401k Cram-session

Confess, you have avoided reading the plan rules in your 401k when you started a new position. In the first days of a new job, the onslaught of new job stress and healthcare open enrollment forces folks to prioritize tasks. This prioritization normally leaves a new 401k plan on autopilot. It surprises many people when we tell them that they are not the owner of the 401k and are considered a participant. As a participant you are subject to plan rules that are not uniform despite some high-level guidance from the IRS and Department of Labor. It is important to understand a few topics because of these inter-plan idiosyncrasies.

Vesting and Match: Employers determine what percentage they wish to match and how long employees need to remain employed to receive that match (your contribution is always yours.) You should take advantage of a match, since it is extra money, if you have the capacity to delay some of your paycheck until retirement.

Contribution Types: In addition to pretax contributions some plans allow post-tax dollars and Roth 401ks. Roth contributions are matched through pretax dollars. The post-tax option can create interesting strategies such as a mega-backdoor Roth. Contribution type selection needs to be well planned to avoid IRS headaches.

Investment Options: 401ks can offer a combination of the following investment options; mutual funds, ETF's, company stock and self-directed accounts. If you have a full financial plan, invest in the most tax efficient asset class that you are lacking (fixed income and alternatives match best for tax deferred assets.) If you don't have a financial plan and haven't a clue what to choose, select a target date or balanced fund, to act as a placeholder, until you better understand. Be aware of the internal fees as many funds spend a great deal of money to get on to these platforms. Don't assume a fund is for you just because it's available (you don't know the circumstance on which these funds were on-boarded to the platform.) The good news is that investment options in 401k plans rarely have transaction cost and you can frequently move in and out of different positions.

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In-Service Options/Loans: Some plans allow easy access to assets in your 401k whether you are active or separated from employment. Be hesitant of withdrawing or taking a hardship unless you qualify for an IRS exemption from a penalty. Extra income could potentially put you into a higher tax bracket so beware the amount your withholding.

Taking a 401k loan is acceptable if you have a plan to pay it back in any circumstance. Don't use a 401k as a piggy bank, since the interest you will pay yourself will lag most asset class performance over the long term. Interest that you pay is double taxed (deducted from post-tax paycheck and on distribution from deferred account.) Reference the plan rules to see if you can keep making payments if you separate from employment.

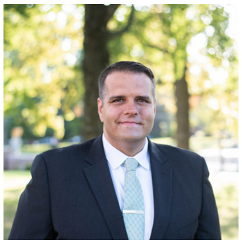
Employer Separation: There are five options (plus NUA) when you separate from an employer:

1. You can leave the 401k where it is (if the plan is continuing to exist, and you met the plan minimums.)
2. Cash it out and pay taxes and potentially penalty.
3. Roll it to a new employers 401k (one set of plan rules to another)
4. Roll to an IRA (more logistical flexibility but you either must pay someone to manage it or attempt to do it yourself.)
5. Covert to a Roth (pay the taxes for this tax year but all future growth will be tax free.)
6. NUA (Net Unrealized Appreciation)- Removes company stock from a retirement account and places it into taxable status. Participants who choose this are required to pay regular income (maybe penalty) on the cost basis but only long-term gains on the growth.

Each of these distribution options have their own advantages and disadvantages. It is important to understand your current situation and make decisions based on your complete financial plan. Anecdotally, we have witnessed participants overrule logic and cash out because they left on bad terms with the company and others refuse to make a change because of company loyalty.

Other considerations: Ownership in the plan sponsor can make things more restrictive then the rank and file employee (see active RMD's.) High income earners may want to front contributions early in the year to maximizes the amount that can be deferred (it will stop contributing once you hit the income limit.) We have seen plans get locked down, in crisis situations, for an indiscriminate amount of time. Never depend on a 401k as an emergency fund.

This insight is intended to bring additional awareness to the various capabilities available to investors through their 401k. This is not intended to replace a comprehensive financial plan.



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