Making the Most of Your Retirement Plan

Defined Contribution Retirement Plans

Many employers offer some form of defined contribution retirement plan. Although the name may vary (401(k), 403(b), 457(b))[1], on a basic level they all function in much the same way. During your working years money is automatically deducted from your paycheck and contributed to the plan. The accumulated funds are ultimately used to help pay for your retirement.

Why Participate?

The answer to this is simple: you'll likely need the money. With people living longer, more money is needed to pay for retirement. And two of the traditional financial pillars of retirement, defined benefit pension plans (providing a known benefit) and Social Security are playing a smaller role in meeting this increased need for retirement income.

- Over time, many employers have changed from defined benefit to defined contribution plans. From 1985 to 2000, for example, the rate of participation in defined benefit plans by full-time employees of medium and large private firms dropped from 80% to 36%.[2] A survey by the Bureau of Labor Statistics, published in 2020, found that only 20% of civilian workers in the U.S. participated in defined benefit pension plans.[3]

  Social Security also faces problems. As the baby boom generation enters retirement (the so-called "silver tsunami"), the number of individuals remaining in the workforce to support these retirees grows smaller. Although politically unpleasant, harsh fiscal realities may force increased payroll taxes, reductions in benefits, or both.

What to Do?

Today, more than ever before, you're on your own. One starting point is to take a more active role in your employer's defined contribution plan:

[1] These refer to the sections of the Internal Revenue Code which authorize the different types of retirement plans.

[2] See, "Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000." U.S. Bureau of Labor Statistics, updated June 16, 2004.

[3] National Compensation Survey: Employee Benefits in the United States, March 2020, Table 2.

- **Investment options:** Or, where do I invest my money? This will depend on a number of factors, including the plan's available options, the amount of your retirement income goal, the number of years until retirement begins, and your tolerance for risk.
- **Contribution rate:** A 3% rate may be the default, but is that enough to meet your needs? Another factor to consider is whether there is an employer match for part of your contributions. At the least you should contribute to the level which will maximize the employer match. Otherwise, you're walking away from "free money."
- **Annual checkup:** Everyone's situation changes over time. Make sure you thoroughly review your retirement plan at least once a year. Are you saving enough? Are your investments still appropriate?

Seek Professional Guidance

Successful long-term investing requires discipline and patience. The guidance of a financial professional is highly recommended.