To Roll Over or Not to Roll Over: What to Do With That Old 401(k)

Maryalene LaPonsie | May 26, 2016

When you're packing up the office to switch jobs, is the 401(k) one thing to leave behind?

A rollover may not be right for you.

A 401(k) plan is standard in many compensation packages today, and the money in the account is yours to keep even if you and your employer part ways. In the event that you do leave your job, you have two choices: Roll over the account or leave it where it is.

If you leave the money with your former employer, you can still manage it by moving investments between available funds. However, some people prefer to roll over the money into another account instead.

Workers are left to grapple with the question of which is the better choice. It's a dilemma financial advisors say has no pat answer. "[A rollover] is not right for everyone," says Sarah Walsh, vice president of retirement solutions at Fidelity. "Make sure you understand what your options are and what is right for you."

Your rollover options. Workers have two options to roll over an old 401(k). The money can be moved to another 401(k) account, such as one offered by your new employer, or sent to an IRA.

While any IRA provider will happily accept rollover funds, the ability to roll money into a new 401(k) may depend on the policies at the new employer. It's possible a new plan will decline to accept a roll over, but Greg Hammer, owner of Hammer Financial Group in Schererville, Indiana, says that's uncommon. "I know very few that are generally unwilling to accept money."

When to take your money with you. Convenience is one of the main reasons to consider rolling over a 401(k). "The problem with leaving it there is if you have three or four employers, you now have three or four investment accounts to track," says Phil Jacobson, managing director at United Capital in Rockford, Illinois.

Josiah Grauso, investment advisor with ASC Financial Group in Allentown, Pennsylvania, says he personally prefers rolling money out of a 401(k) and into an IRA. He likes IRAs for their often diverse and expansive fund options. "You have the full universe of choices," he says.

IRAs also come with other perks that may not be available with 401(k) accounts. For example, early withdrawals from IRAs and 401(k)s are subject to a 10 percent tax penalty. However, money from an IRA may be withdrawn without penalty for qualified education costs, first-time home purchases and health care premiums made while unemployed. 401(k)s don't offer any of those exemptions.

When it's best to leave your money in the 401(k). For most people, leaving money in a 401(k) isn't necessarily an active choice as much as the result of inertia. Rolling over money can seem like a complex process, which workers may not want to bother with. "A lot of people say 'I'm good' and leave it," Walsh says.

That isn't necessarily a bad choice either. "The beautiful thing about 401(k)s is you're getting a discount on your management fees," says Jacobson. Fees may be spread among many employees, lowering the cost for everyone.

Plus, money in a 401(k) comes with benefits not found in an IRA. While not always advisable, loans can be taken from a 401(k) balance for any reason. What's more, 401(k) accounts have additional protections against creditors and garnishments. Those who leave their job at or after age 55 may also be able to take early withdrawals without penalty if they leave their money in the 401(k).

There's another benefit if the money in your 401(k) is invested in company stock. Company stock gets a special tax treatment in a 401(k), but the deal is off if you roll the money over to an IRA. Jacobson says it's something that applies to relatively few plans, but for those who qualify, it can reduce taxes as well as penalties in the case of an early withdrawal.

The new rule intended to protect you. Rolling over a 401(k) has long been a routine financial transaction for many advisors and firms, but a few financial advisors talked savers into moving money from a low-fee 401(k) to a high-fee IRA. A new government regulation that takes effect in 2017 will require anyone who provides investment advice on a rollover to beconsidered a fiduciary. In other words, the advisor needs to be working in their client's best interest rather than making recommendations based upon the commission or other reward they could receive. "You have to have a valid reason for moving over a 401(k) for a client," Hammer says.

However, even with the new rule, workers should take the time to do their own diligence about whether to roll over a 401(k) and, if so, where to move that money. A 401(k) or IRA is a key component to a comfortable retirement. While consulting with an expert may be helpful, don't leave all the decisions about your money to someone else.