can make an additional "catchup" contribution of $6,500 if you are age 50 or over. Plan to increase your contribution each time you get a pay raise.

An important part of deciding how much to save is figuring out how much you'll need. Visit www.aarp.org/retirementcalc today. It will help you determine if you're saving enough, how much you'll need, and when you can retire.

STEP 3: TAKE THE MATCH

Does your employer offer a matching contribution? For example, your employer might contribute $1 for every $1 you save, up to a certain percent of pay. Include this amount in your contribution planning.

Let's say your goal is to save 15% of your pay. If your employer contributes 5%, then you should contribute 10% to hit your goal. Visit www.aarp.org/401kcalculator to see how much your 401(k) can grow and the impact that the employer match has on savings.

STEP 4: CHOOSE YOUR INVESTMENTS

Your plan may offer lots of investment options. What's right for you will depend on things like your age and your comfort with taking investment risk. While the decision is yours to make, here are some guidelines:

- Most plans offer mutual funds. These are made up of a bunch of different investments. A stock mutual fund, for example, holds shares of publicly traded companies. Instead of buying a single company's stock, therefore, you are spreading your risk within the asset class of stocks. Other asset classes may include bonds (think of these as loans to companies or governments) and cash (which may include certificates of deposit or CDs and other low-interest investments).
- Avoid putting all of your contributions into one asset class. Instead, contribute some to stock funds and some to bond funds, for example. That way, if one asset class is doing poorly, chances are the other is doing better.
- To mix up your asset classes using just one fund, you may have the option of a target date fund. These offer a mix of stock, bond and cash investments that change as your retirement date nears. Say you plan to retire around 2035. You'd pick a target date 2035 fund, and the managing of investments is done for you.
- If one of your investment options is employer stock, go easy. If your company fails, your 401(k) assets go down the drain with it.

STEP 5: LOOK AT FEES

Each investment fund comes with a fee, which is a percentage of your holdings. If a mutual fund charges a fee of 1.5% then it has to earn at least 1.5% just for you to break even. Fees vary from plan to plan and fund to fund. Index funds tend to have low fees compared to actively managed funds because they simply track a basket of investments that aren't managed by a team of professionals. If you aren't sure how to look up the fees your
investment funds charge, contact your HR department.

STEP 6: KEEP IT GOING

The whole idea of a 401(k) plan is to save for retirement, so don't work against it. Avoid taking a loan from your plan for these reasons:

- The money can't grow if it's not invested in your account.
- You may have to pay loan fees.
- You have to pay the loan back in full if you change jobs.
- If you can't pay the loan back, you pay taxes and penalties.

When you change jobs, avoid cashing out your retirement account, even if the amount seems small. You can leave it with your old employer, roll it into your new employer plan or you can roll it into an IRA. All of these options are better than cashing out. If you take the money, you'll pay income taxes plus a 10% penalty.

TAKE ACTION!

- [ ] If you aren't participating in your work-based plan, sign up today.
- [ ] Know how much you need to save. Visit www.aarp.org/retirementcalc for a simple way to set a retirement savings goal.
- [ ] Try to save 10%-15% of your income. Include the employer match in your goal if there is one.
- [ ] When you get a raise, give your retirement savings a raise, too.
- [ ] If you leave your job, keep your account where it is or roll it into your new employer's plan or an IRA. Don't cash it out–even if the amount seems small.
- [ ] Read more about money and retirement at www.aarp.org/retirement.