ICI VIEWPOINTS

February 26, 2016

Getting Started in a 401(k) Plan—and Getting the Most Out of It

This week, ICI and the Investment Company Institute Education Foundation (ICIEF) joined thousands of corporations, nonprofits, and government agencies to celebrate America Saves Week. This annual campaign encourages Americans to assess their financial situations, set savings goals, and implement plans to achieve them.

Research from ICI suggests that most mutual fund owners are already on the right track in this regard. By and large, mutual fund–owning households are focused on achieving long-term goals, with 91 percent saying that saving for retirement is one of their financial goals, and nearly three-quarters indicating that retirement saving is their primary financial goal.

The need to meet that goal is bringing more investors to mutual funds. Employer-sponsored retirement plans are increasingly the gateway to mutual fund ownership: 67 percent of households that purchased their first mutual fund in 2010 or later purchased it through an employer-sponsored retirement plan.

Getting started in your employer's retirement plan is a crucial step toward retirement readiness—but it's also important to make sure that you're taking full advantage of the benefits it offers. Sarah Holden, ICI senior director of retirement and investor research, offers three key ways that workers can be sure they're making the most of their 401(k):

1. Max out the employer match. Most—three out of four—401(k) plans feature employer contributions to plan participants' accounts. The formulas of 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. 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 just maxing out the employer match and save even more.

Although 401(k) plans are often designed to encourage plan enrollment and adequate savings rates, participants are free to determine their own contribution levels or to opt-out of enrollment altogether. But even if it may seem like a stretch to save, do yourself a favor and at least max out that employer match.

2. Decide on your investment approach. This step comes down to what kind of investor you are: are you a do-it-yourselfer, wanting to build your own portfolio from the options available in your plan? (On average, 401(k) plans offer 27 investment options.) If so, you will have to adjust your portfolio over time, to maintain an appropriate mix of assets. It's

also important to remember your long-term strategy despite potential day-to-day volatility of the markets. Generally, ICI research finds that plan participants do not overact to market movements; instead, they make modest levels of changes to their asset allocation. For example, in 2014 only 10.5 percent of participants in 401(k) and similar plans changed the asset allocation of their account balances, and 6.6 percent changed the asset allocation of their contributions.

If picking your own investments seems too daunting, you may want to consider investing in a target date fund. Each fund holds a diversified mix of stocks and bonds that is automatically rebalanced depending on an expected retirement year. Nearly three-quarters of 401(k) plans offer a suite of target date funds in their lineups, so it's likely your employer does.

3. Preserve your nest egg when you change jobs or retire. First and foremost, 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, despite the fact that 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.

Second, consider your options: you can roll the money over to an IRA, move it to a new employer's plan, or possibly even keep it in your old employer's plan. Most households that own traditional IRAs with assets from a rollover researched their decision in a number of ways, including consulting professional financial advisers, financial services firms, and materials from their employer. 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 former employer's plan.

Campaigns like America Saves Week are a great tool for spreading awareness of the importance of saving and investing. But we have to go beyond awareness—to action. If you're one of the millions of Americans who are focused on saving for their future in an employer-sponsored retirement account, the three steps above will help you make the most of your retirement plan.
