

# Getting to Know 401(k) Plans

401(k) plans offer a convenient way to invest towards retirement. Let's go over the basics.

## What Is a 401(k) and How Does It Work?

A 401(k) is an employer-sponsored retirement savings plan that allows you to invest a portion of your salary through payroll deductions.

## Potential Tax Advantages

One of a 401(k)'s primary benefits is that it may offer certain tax advantages. With a **traditional 401(k) plan**, your contributions are taken out of your pre-tax pay—in effect lowering your taxable income. Your 401(k) investments have the potential to grow on a tax-deferred basis, and then you pay taxes on the money you withdraw from the account in retirement.

Some companies also offer the ability to save through a **Roth 401(k)**. With this type of plan, you make contributions from your after-tax salary, but then your qualified distributions in retirement are federal income tax-free.

## How Much Should You Save?

This is a personal choice, and it will largely be based on your financial goals. The following considerations may factor into your decision:

**EMPLOYER MATCH:** This is money that your employer puts into your 401(k) account for every dollar you contribute, up to a specified amount, to encourage you to save. If your employer offers a match and you don't save enough to capture it in full, you're essentially leaving money on the table.

**TIME HORIZON:** One of the most important moves you can make with a 401(k) is simply getting started. Thanks to the power of compounding, the longer your money is invested, the longer your contributions—as well as any interest and earnings on them—have to potentially grow in line with the markets.

**CONTRIBUTION LIMITS:** The IRS puts a cap on how much employees can contribute to a 401(k) plan each year. For 2022, you can put up to \$20,500 into your account. If you're 50 or older, you can also make up to an additional \$6,500 in catch-up contributions, helping you super-charge your savings efforts in the years leading up to retirement.



If you need help determining your contribution percentage, a retirement calculator or a financial professional can give you a sense of what might be a sound target for your unique situation.

## Selecting Investments

Workplace retirement plans generally allow you to choose from a menu of investment options, such as mutual funds, exchange-traded funds, and fixed income investments. You may also have the option to invest in a single target-date fund (TDF), which automatically adjusts its mix of investments and risk profile according to your approximate date of retirement.

Most 401(k) plans have a default option known as the "QDIA" (Qualified Default Investment Alternative). If you don't specify where you'd like to invest your 401(k) contributions, they'll likely be invested in the QDIA, which is typically a TDF.

## Withdrawing from a 401(k)

The money you put into a 401(k) plan is earmarked for retirement, so the goal is to leave it there until you reach your golden years. You can generally begin withdrawing money from your account without facing a penalty once you reach age 59½.

In some cases, 401(k) hardship withdrawals may be available. 401(k) loans are also sometimes an option, but they come with tax penalties and may derail your savings efforts while you work to pay them back, so they should be evaluated with caution.



## The Bottom Line

Again, one of the keys to using a 401(k) to help meet your retirement saving goals is to get started, giving your money as much time as possible to potentially grow and benefit from the power of compounding.

**Morgan Stanley at Work is committed to helping you plan for, invest, and transition to retirement with confidence. Learn more in our [Retirement Knowledge Center](#).**

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Investments in target-date funds are subject to the risks associated with their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the workforce. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in a target date fund is not guaranteed at any time, including or after the target date. These funds are based on an estimated retirement age of approximately 65. Should you choose to retire significantly earlier or later, you may want to consider a fund with an asset allocation more appropriate to your particular situation.

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