

## ICI VIEWPOINTS

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## Investing Basics: Saving for Retirement with a 401(k) Plan

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*As part of the ICI Education Foundation's 30th anniversary celebration, we are sharing a series of ICI Viewpoints posts explaining basic investing concepts, drawn from the ICI Education Foundation's Investing Road Trip.*

When I first moved to the Washington, DC, area, I got lost constantly. I was accustomed to looking for green road signs for directional guidance. Those brown recreational signs? I pretty much ignored them. But in and around Washington, the National Park Service manages more than 265 miles of roadway where brown signs contain important information for drivers—like, say, the exit to the airport.

Similarly, the ICI Education Foundation's Investing Road Trip contains road signs with basics for investors meant to point the way to investing success, and the journey ends at retirement, depicted with idyllic images of a park bench and a golf cart. But what if, in real life, you don't quite follow this tidy path? Even for workers who get a late start, hit some bumps, and take a few detours, saving for retirement is still possible.

More than 58 million active 401(k) participants and millions of former employees and retirees hold [\\$5.6 trillion in assets](#) in 401(k) plans. Employers offer 401(k) and other similar plans to attract talented

workers and to provide them a valuable benefit—but employees still must be sure to make the most of that benefit. Here are guideposts to get you started, maintain your progress, and make the most of your 401(k) as you journey to retirement.



## **Saving for retirement at work**

Many employers offer a retirement plan—the 401(k) plan is the most common—and even help workers save more by adding money to their accounts. These plans let you choose from a variety of investments and save automatically from every paycheck.

## **Just Getting Started or Starting a New Job**

As the saying goes, a journey of a thousand miles begins with a single step. That first step, if you have a 401(k) plan available to you, is to make sure you're enrolled in it. Some employers automatically enroll employees in 401(k) plans, selecting a default initial contribution rate and a default investment, unless the employee indicates otherwise.

If you're not enrolled automatically, you'll have to opt in and choose how much you want to contribute and how you want your contributions to be invested. You can build your own portfolio from the investment options available in your plan (on average, 401(k) plans offer [28 investment options](#)) and adjust your portfolio over time to maintain an appropriate, [diversified mix of assets](#).

If picking your own investments seems daunting, more than three-quarters of 401(k) plans offer target date funds among the investment options, which can simplify portfolio building. Each target date fund holds a diversified mix of stocks and bonds that is automatically rebalanced depending on the target date, which is usually your expected retirement year.

## **Balancing Competing Financial Demands**

[Saving for a far-off goal](#) such as retirement can be challenging, especially when near-term obligations are pressing. But even when balancing saving for major financial goals—such as college costs or a home purchase—with retirement, you should at least try to contribute enough to your 401(k) plan to maximize your workplace benefits.

Employers contribute to workers' 401(k) accounts in [eight out of 10 plans](#), and often base their contributions on how much the employee contributes. The formulas for these contributions vary by employer, but the most common approach is a simple match, where the employer matches a certain percentage of employee contributions up to a maximum percentage of employee salary. Not maxing out the match is leaving money on the table—money that is a valuable part of your employee benefit. Review your contribution rate to make sure you are at least taking full advantage of any match your employer offers.

Depending on your situation, you may want to go beyond maxing out the employer match to save even more.

## Experiencing Financial Hardship

The best thing to do during challenging times, if you're able, is to stay the course—and most retirement savers do. Despite the economic stresses brought about by the COVID-19 pandemic, only 2.0 percent of participants in 401(k) and 401(k)-style defined contribution plans stopped contributing to their plans in the first half of 2020, according to [recent ICI research](#). The most important thing to remember, if you do have to pause your 401(k) contributions, is that you start contributing again when you are able.

## Changing Jobs

When leaving a job, avoid the temptation to cash out of your employer plan, even if your account balance is small. Research has shown that younger workers are more likely to withdraw small account balances, even though they have the most to lose by missing out on the [future returns of those assets](#). Plus, if you do cash out, you could be hit with tax penalties.

So how do you maintain your savings—and the tax advantages of your workplace plan—when switching jobs? You'll likely have three options available: roll the money over to an individual retirement account (IRA), move it to a new employer's plan, or possibly keep it in your old employer's plan. IRA rollovers are especially appealing to those who want to consolidate their assets as they progress through their careers, rather than leave them behind in a series of former employer plans.

## Getting a Late Start

Even if you start saving for retirement later than you may have liked, all is not lost. While you may not have time to enjoy the full magic of compounding, the IRS does offer help to older workers by allowing for catch-up contributions. Savers aged 50 and older may make additional [catch-up contributions of \\$6,500](#) to their 401(k) or similar plans, on top of annual deferral limits of \$19,500 for tax year 2020. With this provision, workers who are ready to make retirement saving a priority can go a long way to

prepare in the run-up to retirement.

After a lot of U-turns, I finally learned to pay attention to the road signs here in Washington. I hope that the road signs in this series and in the Investing Road Trip offer helpful guidance, wherever you are in your journey of saving and investing.

## **Other Posts in the Investing Basics Series**

- [What Is Investing?](#)
- [What Is Risk?](#)
- [Types of Investments](#)
- [Diversification](#)
- [Dollar-Cost Averaging](#)
- [Benefits of Mutual Funds](#)
- [Tax Benefits to Encourage Saving](#)
- [529 Savings Plans](#)
- [Compound Returns and the Power of Reinvestment](#)
- [Understanding Fees and Expenses](#)
- [Saving for Retirement on Your Own](#)
- [Saving for Retirement with a 401\(k\) Plan](#)

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