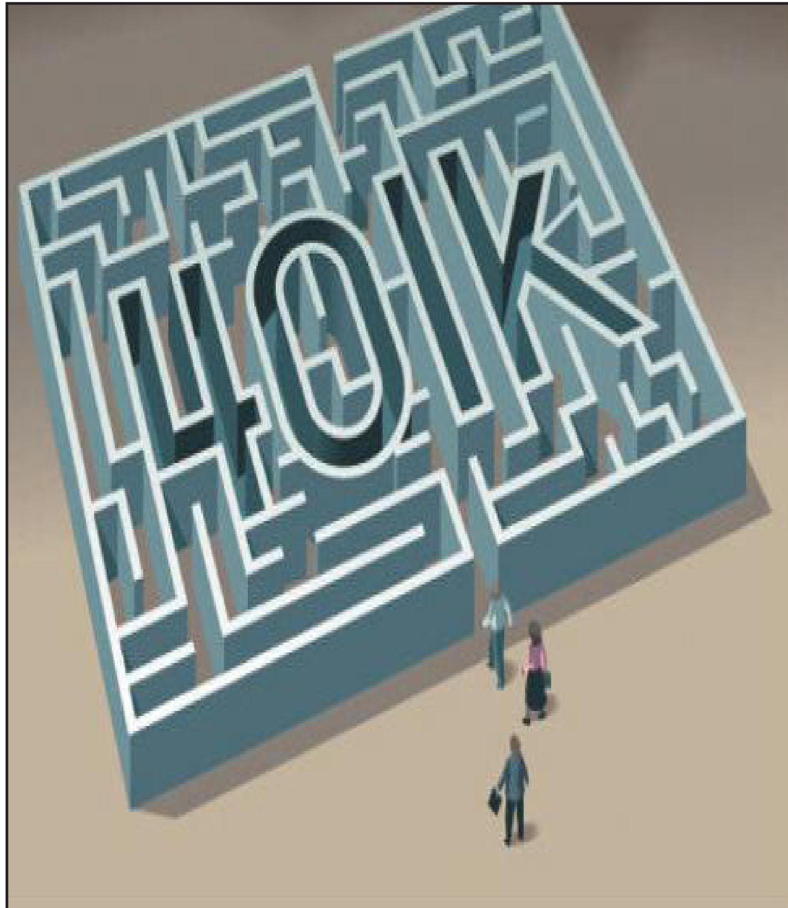
Why You Should Participate in Your Employer's 401(k) Plan

By Ary Rosenbaum, Esq.

Whether your employer has set up a new 401(k) plan, or you are now eligible to participate, or deciding to participate after years of not deferring, you will have many questions concerning participating in the plan. The decision you make with participating in your employer's 401(k) plan will have far reaching consequences that can last a lifetime. While that seems daunting, this article is going to try to clear up any trepidation you may have about actively participating in your 401(k) plan. So this article is why you should participate in your employer's 401(k) plan and things you should be aware of to make sure that participation will be a rewarding experience.

It's An Employee Benefit

While you are probably more concerned with employer provided benefits that impact you today like health insurance, dependent care spending, and free coffee; you should never lose sight that a 401(k) plan is an employer provided benefit. While people may criticize the effectiveness of 401(k) plans, they have yet to find a plan that is better in being cost effective. There are enough businesses out there that don't have any retirement benefits or they may have a small business employer plan that limits the amount of money you can defer, so it's a plus that your employer has a 401(k) plan. Like any employer provided benefit, what matters is how you use it and you should use it.



You are never too young to save for retirement

When I became a participant in a 401(k) plan for the first time at age 27, my mother wondered why I bothered to save for retirement since it was 35-45 years down the road. My mother has as much financial sense as that nation of Greece. You are never too young or too old to save for retirement. Our country has a retirement crisis. Too many businesses, governments, and union employers have ditched employer funded pension plans because they can no longer foot the bill. In addition, Social Security is looking more like a financial investment offered by Bernie Madoff. Even if it isn't a Ponzi scheme, Social Security can't support retirees fully who have aspirations of living above the poverty line. Thanks to dollar cost averaging and the compounding of interest/ capital appreciation, you will lose a ton of a lot more money than the money you decided not to defer in your 401(k) plan. The further you delay in saving for retirement, the further you will put a hole in your retirement savings. While I know times are tough and everything seems to be going up except your pay, anything you can save in your 401(k) plan will help you in the long run. Too many people think about just today, but there will be a tomorrow and you can't work when your mind and/or body has decided to retire.

Employer contributions are "free money"

While 401(k) plans are mostly funded by salary deferral contributions, many employers do make contributions to their employees out of their own pocket. It's important you understand whether your employer provides contributions to the Plan and what type of contributions they are. Your Employer can make a discretionary non-elective contribution known as a profit sharing contribution (yes, that's a mouthful). Even though your Employer doesn't need profits to make a profit sharing contribution (yes, it's even confusing for some of us in the retirement plan industry), you should know that such contributions are made, based on a

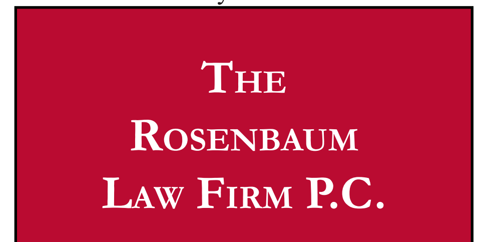
percentage of your compensation. That means such contributions don't require you to make 401(k) salary deferrals, but may be conditioned on you working full time or working on the last day of the Plan Year (usually December 31st). The other contribution that your employer may make is a matching contribution. As it names implies, the matching contribution is made to match a portion of the 401(k) salary deferrals you make to the plan. The formula may vary, so you should find out what it is. Under the matching contribution formula, you get nothing if you defer nothing. That's important to know because by not deferring or in some cases, not deferring enough (if the matching contribution matches deferrals in excess of what you are contributing), you are essentially leaving money on the table by not partaking in the "free" money your employer is willing to set aside for your retirement. These employer contributions may require you to work as many as six years to fully keep your employer contributions if you terminate or they may be 100% vested at all times (especially if the employer contributions are "safe harbor" contributions in order for the plan to automatically pass its discrimination tests). The size and requirements of any employer contributions is important not only for your retirement savings, but it's a gauge as to whether your employer has enough benefits for you to stay. I worked at a semi-prestigious law firm on Long Island where I had to deal with a snobby Managing Attorney and law firm partners who wouldn't give me the time of day because I was an associate. However, the law firm offered a 5% profit sharing contribution that was fully vested at all times. So that was one way to stomach the Managing Attorney who was a namedropper and all the lousy or non-existent benefits we had. We had a human resources director who badly managed the plan (until I helped her) and I kept on insisting to her that she should trumpet the fact that employer contributions were rather generous.

Make sure you get the education to make investment decisions

With the 401(k) plan that your employer has, it's more likely that you direct the investments under your own account. If you love personal investing, that's great. If you don't, that can become a nightmare. Plan participants who have no background in investing and who receive no help from their employer in providing investment education or advice tend to do at least 3% worse as an annual rate of return than 401(k) participants who receive some level of investment education and/or advice. Investment education is general information regarding investing, while investment advice is advice specific to your financial goals and the investments in the plan. Simply handing out Morningstar profiles or the list of investments under the Plan isn't education. If your employer doesn't offer any type of investment education or advice, ask them whether they will provide it because it will help their employees like you save for retirement as well as limit their potential liability as plan sponsors.

It costs money to run it, but its one of the most cost effective investments

As a participant in the 401(k) plan, you will receive a quarterly statement that will also include the expenses charged to your account. As with anything, it does take money to run a 401(k) plan and in most cases, these costs are borne by the plan participant. You should review the expenses charged to your account and determine whether these fees are reasonable or not. A great resource for you is Brightscope.com, which is a 401(k) participant friendly website that can easily identify issues with your plan by assigning it a score. The score is dependent on plan expenses, investments, and employer contributions. If you find out that the expense in your plan are excessive, when compared to plans of similar size, it maybe a great opportunity to speak with your employer on trying to contain these expenses because high fees can negatively impact your retirement savings. While it does cost money to run a plan, a 401(k) plan is still probably the most cost effective retirement plan product out there because if your plans has the right providers, you are getting experts in retirement administration and investments that you probably couldn't afford on your own.



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