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Retirement Account Basics

Overview: Your plan for saving for retirement may experience a great deal of change between your first job and retirement. No matter what changes or unexpected events occur, it is essential to continue saving.

The purpose of saving in a 401(k) plan is to provide you with a financially secure future. It sounds easy, but getting from Point A to Point B can be complicated. Economic factors and life events can affect even the best-laid plans. The following addresses common questions about retirement accounts including 401(k)s, Roths and IRAs.

What is the difference between a Roth 401(k) and a 401(k) account?
A Roth 401(k) allows you to contribute to your 401(k) plan with after-tax dollars and grow your money tax-free. A Roth 401(k) is not a separate account but rather a potential option within a 401(k) plan. When you retire, withdrawals from a Roth 401(k) are not taxed.

A traditional 401(k) allows you to contribute to your plan with pre-tax dollars, and your money will grow tax-free. However, when you retire, withdrawals from a traditional 401(k) will be taxed.

Is it safe to assume tax rates will decrease in retirement?
You should not assume your tax rate will be lower in retirement; this may not be the case. There is no one right answer for deciding how much to place in pre-tax and Roth accounts. If you expect to be taxed at a higher rate in retirement, you should save to the Roth 401(k). If you expect to be taxed at a lower rate in retirement, you should save to the traditional 401(k).

However, because we can only speculate about future tax rates, a good course of action would be to diversify the tax treatment of your retirement savings by splitting your savings between a traditional and a Roth 401(k).

What happens if the plan provider is in financial trouble?
Your plan is safe, even if an employer, plan provider, custodian or record keeper is in financial trouble. Your money is held in a trust, the assets are not owned and the funds are not subject to creditors. In the event of a company's decision to terminate your plan, you will receive notification and rollover forms. Your plan may go through some alterations, but your savings are secure.

Is it a good idea to keep multiple accounts from previous employers?
It is not unusual for an individual to acquire several retirement plan accounts over different phases of a career. When it comes to retirement accounts, simplicity is key. Having several plans may seem like a fail-safe in troubled times, but from a personal bookkeeping perspective, it will be easier to keep track of and maintain fewer accounts when retirement begins. Holding fewer accounts should also reduce account expenses paid over time.

If your current employer offers a plan with reasonable costs and diversified investment choices, consider rolling small accounts into your current plan (as long as your plan allows for incoming rollovers). If your employer does not offer reasonable options, such accounts can be moved into an IRA or Roth IRA.

Note: Roth 401(k) accounts are eligible for rollover distributions into Roth IRAs upon retirement or separation from employment. Traditional 401(k) accounts, on the other hand, can be rolled into regular IRAs.

Which one first? Saving for a child's college education or retirement?
Saving for retirement before saving for a child's education may seem surprising. However, it is a wise approach for securing the future for you and your family. One reason for prioritizing saving for retirement would be the financial stress potentially placed on a family if an individual reaches retirement age without enough saved to live independently.

While college loans are more difficult to obtain in today's economy, it is easier for a student to obtain a loan to pay for education than for a retiree with fewer options for borrowing. Ideally, of course, something would be set aside for each goal.

Now and later: Good times to save for retirement
When you save for retirement, you are saving for the long run. Over time, you should expect cycles of volatility. But when it comes to retirement plans, time is the greatest asset. If you ignore market noise and stick to your existing plan, you give yourself a better chance of remaining on course to achieve your long-term financial goals.