401(k) Secrets That Your Employer Does NOT Want You to Know About

Over the past several decades, 401(k) plans have been considered a major vehicle for saving for an individuals' future retirement. However, the over confidence in the ability of 401(k) plans to meet all of a retiree's income needs is based largely on misinformation. And, in many cases, this leads to 401(k)s being relied upon much too heavily in investors' overall retirement savings plan.

While it is true that 401(k)'s can offer some tax advantages, along with the potential for "free money" from an employer's matching contribution, there are a number of other factors that investors should be aware of prior to relying on such plans for their future retirement income requirements. Many of these factors can be huge retirement pitfalls that could seriously alter your retirement plans. Here are 10 401(k) misconceptions that many employers and 401(k) plan sponsors do not want you to know about.

Misconception #1
A 401(k) plan will fit all of a person's retirement savings needs.

When originally created, the 401(k) plan was intended to only be one "leg" of the three-legged retirement savings stool - with the other two components being Social Security and defined benefit pension plans, such as corporate and government employee pensions. Today, however, defined benefit plans are nearly non-existent, and Social Security is facing an uncertain future.

Therefore, although the funds in a 401(k) plan are much more likely to be available to retirees than the other two components, the amount of such funds in many cases will not be enough to sustain an individual's total income needs throughout their retirement years, due to a number of reasons including excessive fees.

Misconception #2
401(k) plans are tax-friendly.

It is true that employees receive certain tax benefits. For instance, contributions typically go into a 401(k) plan pre-tax, meaning that the employee is taxed on lower income. In addition, the funds that are inside of a 401(k) plan grow tax-deferred, and therefore they may be able to accumulate at a faster rate than similar funds inside of a taxable investment account.

Upon withdrawal, all of the funds will be taxed at the investor's then-current income tax rate. Those who are proponents of 401(k)s state that the income tax bracket for those in retirement is likely to be lower than it was in their earning years. This, however, may or may not be true, as one's future amount of income is difficult to predict, as are the income tax rates that are likely to be in force in the future.

Misconception #3
401(k) plans are equivalent to pensions.

Although 401(k) plans and pensions both offer future retirement income, these two types of plans are not at all the same. Pensions are typically referred to as "defined

benefit" plans. This means that a retiring employee will receive a specific (defined) amount of income throughout retirement. The responsibility for ensuring that there is enough money in a defined benefit plan to provide the stated amount of income is up to the employer.

Alternatively, 401(k) plans are known as "defined contribution" plans. In these plans, participants may only contribute up to a maximum (defined) annual amount. The end result is that the amount of retirement income that is ultimately received from defined contribution plans is completely dependent upon how much money is contributed and the investment performance of the funds within the account.

With a defined contribution plan such as a 401(k), the responsibility for making contribution as well as deciding on the investment vehicles within the account (typically from a limited menu of options) - is solely up to the employee-participant.

Misconception #4
An investor can borrow an unlimited amount of funds from their 401(k) plan.

Many employers allow their employees to borrow money from their 401(k) plan. However, regardless of one's total account balance, a participant may only borrow the lesser of $50,000 or one-half of the account's balance.

There are a number of drawbacks to borrowing from one's 401(k) account. First, the amount that is borrowed cannot be invested towards retirement. Therefore, all potential investment gains will be lost on those funds.

In addition, when paying back the loan, the employee does so with after-tax dollars. This means that the individual will have a reduced amount of take-home pay throughout the loan repayment period.

Misconception #5
Funds that are borrowed from a 401(k) plan do not need to be repaid.

Unless funds are used to acquire a home, those who borrow money from their 401(k) plan must repay that loan within five years or less. (Those who borrow funds to purchase a home must still repay the loan, however the repayment term can be longer).

In most cases, the borrower must agree to start repaying the loan beginning with their next pay period. Oftentimes, repayment of a 401(k) plan loan is done via automatic deduction from the employee's paycheck.

Misconception #6 - HUGE -
That your 401(k) does not have fees associated with it

This is one of the most widely misunderstood 401(k) myths of all. On average, annual 401(k) fees and expenses range from 1.5-2.5 percent depending on the size of the plan and the employees' allocation choices. However, fees and expenses can go much higher than 2% in many plans with aggressive mutual funds and/or expensive money managers. Where do you think the hundreds of millions in fees to Wall Street are coming from every year from the 401(k) business???

Do the quick math here. If you average $200,000 in your 401(k) over a 30 year period

with 2% in fees each year, that is $120,000 in fees you paid (not counting the amount of interest lost on that money) into your 401(k) without even realizing it. There is a reason that these 401(k) plans are finally being forced to disclose their fees.

Misconception #7
401(k) plans require an employer match.

Although many employers will match a percentage of their employees' 401(k) plan contributions, employers are not required to do so.

Misconception #8
401(k) plans provide freedom of choice with regard to investment options.

While employees usually are given some choice in the investment vehicles that are available, 401(k) plans typically only offer a limited menu of options. In many cases, choices include several mutual funds, along with the employer company's stock (if applicable).

Many employees are not aware that the investment options that are offered within their 401(k) plan are not necessarily the best available alternatives. Unfortunately, when making such choices, most employees are left to fend for themselves regarding which investments will best fit their needs. On top of that, given today's volatile stock market, it has become much more difficult to accumulate - and lock in - an adequate amount of assets for the future.

Misconception #9
401(k) plans are a win-win situation for all parties that are involved.

It is true that there are many benefits that employees enjoy by participating in an employer sponsored 401(k) plan - including tax-advantaged contributions and tax-deferred growth of funds within the account. However, the real winners in these plans appear to be employers, plan administrators, and mutual fund companies.

Although many years ago defined benefit pension plans were the primary retirement vehicle available to company's employees, employers came to realize that these plans were quite costly to operate, in turn causing a large financial burden.

As a result, 401(k) plans came to be a nice alternative, as they allowed employers to avoid contributions completely, or to just simply match a small percentage of contribution dollars that were made by employees.

With the 401(k) plan being a much less expensive option, companies could also avoid the potentially substantial previous liabilities of providing a defined amount of pension payments throughout the lives of their retired employees.

The 401(k) plan administrators also benefit nicely from these plans - namely from the payments that they receive from mutual funds within such plans, as well as the administrative fees that they receive from the plan participants.

Many mutual fund companies are also benefitting from established 401(k) plans in that these companies have a "captive audience" of investors. Because there are oftentimes few available options for employees as investment vehicles in their plans, it is also not

necessary for the included mutual fund companies to allocate a great amount of resources to managing such funds.

Misconception #10
The income received from the assets in a 401(k) plan will last for the participant's entire life.

Today, saving enough money to last throughout retirement is now solely up to the individual employee. Yet, most retirees are left with a dramatically reduced lifestyle once their employer paycheck stops.

This low level of savings, coupled with volatile stock market performance, has left many with very little in terms of potential future income. In addition, most of the investment vehicles that are placed into 401(k) plans offer no guarantee of returns.

The Bottom Line

Given the many restrictions and limitations that are affiliated with 401(k) plans, investors must be aware that although these plans do offer some amount of benefit, there are also a number of pitfalls - especially if the plan is an investor's only source of retirement saving.

Today, many investors consider their 401(k) assets as something that has a target date "far into the future." With this in mind, some feel that these investments do not need to be carefully managed, simply going with a "buy and hold" perspective. Unfortunately, this can lead to disappointing results for investors - and ultimately an inadequate amount of income for retirement.

In addition, because 401(k) assets are often invested in stock market related vehicles, one could be putting all of his or her future savings in jeopardy. Therefore, in order to obtain much more freedom and control over their savings, investors should consider other alternatives as well.

Other retirement savings options such as fixed indexed annuities can allow their holders to obtain upside growth when the underlying market is performing positively, yet a guaranteed safety of principal when underlying markets perform poorly. In addition, these financial vehicles can provide their holders with a guaranteed stream of income throughout the remainder of their life