

## The Importance of 401(k) Plans

*Securing Financial Futures Through Employer-Sponsored Retirement Accounts*

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For millions of Americans, retirement planning is an essential part of helping to ensure long-term financial security and stability. Among the many tools available, the 401(k) plan stands out as one of the most popular and effective employer-sponsored retirement savings options. Created through legislative action in the late 20th century, 401(k) plans have transformed retirement savings habits and helped countless individuals build substantial nest eggs for their post-working years. This article explores the foundational elements of the 401(k) plan, its advantages and the crucial role it plays in fostering financial independence.

### Understanding the 401(k) Plan

A 401(k) plan is a retirement savings account offered by employers to their employees, allowing individuals to contribute a portion of their wages into the plan on a pre-tax basis. These contributions are invested in a variety of financial products, such as mutual funds, stocks and bonds, with the intent of growing the balance over time. The name “401(k)” derives from the section of the Internal Revenue Code that established this type of account. 401(k) plans are typically used by for-profit employers, while their counterpart, 403(b) plans, are commonly used by nonprofits, healthcare and educational institutions.

### Navigating Recent Legislative Updates to 401(k) Plans

In recent years, several legislative changes have reshaped the retirement planning landscape, especially when it comes to 401(k) plan accounts. Updates such as the SECURE Act and SECURE 2.0, passed by Congress, have adjusted contribution limits, increased the age for required minimum distributions (RMDs), and expanded catch-up contribution options for those approaching retirement. Some provisions now allow for easier automatic enrollment and greater flexibility for part-time employees to participate in employer plans.

It’s also important to note that changes aren’t limited solely to 401(k) plans. Rules impacting IRAs and 529 college savings plans have also evolved, which can influence broader retirement and financial planning strategies. Given the pace of regulatory updates, consulting a trusted tax advisor or financial professional before making big decisions can help ensure you’re maximizing your retirement plan under the latest rules.

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## **Pre-Tax Contributions and Tax Advantages**

One of the most significant benefits of the 401(k) plan is its tax-deferred nature. Employees can elect to have a percentage of their paycheck automatically withheld and deposited into their 401(k) plan account before federal income taxes are applied. This not only reduces their taxable income in the present but also allows investments to grow tax-deferred until withdrawal, typically in retirement. For many, this means their money can compound more efficiently, generating potentially larger returns over decades.

### **Employer Matching Contributions**

Many employers enhance the value of 401(k) plans by offering matching contributions. For example, an employer may match 50 cents for every dollar an employee contributes, up to a certain percentage of their salary. This “free money” is a powerful incentive, providing immediate returns with the intent of helping employees reach their retirement goals faster. Not contributing enough to receive the full employer match is effectively leaving money on the table, so financial advisors frequently recommend maximizing employee contributions.

## **Traditional vs. Roth 401(k): Key Considerations**

When evaluating whether to contribute to a traditional or Roth 401(k) plan, it's important to consider how taxes impact your retirement strategy both today and down the road. While traditional 401(k) plan contributions are made with pre-tax dollars, giving you an immediate reduction in taxable income. Roth 401(k) plan contributions are made with after-tax dollars, which means qualified withdrawals in retirement are generally tax-free. Choosing between the two often comes down to your current tax bracket and where you expect it to be in retirement. If you anticipate being in a higher tax bracket later, paying taxes now via Roth contributions could be advantageous. Conversely, if you expect your income and tax rate to decrease in retirement, the immediate tax break of traditional 401(k) plan contributions may better serve you.

Some savers even opt to split contributions between both options, creating flexibility to manage taxable income in retirement. Reviewing your current financial circumstances, considering your future earning potential, and, when in doubt, consulting with a financial advisor can help determine which approach, or combination, may best fit your long-term goals.

## **Compound Growth Over Time**

The 401(k) plan leverages the power of compound growth. As contributions are regularly made and invested, earnings from investments, such as dividends and capital gains, are reinvested, allowing the account to grow exponentially over time. The earlier an individual begins contributing, the greater the impact compounding has, making 401(k) plans particularly beneficial for younger workers who have decades before retirement.

## The Role of 401(k) Plans in Modern Retirement Planning

With traditional pensions becoming increasingly rare, the responsibility for funding retirement has shifted more heavily onto individuals. The 401(k) plan is a key instrument in this new landscape, offering flexibility, autonomy and accessibility for workers across industries.

### Supplementing Social Security

Social Security is intended as a safety net, not the sole source of retirement income. For many, Social Security benefits alone are insufficient to maintain their desired standard of living after retirement. The 401(k) plan provides a vital supplement, allowing individuals to save proactively and prepare for the future.

### Portability and Convenience

401(k) plans are highly portable. When employees change jobs, they typically have the option to rollover their 401(k) plan balances into new employer plans or individual retirement accounts (IRAs) without tax penalties. This seamless transferability enables workers to continue building retirement savings even as their careers evolve.

### Control and Investment Choices

Most 401(k) plans offer a range of investment options, empowering employees to tailor their portfolios to their risk tolerance, retirement timeline and financial goals. From conservative bond funds to aggressive equity investments, 401(k) plan participants can build diversified portfolios suited to their unique circumstances.

### Automatic Savings Discipline

401(k) plan contributions are automatically deducted from employees' paychecks, encouraging consistent savings habits. This "set it and forget it" approach is a powerful force against inertia and procrastination, helping even those who might otherwise struggle to save for retirement.

### SECURE 2.0 Act: Changes to 401(k) Plan Contributions and Withdrawals

The SECURE 2.0 Act brings several important adjustments that shape how individuals can contribute to and access funds within their 401(k) plans, making it even more critical to stay informed and proactive in retirement planning.

### Expanded Contribution Opportunities

For employees looking to maximize their retirement savings, the Act increases flexibility. Beginning in 2025, the standard annual employee contribution limit for 401(k) plans rises to \$23,500 for those under age 50, with a further increase slated for 2026. If you are age 50 or older, you can make additional "catch-up" contributions, \$7,500 extra for 2025, with enhancements in future years. Notably, individuals aged 60 to 63 may take advantage of a higher, special catch-up contribution (up to \$11,250) if their employer plan allows. It's important to note that if you participate in more than one 401(k) plan – such as both a traditional and a Roth 401(k) plan; your combined contributions across all accounts cannot exceed the annual limit set by the IRS.

High-income earners should pay attention: Starting in 2026, if you earned over \$150,000 the previous year, any catch-up contributions you make must be to a Roth 401(k) plan, meaning these amounts will be taxed now rather than later. This threshold is adjusted annually for inflation, so consulting your plan administrator is wise to ensure compliance and optimal strategy.

### **Handling Excess 401(k) Plan Contributions**

Occasionally, employees may accidentally contribute more than the IRS annual limit to their 401(k) plan accounts. Fortunately, most plan administrators monitor contributions and alert participants if they've exceeded the maximum. If you do find yourself over the limit, you have until April 15 of the following year to remove the excess amount, along with any earnings attributable to those excess contributions. Failing to correct the overage can lead to double taxation: you'll owe income tax on the excess in the year it was contributed, and again when you eventually withdraw those funds in retirement. Careful monitoring throughout the year can help ensure contributions remain within permissible boundaries.

### **New Withdrawal Provisions**

The SECURE 2.0 Act also introduces additional circumstances under which you can access your 401(k) plan savings early without facing the typical 10% penalty. Beyond longstanding exceptions, such as separating from service after turning 55, certain hardships, or major medical expenses; the Act now allows penalty-free withdrawals in cases of domestic abuse, qualified emergency expenses, federally declared disasters, and substantial financial hardship surrounding birth or adoption.

These changes are designed to provide more flexibility and security, recognizing that life events can arise unexpectedly. However, they also make it essential to carefully weigh the long-term impact of taking early withdrawals and to seek guidance to make the most of new contribution rules.

### **Understanding 401(k) Plan Loans and Their Risks**

While withdrawing funds early from a 401(k) plan typically triggers taxes and a 10% penalty, some plans allow participants to borrow against their account balance through a 401(k) loan. This option can offer short-term liquidity without the immediate tax hit, but there are important considerations.

When you take a loan from your 401(k) plan, you're essentially borrowing your own money, and repayment is structured through automatic payroll deductions. This reduces your take-home pay, which may affect your monthly budget. Additionally, any amount borrowed is temporarily removed from your investment portfolio, meaning those dollars miss out on compounding growth until they're repaid.

It's also crucial to consider job stability. If you leave your employer, voluntarily or not, before the loan is fully repaid, the outstanding balance typically becomes due quickly. Failing to repay the remaining amount in the specified time

frame (often by the next tax filing deadline) will result in the loan being reclassified as a distribution, subjecting you to income tax and, if you're under age 59½, an early withdrawal penalty.

In summary, while 401(k) plan loans can be a helpful resource in certain situations, they should be approached with caution due to their impact on long-term savings and the potential tax consequences if repayment terms aren't met.

### **Required Minimum Distributions (RMDs)**

Retirees must begin withdrawing minimum amounts from their 401(k) accounts once they reach age 73 (as of 2025). These RMDs are subject to taxation and failure to comply can result in steep penalties. Proper planning is necessary to meet RMD requirements and manage tax liabilities.

RMDs aren't limited to 401(k) plans; they also apply to traditional IRAs and most workplace retirement plans. The amount you must withdraw each year is calculated based on your account balance as of December 31 of the previous year and your life expectancy. For those still working, an exception may allow you to delay RMDs from your current employer's retirement plan until you retire, unless you own 5% or more of the business sponsoring the plan. Keep in mind, this exception does not extend to traditional IRAs, SEP, or SIMPLE IRAs, where RMDs must begin once you reach the required age.

Missing an RMD can be costly. The penalty for not taking the required amount can be as high as 25% of the shortfall, on top of taxes owed when you eventually make the withdrawal. If you're unsure how much to withdraw, consider consulting a financial or tax professional to help you calculate the correct amount and avoid unnecessary penalties.

## **The Impact on Employees and Employers**

401(k) plans offer distinct advantages not only to participants but also to the organizations that provide them.  
Employee Benefits and Retention

Offering a robust 401(k) plan enhances an employer's benefits package, making the company more attractive to top talent. Such plans can improve employee satisfaction, loyalty and retention, while reducing turnover costs and fostering a positive workplace culture.

### **Financial Well-being and Productivity**

Employees who feel secure about their retirement prospects are likely to experience less stress and greater productivity. Offering 401(k) plans allows employers to support the overall financial well-being of their workforce.

## Tax Benefits for Employers

Businesses may benefit from tax deductions for their contributions to employees' 401(k) plans. Furthermore, sponsoring a retirement plan can demonstrate corporate responsibility and commitment to employee welfare.

## Maximizing the 401(k) Plan

To reap the full benefits of a 401(k) plan, individuals should follow best practices:

- **Start Early:** The sooner contributions begin, the greater the impact of compounding. Compounding is the process by which your investment earnings generate their own earnings over time, creating a snowball effect. This means that even small, early contributions can lead to significant growth by retirement age, thanks to the power of tax-advantaged, long-term investing.
- **Leverage Employer Contributions:** One of the most valuable features of a 401(k) plan is the opportunity for employer contributions, commonly in the form of a match. Employers may offer a full, dollar-for-dollar match up to a certain percentage of your salary, or a partial match (for example, 50% of your contributions, up to a defined limit). Aim to contribute at least enough to receive the full employer match, otherwise, you may be leaving free money on the table.
- **Contribute Consistently:** Regular contributions help build your retirement savings steadily, taking advantage of market growth and dollar-cost averaging.
- **Diversify Investments:** Select a mix of assets that reflects your risk tolerance and goals. Diversification helps manage risk and can smooth out investment returns over time.
- **Monitor and Adjust:** Review your account regularly and adjust contributions or investments as necessary. As your financial situation or retirement goals evolve, ensure your 401(k) plan strategy keeps pace.
- **Educate Yourself:** Take advantage of employer-provided resources and financial education programs. Understanding plan features, investment options, and retirement strategies empowers you to make informed decisions.

With the increased significance of 401(k) plans for employees looking to retire, it is essential for employers to proactively manage their retirement plan. Fiducient Advisors acts as a fiduciary advisor to 401(k) plans across the country, providing investment advice that is in the best interest of the 401(k) plan and plan participants. We work collaboratively with employers to build plans that improve participant outcomes and help them appropriately discharge their fiduciary responsibilities. To learn more about our [services](#), please visit [www.fiducientadvisors.com](http://www.fiducientadvisors.com).

401(k) plans represent a cornerstone of modern retirement planning, offering tax advantages, employer contributions, flexibility and the power of compounding growth. By participating in a 401(k) plan, employees can take meaningful steps toward financial independence, supplementing Social Security and mitigating the risks associated with longer lifespans and rising living costs. Both workers and employers benefit from these powerful tools, which foster a culture of saving and security. The key to maximizing the 401(k) plan lies in early

participation, ongoing education and proactive management, each a vital ingredient in securing a comfortable and dignified retirement.

## About the Author



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Greg services institutional clients by providing counsel and guidance on portfolio design, asset allocation, manager selection, investment policy statements and performance monitoring. He is also a member of the Recordkeeper Oversight Council. Greg joined Fiduciary Investment Advisors, LLC in 2017, which combined with Fiducient Advisors in 2020.

Before joining the firm, Greg worked in both institutional and individual wealth management helping create positive retirement outcomes for plan sponsors and plan participants. He received his BA from the University of Connecticut and is a ChFC® (Chartered Financial Consultant). He volunteers as a Chair of the Board for MARCH, Inc. of Manchester, a Connecticut organization dedicated to enriching the lives of individuals with intellectual and developmental disabilities, as a Board Member of the Connecticut Council on Problem Gambling, and as a Board Member for Riverfront Recapture. Greg enjoys biking, hiking, kayaking, running, lacrosse and football in his free time.