EIGHT 401K BLUNDERS DOCTORS CAN'T AFFORD TO MAKE

Automatic enrollment, increased contribution rates, matches and tax advantages are having a positive effect on retirement savings in recent years. Investment in 401k plans or defined benefit plans, especially those offering an employer match, seems like a "no-brainer" as part of any family's financial plan. For many physicians starting out, amidst the pressures of training and the time constraints of residency, retirement planning often becomes buried in the "to think about later" pile. Here are eight considerations you should think about NOW before it costs you money you're going to need later.

1) NOT SIGNING UP

There is rarely a reason to not participate in your employer's plan. Recent retirement plan regulations are spurring many employers to offer automatic 401k enrollments with a default investment account holding the funds. Employees are given the opportunity to opt out of automatic enrollment – but don't! Even if your company doesn't offer a match, your employer contributions are deducted pre-tax, thereby lowering your overall taxable income. Further, the funds grow on a tax-deferred basis and are creditor-protected by law. Might as well do it!

2) WAITING TOO LONG TO SIGN UP

Making money on your money is the concept behind compound interest, and it's an important reason to start contributions as soon as your budget allows. How it works: earnings from your investments are reinvested and start earning for you as well. And because it's a tax-deferred account, this growth can accelerate because you don't have to eat into those earnings to pay taxes each year. If you were thinking about waiting a few years, the help of a compounding calculator can show you how much money you stand to lose by waiting. The earlier you start, the longer your money can compound.

3) NOT TAKING ADVANTAGE OF THE FULL COMPANY MATCH

What's the best kind of money? Free money! Who doesn't want free money? Who wouldn't elect to receive free money; especially money which grows tax-deferred? A common employer match is 50 cents on the dollar, or dollar-for-dollar, and other variations exist. Sometimes employers will place a condition on the match, such as length of employment or a minimum employee contribution rate. Find out what your employer's match entails, so you can make informed decisions.

4) TAKING TOO LITTLE RISK

Most automatic enrollment funds will be low-risk, conservative funds to protect against loss in an employee's account. If you don't take the time to choose a fund that fits your personal risk profile and timeline, your 401k may not reach its potential growth. Your sensitivity to market fluctuations and the amount of time you have until you'll need the funds for retirement income are two important factors to consider. An age-based fund might be the best choice, as they automatically adjust for your time horizon. In addition, many risk profile questionnaires and calculators exist to help select investments.

5) TAKING TOO MUCH RISK

On the flip side of #4 is the reverse: taking too much risk could expose you to losses during times of market volatility. This becomes especially important as you approach retirement and less time exists to rebound from market losses. Your 401k investments should be reviewed at least annually, to ensure that your investment risk is monitored, potentially reducing the portfolio's overall risk as you near retirement. Your investments will naturally rise and fall, but the amount of fluctuation (how high, how low) with the market should be decreasing over time.

6) TOO MUCH COMPANY STOCK

Owning company stock in your 401k can be a way for employees to participate in their company's growth. But if Enron and WorldCom taught us anything, it's prudence with regard to investing too much in the company stock. The old adage about putting too many eggs in one basket applies to your 401k's investment diversification for a few reasons: the stock could fall, and there could be restrictions to its liquidity if you needed a loan or withdrawal. Consider limiting your exposure to company stock to a limit of 10% of your balance.

7) TAKING OUT LOANS

If a financial crisis were to arise, you may be tempted to consider a loan from your 401k. The interest rate on this 401k loan may be lower than your bank, and you're paying "yourself" back with interest. STOP! Consider this as a LAST RESORT for many reasons. In addition to losing out on growth (see #2) the potential fees charged to administer the loan, and double taxation as you repay the loan account with after-tax money only to be taxed again at retirement, there may be even worse consequences. What if you leave or lose your job? The loan balance then becomes due which results in taxes and IRS early withdrawal penalties on the unpaid balance. Outside of only the rarest special situations, it is prudent to consider your 70-year-old self on a limited income before touching the 401k.

8) CASHING OUT

Next to not signing up, cashing out is the worst move to make. Taxes and penalties are the main reason: withdrawing money from a 401k before you reach age 59 ½ will subject those dollars to federal income tax and a 10% early withdrawal IRS penalty. If you are leaving your employer, myriad options exist to help you avoid cashing out the 401k such as a rollover to an IRA, a roll-in to your new employer's 401k plan, or simply keeping it where it is. Lastly, the purpose of the 401k is to provide for you in retirement, when your income earning years are behind you. Before you make this critical error, make sure you've exhausted all other options carefully.

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