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Personal Finance

## Six Common 401(k) Missteps

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Special to TheStreet.com

5/6/2006 9:39 AM EDT

URL: <http://www.thestreet.com/university/personalfinance/10284003.html>

*More, more, more.*

Not the Billy Idol song -- but another refrain you're probably sick of hearing, as in funding your 401(k) plan.

The latest numbers from the Federal Reserve's Survey of Consumer Finances did paint a pretty rosy picture. Compared with 2001, when the survey was last done, more eligible employees are saving in 401(k) plans -- 79% in 2004 vs. 74.4% in 2001.

In addition, more of you are not cashing out when you change or leave jobs (55% vs. 45%), and fewer of you are investing too much in company stock (15% vs. 19%).

Also, those of you at midcareer (40-49) are doing especially well -- almost 50% more of you are saving in 401(k) plans (43% in 2004 vs. 29.5% in 2001).

But there's another side to the numbers, and it spells bad news for younger workers. "They're still coming up short," says Alicia Munnell, who directs the Center for Retirement Research at Boston College and who wrote the 2001 book by the same title with Annika Sunden (*Coming Up Short, The Challenge of 401(k) Plans*).

From 2001 to 2004, the number of workers eligible for a 401(k) dropped from 55% to 48% among those 30 to 39 years old, and from 56% to 51% among those 40 to 49.

Fewer younger workers are eligible to participate in a 401(k), says Munnell. "It's distressing."

As a result, "The amount of money saved is shockingly small," says Munnell. For 2004, the median (half save more, half less) is about \$40,000, but among those 35 to 44, it's far less -- \$25,000. To be on track to retire at 62 with a nest egg of \$380,000, you need a balance of \$63,500 *now*, according to her calculations.

That's quite a gap, but most of us keep making the same six mistakes that trip us up.

Let's walk through Munnell's six common missteps, so you can change your behavior. Think of this as "money therapy," if that makes you feel better.

### Folly of Youth: Younger workers are not participating enough in 401(k)s.

Age	% of workers eligible for 401(k)s		% of eligible workers participating in 401(k)s		% of all workers participating in 401(k)s	
	2001	2004	2001	2004	2001	2004
20-29	43.70%	42.40%	66.70%	62.00%	29.10%	26.30%
30-39	54.50%	48.00%	75.60%	77.77%	41.20%	37.30%
40-49	56.20%	51.30%	73.50%	83.30%	29.50%	43.10%

Source: Federal Reserve's Survey of Consumer Finances

To watch Gregg Greenberg's interview with Mike Scarborough about 401(k) mistakes and how to avoid them, [click here](#).

### The Six Missteps, Revealed

- **Less than full participation.** In 2004, the number of eligible workers who didn't participate in 401(k)s dropped, from 26% to 21%. If you find it hard to save, ask your employer to put your savings on autopilot. Or you may be lucky -- your employer may offer automatic enrollment. In 2004, about 30% of large plans offered this feature (i.e., firms such as **Nike** (NKE) and **Cisco** (CSCO) with 5,000 and more employees), along with 18% of midsize plans (i.e., **Genentech** (DNA) and **Yahoo!** (YHOO) , and 10% of small plans.
- **Inadequate contributions.** Contribute 6% of your salary, the magic bullet that triggers the full match (typically, 3% up to 6% of your salary). And don't skip -- whenever you change jobs, make sure you save that money in an IRA while waiting to participate in a new 401(k). By the way, you can save more than 6%; the law allows you to save up to 15% of your salary, to a maximum of \$15,000 in 2006 (another \$5,000 if you're 50 or over).
- **Failure to diversify.** It's a question of too much or too little. Equities, that is. According to a 2005 survey from the Employee Benefits Research Institute, about one in three participants, or 32%, have no equity at all in their portfolios. On the other end of the scale, one in five, or 21%, have too much: 80% or more. Two words to mend the gap: asset allocation, which means you balance your risk.
- **Overinvestment in company stock.** On average, only 15% of employees invest in company stock. Most companies with 401(k) plans, however, don't offer company stock; only companies with 5,000 or more employees do. Among these companies, more than twice that number -- 34% -- invest in company stock. A better number to aim for is 10%.
- **Failure to rebalance.** Once you've set an asset allocation, rebalance annually, to absorb changes in the stock market or those big life events that come along with some regularity (getting married, having a baby, buying a big red Hummer). Your employer may offer automatic rebalancing. If not, do it yourself.
- **Cashing out.** Before a 2005 regulation from the Department of Labor, 87% of you cashed out balances of \$5,000 and less; now you must roll over any 401(k) plan with a value between \$1,000 and \$5,000 into an IRA. There's been a healthy drop of 10% since 2001 among those who cash in 401(k) assets when they leave or change jobs, but 45% is still too high.

### Getting Going

A combination of the first two mistakes defeats most participants, says David Wray, president of the nonprofit Profit Sharing/401(k) Council of America in Chicago. Participants leave an estimated \$30 billion on the table every year, according to a recent study from Aon Consulting for the PSCA, simply because they don't contribute enough.

**Heads-Up No. 1:** Your employer may offer a higher, or lower, match -- or none at all. Read "Employer Maximum" in your Summary Plan Document.

**Heads-Up No. 2:** Contribute regularly. If you're earning \$60,000, here's how the numbers look: Save \$300 a month, and you get \$450, 50% more -- who doesn't love 401(k) math? And you lower your taxes *now*. If you're willing to wait, save the money in a Roth 401(k). There's no tax deduction up front, but you pay no taxes when you withdraw. (This raises another topic for a future column: comparison of regular vs. Roth 401(k)s.)

Just for the heck of it, play with the calculator at offered by the PSCA.

Can you afford to wait? Short answer: no. "The cumulative impact of these 401(k) 'missteps' has a major impact on accumulations," says the CRR's Munnell. Traditional pensions are going the way of the dodo. Like it or not, "We're entering a world where people are dependent on these plans."

If your employer offers a 401(k), take advantage of the free money, says the PSCA's Wray. This year, plan to save enough to get the full match. Next year, add another percent -- and keep going until you reach the maximum. Some employers now make it automatic, allowing you to check "yes" on your summary plan description (SPD) to automatically increase your annual contribution. "People are always challenged not to save. There are lots of reasons." Don't let laziness be one of them.

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*Dorianne Perrucci has been helping consumers dig into personal finance since 1998, when she reported for Jane Bryant Quinn's groundbreaking columns in *The Washington Post* and *Good Housekeeping*. Since 2001, she has written for *Newsweek*, *The New York Times* and *Consumer Reports*, among others. Got a question or comment? Contact Dorianne at [this email address](#).*

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