What Should I Do With My Old 401(k)?

By: Exchange Capital Management

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The days of starting your career and sticking with one employer until retirement are long gone. When you leave an employer and enter the next phase of your life, you'll have to decide what to do with your previous 401(k). There are two scenarios you could find yourself in; either you've gotten another job, or you've left your job and stopped working entirely. Depending on where you fall, there are a few options on what you can do.

What Are My Options?

1. Do Nothing

Most employer-sponsored plans have a minimum balance requirement of $5,000 for you to be eligible for this option. If you meet this requirement and your plan allows for it, you can leave your old 401(k) where it is. However, there is no certainty that you can stay in the plan forever. The administrator may force you out any time they see fit. Additionally, the previous employer can change custodians and investment selections over time. If you aren't a current employee, you may miss out on these notifications and lose track of your 401(k) or its investments.

If you change jobs a few times and get in the habit of leaving old retirement accounts in the plan of previous employers, you will likely rack up quite a few accounts across multiple custodians. The more retirement accounts you have, the greater the risk of losing track of your money and investments. We often advocate for consolidation whenever possible. However, if the investment choices and costs are superior compared to other options and you want to take the path of least resistance, it may make sense to leave the account as is.

2. Cash Out

It is generally not advisable to cash out an old 401(k) because of a job change or retirement. Withdrawing the full amount of your 401(k) (or "cashing out") is a taxable event. The value of your account withdrawn will be added to your income in that calendar year and you will be taxed accordingly. Often, you'll be required to withhold at least 20% of the withdrawal amount for tax payments. Additionally, if you're not yet age 59 ½ or older, you'll pay a 10% early withdrawal fee.

3. 401(k) Roll Over

Rolling over an old 401(k) account is not a taxable event and helps consolidate retirement accounts. There are two types of rollovers you can consider:

> **Roll over to your new 401(k):** If you're starting a new job, rolling over from your old 401(k) to your new 401(k) might be in your best interest. By meshing the two accounts together, you can navigate changes and complexities easier through your current employer. If you need to change beneficiaries or investment selections, you only need to inform one custodian instead of two. Additionally, the more money you roll over to your current employer, the more borrowing power you'll have through 401(k) loan programs.
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> However, by choosing this option you are saying goodbye to your old plan's administrator and investment selections. Your money will be transferred into your current employer's 401(k) and will be subject to their guidelines. Another potential downside involves flexibility with investments. In general, a 401(k) has limited investment options compared to an IRA.
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> **Roll over to an Individual Retirement Account (IRA):** On the other hand, you can ditch your 401(k) entirely and move over to an IRA. IRAs are usually more cost-efficient, especially for the do-it-yourself investor. Additionally, they have a vast range of investment options so you can tailor your retirement strategy to your individual circumstances. However, more flexibility with investment options can be overwhelming for some investors. The good news is that IRAs open the door to working with a financial advisor who can take the reins. While hiring an advisor to build a financial plan and manage your IRAs can take the stress off your shoulders, it comes at an added cost. Lastly, rolling over to an IRA can create tax implications if you are considering a backdoor Roth contribution.

The Bottom Line

Regardless of if you decide to cash out, do nothing, or rollover your accounts, your decision often relies on whether you want simplicity or cost-efficiency. Most of the time, we believe an IRA can provide significant advantages over a 401(k). However, sticking with your old or new 401(k) can be comfortable for investors. While you should always consider the financial gain of one account versus the other, you also need to factor in your personal investment experience and comfortability.