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Avoid These Common 401(k) Mistakes to Stay on Course

Saving for retirement is, without question, a journey. And like any journey, even the slightest wayward turn can send you off course, making it more challenging to arrive at your destination. Below are four common mistakes every retirement investor should avoid, along with some suggestions for course correction.

Mistake #1: Leaving Free Money on the Table

Most employers (92 percent, according to the 2019 Deloitte Defined Contribution Benchmarking Survey) help employees save for retirement by matching a portion of the money workers contribute from their paychecks. Are you taking full advantage of this benefit? If not, you're missing out on free retirement funds!

Fortunately, this mistake is an easy one to fix—simply bump your contribution percentage up to *at least* the maximum contribution match your employer offers. For example, if your company will match up to 50 percent of the first 6 percent you defer out of your paycheck (a common retirement plan match formula), then you should strive to make 6 percent your *minimum* contribution rate. If you defer less, you could be making an expensive mistake. Matching formulas and eligibility requirements vary by company, so contact your Human Resources department to find out what your employer offers.

Mistake #2: Keeping Savings Rates Static

Choosing to contribute to a 401(k) is a monumental achievement, as it kick-starts your retirement savings journey. But enrolling in your company's retirement plan is merely the first in a series of actions you should take to make your financial future more secure. Incrementally increasing the percentage of your paycheck that you put away for retirement is an important step toward continuing your savings momentum.

Let's look at an example:[1] Julia, age 35, earns $50,000 annually. She enrolled in her company's retirement plan and is deferring 2 percent of her paycheck. If Julia continues to defer 2 percent of her salary until she retires at age 67, her savings would be $100,810—not bad, Julia! But what if she increased her contribution rate by 1 percent each year until her rate was 15 percent? If she did, her account value would be $562,242—an improvement of **$461,432**! But let's not stop there. If Julia took advantage of a company match, as described above, her account value would be $701,886—**$601,076** more than if Julia's saving rate had remained static.[2]

So, consider gradually increasing your contribution to your retirement plan. Or, even better, see if your retirement plan offers a feature that automatically bumps your contribution rate by 1 percent annually if you provide a onetime authorization. As evidenced by Julia's example, small changes really do make a big difference.

Mistake #3: Not Being Prepared to Plug the Savings Leak

Retirement plans are designed to be a long-term savings vehicle. And taking out loans or premature withdrawals while you're still working or cashing out when you change employers—known as retirement plan leakage—can cripple long-term savings goals and deplete the account balances you worked so hard to build. Why? Because those transactions can trigger costly taxable events and, in some cases, early withdrawal penalties—not to mention put you behind the eight-ball as you try to replenish your lost retirement savings.

But let's face it. Life is full of surprises, and quick cash to pay for an unexpected expense is sometimes a necessity. To prepare for life's curveballs, think about opening an emergency fund (i.e., money set aside for when you're in a financial jam). Having easy access to funds that are dedicated to helping you through tough financial times will alleviate the need to dip into your retirement savings.

Mistake #4: Off-the-Cuff Investing

For many people, investing can feel intimidating. Often, do-it-yourself investors select an asset allocation mix that doesn't align with their financial goals or investment objectives. Further, inexperienced investors may find it difficult to separate the emotional aspects of investing from the calculated, dispassionate decision-making successful investing often requires.

[1]Source: dinkytown.net. The following assumptions were used to make these calculations: Julia's age when she begins contributing: 35; age at retirement: 67; annual salary: $50,000; beginning account balance: $0; annual expected salary increase: 2 percent; annual rate of return: 5 percent; employer match: 50 percent up to 6 percent of salary deferred.

[2]This is a hypothetical example and is for illustrative purposes only. No specific investments were used in this example. Actual results will vary. Past performance does not guarantee future results.

Fortunately, options are available for those who don't feel comfortable choosing their own investments. Target-date funds (TDFs), available to most 401(k) plan investors, are professionally managed mutual funds that automatically allocate the appropriate mix of stocks, bonds, and fixed income products based on the date an investor expects to retire. In short, TDFs take the guesswork out of the equation for novice and seasoned investors alike. Another option is to enlist the help of a financial advisor, either on your own or through your company's 401(k) plan. Regardless of your investment aptitude, working with a trained investment professional will allow you to put his or her investment acumen, experience, and specialized expertise to work for you.

Understanding Your Plan: What Is Vesting?

If your employer offers to deposit money into your retirement account, you may be wondering what it means when that money is subject to a vesting schedule. *Vesting* refers to the ownership of a retirement plan account balance. If your employer makes matching or profit-sharing contributions to your plan, you may be required to wait for a specified period until you can claim ownership of those funds. The amount of time you must wait is tied to when you became eligible for the contribution and how long you have worked at your company.

Vesting schedules vary from company to company, and they come in two kinds: *cliff* and *graded*. Cliff vesting is when employees become 100 percent vested after a specified period (e.g., after five years of service). Graded vesting is when employees become partially vested each year that they work for their company until they achieve 100 percent vesting.

For example, if your company has a five-year graded vesting schedule, your funds would be 20 percent vested after one year of service, 40 percent vested after two years of service, and so on until you hit 100 percent vesting at five years of service. If you leave your company, any unvested funds will go back to your employer. Once funds become vested, however, you own them, and your employer cannot take them back.

Remember that any money *you* contribute to your retirement plan from your paycheck is always 100 percent vested. And, according to IRS standards, the longest you will ever have to wait to claim ownership of employer contributions is six years. To find out what your company's eligibility requirements and vesting schedule are, reach out to your Human Resources or Benefits department.

What Motivates You? Pursuing Your Ideal Retirement Lifestyle

A popular goal-setting acronym is SMART (**S**pecific, **M**easurable, **A**chievable, **R**elevant, **T**ime Bound). In any aspect of life—whether it be your career, your hobbies, or your relationships—SMART principles provide a clear structure around which to center your goal-setting strategy.

When it comes to planning for financial security in retirement, a great first motivation is to define what your *specific* retirement dream looks like.

Transamerica's 19th Annual Retirement Survey asked American workers how they dream of spending their retirement. Here are their answers:

- **67 percent** said they would like to spend time with family and friends.
- **57 percent** said they would like to pursue hobbies.
- **48 percent** said they would like to do volunteer work.
- **30 percent** said they would like to do some form of work (e.g., pursue a new career, start a business, or continue to work in the same field).

Do you share the same retirement dreams as the respondents in the survey? Or are yours different?

Exercise: Spend a few minutes visualizing the specific lifestyle you want in retirement. What are you doing that makes you happy? Where are you doing it? Who are you surrounded by? What will you need financially to turn your dreams into reality? Being clear about your expectations and aspirations for your life in retirement can help you set specific goals and develop a plan to achieve them.

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