How To Determine Whether To Take Or Leave Your 401(k) At A Former Job

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"Should I stay, or should I go?" When The Clash sang those words over 40 years ago, the 401(k) plan barely registered in the retirement plan landscape. The idea of choice captivated workers. This newly defined contribution plan promised employees freedom that defined benefit plans only teased at and, more often than not, reneged upon.

But that choice had a downside. You had to decide. Today's streamlined plans have removed many of the tough decisions. Automatic enrollment, automatic escalation, and default investments all allow employees to avoid thinking about their retirement plan. They can leave it on autopilot.

But what happens if you switch jobs? In this case, a lot of workers opt for a new default: leaving the retirement money with an old employer.

“Mostly, it seems to be a function of it being the easiest thing to do (e.g., do nothing),” says Nevin Adams, industry thought leader and author from Manassas, Virginia. “Rollovers are still a (relatively) complicated process, and it seems that most still want to make you cash out your balance and cut you a traditional check and mail it to you—that’s days out of the market (at least), and a lot of money to trust to the US Postal Service.”

Is this the right thing to do? That depends on the facts and circumstances surrounding your situation.

What criteria should you look at when deciding to roll the money out of the old plan?

The formula that determines whether you should leave your 401(k) account at your former employer or move either to a new employer’s plan or roll it over into an IRA contains quite a few variables. The fact that the decision contains at least three distinct possible endpoints shows you how complicated it can be.

Before you get to the result, however, you need to assemble the facts. These represent measurable data that shouldn’t be too hard to get.

“Participants should consider investment fees, administrative fees (particularly if there is a higher fee charged to separated participants), whether they are happy with investment options, the potential convenience of aggregating assets, the better protection of 401(k)s versus IRAs under bankruptcy laws, the potential need for loans from a 401(k), and potential tax advantages if the participant is invested in employer stock,” says Eric Gregory, a member at Dickinson Wright PLLC in Troy, Michigan.

When is it a good idea to leave the money in the old plan?

Given these criteria, when is it a bad idea to roll the money out of the old plan? You'll find different folks have different answers. It's important to consider why they might offer opposing views when you ask them, "When is it better to leave your 401(k) at your former employer after leaving your old job?"

"Almost never," declares Lawrence (Larry) Starr, VP at Cornerstone Retirement/QPC in West Springfield, Massachusetts. "I suppose if there is an investment in the plan that just can't be duplicated elsewhere and that the participant is in love with, you might argue for leaving some money behind. (They should never be in love with a specific investment, but people also like to play the lottery!)."

"Always, for those participants who don't know what they are going to do," counters Jack Towarnicky, Of Counsel at Koehler Fitzgerald, LLC in Powell, Ohio. "Always, until the participant makes a determination that there is a better alternative."

Fortunately, there's a happy medium between "always" and "never." It really comes down to an apples-to-apples comparison between the choices.

Susan Shoemaker, principal at CAPTRUST in Southfield, Michigan, says it's a good idea to keep your money in the old plan "when there isn't a better option as it relates to fees, services, and investment options. It also may be a good idea when the participant wants time to research their options. This should not be a hurried decision. Overall, 401(k) plans can offer services that are not available outside the plan, and fees are often competitive."

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Notwithstanding the above, when is it a bad idea to leave the money in the old plan? “If the plan funds have high relative expenses and poor relative performance,” says Harold Evensky, founder of Evensky & Katz in Lubbock, Texas.

More broadly, there are plenty of occasions where employer-sponsored plans have structural disadvantages, whether from logistical obstacles to regulatory burdens.

“Employer plans have a limited number of investment options, additional layers of administration, and potentially higher fees,” says Richard Bavetz, investment advisor and federal retirement consultant for Carington Financial in Westlake Village, California. “There are also Round-Trip rules that can inhibit an individual’s ability to manage volatility and maneuver between investments. On the other hand, the investment choices offered within their own IRA would be virtually unlimited. In determining where to roll their money, a former plan participant investor should be seeking greater investment options and fewer restrictions while reaching for higher levels of service and transparency. This can typically be achieved at a reduced cost of ownership. Professional guidance is also highly recommended to assess and make the final determination.”

Bavetz adds, “Another consideration is how frequently individuals change employers and/or careers these days. It would make the most sense and be most efficient to accumulate these ‘old plans’ in a single IRA that one keeps for good.”

These comparisons may lead to an obvious answer, but sometimes, you need to look beyond quantifiable benchmarks. You also need to consider what your current financial landscape looks like as you contemplate when it is better to take your 401(k) with you after leaving your old job. For example, will you need the money for a short term?

"If you anticipate needing a loan against 401(k) assets, it's best to roll to a new employer's plan," says Michael Kazakewich, partner and advisor at Coastal Bridge Advisors in Westport, Connecticut. "As an alternative, you can borrow against an individual IRA for 60 days once every 12 months."

No matter what you decide, make sure you take the time necessary to make an informed decision. You don't have to make your decision before your last day at work, but sometimes it's easier if you do. That's just another factor to bear in mind. And what that means is the sooner you start comparing options, the sooner you can make that informed decision.

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