



UNDERSTANDING YOUR 401(K)

More and more employers offer a 401(k) plan for retirement savings. This can be a great benefit, but you might not really understand why you should be excited about this or how to best take advantage of such a plan. Does it feel like there is a lot to understand? Well, that's because there is. While 401(k)'s were established to allow employees to contribute a portion of their paycheck, many employers do little to help you understand all the decisions you are about to make and why they really do matter.

Let us dive into some of the features of your 401(k) and some action items to keep in mind along the way.

When am I eligible to contribute?

Depending on the terms of your employer's plan you may be eligible to contribute immediately as a new employee. Other plans have what is called a "waiting period" that requires you to wait until you have been with the firm a certain amount of time before you can begin making contributions. This should be discussed with your manager or human resources to understand your specifics. Once you are eligible to contribute, you will need to determine the amount you would like to contribute through automatic payroll deductions.



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Action Item: Verify when you are eligible to start contributing to your retirement program and be sure to respond to any emails or set up links you receive from the 401(k) administrator- check with colleagues if you receive a notice you don't recognize as 401(k) administrators are often completely different companies than your employer.

Am I the only one that contributes to my 401(k)?

Both you, as the account owner, and your employer can make contributions to your 401(k) up to certain dollar limits set annually by the IRS.

As the employee you can contribute 25% of your salary up to \$23,500 in 2025. If you are 50 or older you may contribute an additional \$7,500 for the year. You can choose to contribute either a percentage of your salary or a specific dollar amount to come out of each paycheck. Under the SECURE 2.0 Act, individuals aged 60-63 can make a larger catch-up contribution of \$11,250.



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“Be sure to respond to emails or set up links from your 401(k) plan administrator.”

Contributions come out of your paycheck automatically and are deposited into your 401(k) account. It is good practice to review your contributions on a yearly basis.

Employers can also additionally contribute to your account, but they are not required to do so depending on the type of 401(k) plan. Your employer may offer a matching contribution which means they will match your contribution up to a certain percentage of your salary. If, for example, you choose to contribute 10% to your plan, your employer may only match up to a set percentage, such as 3%. Your employer may also elect to contribute a certain

percentage of your salary regardless of what you contribute. If your plan is a considered a “safe harbor” plan for the purposes of meeting certain 401(k) structural requirements, then your employer will either match your contributions up to 3%/4% or they will contribute 3% of your salary regardless of your contributions.

Action Item: Make sure you understand what your employer is offering. If they require you to make contributions to receive the match, you want to make sure you are meeting the threshold so not to leave money on the table. Check with your employer to see if they offer a Roth 401(k) and consider adjusting your contributions. Work towards trying to contribute the maximum amount each year. Lastly, make it a point to review your contributions on a yearly basis and especially when you receive a raise, make it your goal to contribute the maximum each year.

Finally, your employer may also make a profit-sharing contribution to your 401(k) if that is part of your plan. This is a discretionary additional contribution each year. With an employer match and profit sharing, the total contribution into your 401(k) each year is limited by 25% of your total salary or \$70,000 in 2025.

Which 401(k) option is right for me?

Today, many plans offer a choice of contributing to a traditional pre-tax 401K or to a Roth 401K. The plans offer their own pros and cons. Let’s review which may work best for you.

Traditional pre-tax 401(k)

Contributions made to a traditional 401(k) are made pre-tax. This means that contributions come out of your salary before taxes are calculated. Pre-tax contributions lower your taxable income which may result in lower taxes for that year. Your savings will continue to grow in your account, and you will be protected from having to pay taxes for as long as the funds remain in the account. Once you begin taking withdrawals you will be required to pay ordinary income taxes on the distributions- this includes both money you contributed as well as the growth in your balances.

At a certain point all owners of traditional 401(k) accounts are required to take distributions, known as required minimum distributions or RMD's. At the latest, these will be required when you stop working and reach age 75. At that point, if you have a large account, you could be required to take big distributions in retirement which could push you into a higher tax bracket than expected.

Roth after-tax 401(k)

The other option maybe a Roth 401(k). Most high earners think they can't contribute to a Roth 401(k) due to income limitations, but that only applies to Roth IRA's and not Roth 401(k)'s. With a Roth 401(k), contributions are made after taxes in your paycheck. Although you are paying taxes on the money going in today, you will pay no taxes on the



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“Most high earners think they cannot contribute to a Roth 401(k) due to income limitations, but that is not the case.”

distributions going out. Another major benefit of a Roth 401(k) is there are no required minimum distributions or RMD's, like there are with a traditional 401(k). Since you will have already paid the taxes on the contributions, both your contributions and the growth can be withdrawn in retirement completely tax free.

We typically suggest contributing to a Roth 401(k) since it is a great savings vehicle with meaningful benefits. We recognize that switching 100% from a traditional to a Roth 401(k) may have a significant impact on your current taxes and your take home amount. So consider splitting your contributions 50/50 to both a traditional and a Roth 401k for

a period of time and continue to adjust your allocation over time. If you decide to contribute to both a traditional and a Roth 401(k) your total contribution may still not exceed the maximum amount for that specific year.

“When reviewing your 401(k) investment options, keep it simple and as low cost as possible.”

If you are contributing 100% to a Roth 401(k), your employer contributions will always be pre-tax contributions which means you will also have a traditional 401(k) account. This is important to know in the event you leave your current employer; you will need to know that you may have two different accounts for the same 401(k).

How should I invest my 401(k)?

In most cases the plan administrator may not offer advice on how to invest your account and this can leave you wondering if you're making the right selections.

Most 401(k) plans offer what are called target date funds as a default investment. These funds may seem like the easy option but may not be the best longer term. We don't typically recommend these types of funds because of their cost and their poor track record for adjusting to changing market conditions over time. We prefer a simple allocation using funds with the lowest costs available. In most cases

Action Item: Review your allocation on a yearly basis. Pay attention to communications from your plan administrator if investment options or fees are changing year to year. Work with your advisor to review your 401(k) allocation.

selecting a large cap fund like an S&P 500 or a Total Market fund and a small cap index fund is all you need. Depending on your risk tolerance you may choose to add a bond fund or income fund to be more conservative or an international fund to be a bit more aggressive. When reviewing your options, you want to keep it simple and as low cost as possible.

Can I withdraw the funds in my account?

The simple answer is yes you can access the funds in your 401(k). Generally, if you take a distribution from a 401(k) you

will likely have to pay taxes and potentially early distribution penalties. Before taking a distribution from your 401(k), it is important to consider other resources to avoid these taxes and penalties.

In the event you still choose to withdraw from the funds, there are some exceptions that may allow you to avoid penalties. These include attaining age 59 ½, qualified medical expenses, hardship withdrawals and education costs to name a few. It is important to note that with each of these the IRS has certain rules that may allow you to access the funds with minimal taxes and penalties.

Another option might be a 401(k) loan. Some plans offer the option to borrow against your account but not all employers offer this, and it is important to confirm the terms with your plan administrator. The IRS allows a maximum loan of \$50,000 or half of your 401(k) account balance. Loan repayments may come directly from your paycheck. If you were to leave your employer, typically the loan will be due within 60-90 days, terms may vary depending on the loan

Action Item: While it is important to fund your 401(k), it is also crucial to have other savings aside. In a time of need you will want to be able to access an emergency fund or other savings before making withdrawals from your 401(k). This may mean contributing a little bit less to your 401(k) so you can also establish your emergency fund.

administrator.

Lastly, the rules are a little different with a Roth 401(k). Since taxes are paid before contributions are made, generally any withdrawals of your contributions are free from taxes and penalties. If the value of your withdrawal includes the growth in the account, then taxes and penalties might apply.

What happens to my account if I leave my employer?

You have a few options for dealing with old 401(k) accounts. Before transferring your account, you will need to confirm what portion of your 401(k) is made up of traditional and Roth contributions. This is important because traditional 401(k) contributions should be transferred to a traditional IRA to avoid additional taxes and Roth 401(k) contributions are transferred to a Roth IRA.

Contact the current plan administrator to confirm what information they require in order to get started with your desired strategy:

Rollover to your new employer's 401(k)



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“Funding your 401(k) is crucial, but so is having other savings set aside.”

your new employer has an attractive plan with low fees and a variety of investment choices, then moving over your old 401(k) is often a great choice. Before you make the move, you will need to confirm with your new plan provider that this option is available. Not all plans accept transfers from other 401(k) plans. If this type of transfer is allowed, your new plan provider will be able to walk you through the transfer process.

Stay with the current custodian

If you decide to keep your 401(k) at the current custodian, no further steps are necessary. It is important to note however, that some custodians will not maintain small accounts and they may also charge annual administrative fees for accounts that are no longer in an active plan. Additionally, you will want to log in to your account quarterly or at least twice a year to monitor account transactions and review your investment choices and allocations.

Rollover to an IRA

If you can't consolidate your accounts at your new employer or if you prefer to direct your investments going

forward, then distributing your old 401(k) to an IRA is a great choice. Setting up an IRA can be relatively easy, and it can even be done online. As previously mentioned, if your 401(k) is made up both pre-tax and post-tax contributions you will need to open a traditional IRA and a Roth IRA. If you already have a traditional or a Roth IRA you won't need to set up new accounts, but simply direct the transfer of the 401(k) account into the existing account. Once all appropriate accounts have been established, contact the current custodian to initiate the account transfer.

If the current 401(k) custodian allows for an "in-kind transfer" to the IRA(s), they will ask for your account information and transfer the assets for you. If the custodian requires you to liquidate your account to cash, a check will be cut and sent to you. The check will need to be deposited to your IRA within 60 days of the withdrawal to avoid a 10% penalty. Remember to make a copy of the check for your records just to be sure.



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Action Item: Be sure to review your options, consider your goals and evaluate the investment choices and administrative fee in various plans before determining what to do next.

Contributing to your 401(k) is one of the most important financial commitments you will make in building future wealth and comfort. So why do they make it so complicated? Start by taking using these action items to feel more confident in your plan and your decisions. Work to maximize your contribution to the annual IRS limit as soon in your career as possible and review your account once a quarter or at least annually. Now you will be setting yourself up for success. Work with your financial advisor to make sure you're on track for saving enough for your long-term goals.



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