Step-by-Step Guide to Rolling Over Your 401(k)

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Introduction

If you're currently employed and gearing up for retirement, you're among the 55 million[1] American workers who have a 401(k) retirement account. Plans like the 401(k) allow employers, employees, or both to regularly make tax-deferred contributions—and they offer some latitude as to how you want to invest those funds, too.

As of June 2018, 401(k) plans held approximately $5.3 trillion[2] in assets, representing 19 percent of all retirement assets held in the United States. To put that number into perspective, it's the equivalent of Japan's entire annual economic output as the world's third-largest economy.

For most people, a 401(k) account is both a fairly easy and ideal way to grow your retirement nest egg and save without much steering on your part. You determine what percentage of your salary each pay period you want to contribute to your account—up to certain annual limits—and watch it bear interest over time.

But what happens to your 401(k) account when you retire? And what if you change jobs? In this e-book, we walk you through why you should roll over your 401(k) and how to make it happen so you can worry less about your retirement nest egg and spend more time on the things you love.

Rolling Over Your 401(k): Why, What, and How

Why should I roll over my 401(k)?

The average American worker changes jobs an incredible 10 to 15 times in a lifetime, which means there is a good chance a 401(k) account is getting lost or left behind.[3] In fact, an astonishing $7.7 billion in retirement savings was "accidentally and unknowingly" left behind in 401(k) accounts in 2015 alone, according to the National Association of Unclaimed Property Administrators.[4]

Whether you're switching jobs or ramping up for retirement, you might find yourself among those with a 401(k) and an uncertainty about what to do with it. Plus, if you're a baby boomer—someone born between 1946 and 1964—you're among the roughly 10,000 workers retiring *per day*.[5]

Although most workers put their 401(k) on autopilot and aren't optimizing for maximum growth, retiring workers can reap the rewards of rolling over a 401(k) account. Now is the time to explore which rollover option is the best for you and how it will affect your lifestyle in retirement.

> *12.5 million people with a defined contribution retirement plan like a 401(k) leave money behind every year after changing jobs or retiring, according to the Retirement Clearinghouse.[6]*

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What does it mean to be fully vested?

The question you want to know before considering a rollover is whether you're **fully vested**. At many companies, you can benefit from a "company match," which is when your employer contributes an exact or partial equivalent of your retirement contribution to the fund.

Although the money you contribute to a retirement plan from paycheck to paycheck is 100 percent yours, the funds matched by your employer vest over time, often at a rate of 25 percent or 33 percent per year. In some cases, the amount will be fully vested after an agreed upon timeframe, such as three or five years.

Once you're fully vested, you can take all of the funds with you when you leave a job, get let go, or retire. Although some companies will let you take a portion of the match, some won't let you take any of the vested funds. So, before you decide to make a career move and switch jobs or retire before your funds are fully vested, think twice about abandoning what is, essentially, free money.

What are my rollover options?

Although there is no one-size-fits-all 401(k) rollover solution, it's important to consider your own individual tax implications and other factors that can affect your long-term retirement plans. The most common types of 401(k) rollovers are:

- Former employer's 401(k) to new employer's 401(k)
- 401(k) to traditional individual retirement account (IRA)
- 401(k) to Roth IRA (this requires doing a traditional IRA rollover followed by a Roth IRA conversion[7])
- Keep in existing 401(k)

If you're not quite ready to retire and are switching employers, you'll likely consider a 401(k) rollover straight into your new employer's plan. On the other hand, if you're switching jobs but are happy with the rate of return on your current 401(k), you can leave the fund where it is until retirement—just know that you won't be able to make any further contributions if you go this route. Then again, if you're taking the leap and retiring, the most common rollover for retirees is the 401(k) to traditional IRA path.

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How do I choose a rollover based on my retirement needs?

Let's take a look at the differences between the traditional IRA versus a Roth IRA for rolling over your 401(k), so you can decide which makes more sense for you.

Traditional IRA

A **traditional IRA** rollover typically offers more investment options, but there are a few important things to know about this plan, including:

- You're required to take mandatory distributions starting at age 70½ whether or not you're retired, and you can't make contributions to a traditional IRA once you turn 70½.
- Although your contributions are tax deductible, you'll owe taxes on distributions.
- There are no income restrictions for contributing to a traditional IRA, but your income could affect how much of your contributions you can deduct from your taxes.
- You can start withdrawing at age 59½ in order to avoid penalties.

Roth IRA

The Roth IRA is an attractive option, but take a look at some of the particulars to see whether it will fit your needs:

- You can benefit from tax-free withdrawals and you can withdraw contributions at any time—but if the Roth IRA is less than five years old, there can be penalties.
- There are no mandatory minimum distributions.
- Growth acquired during the course of saving is generally not subject to taxes.
- There are contribution limits based on household income, which can hinder Roth eligibility partially or completely for big earners.

> ***What's in a name? The Roth IRA originated with the Tax Relief Act of 1997 and is named for the late Senator William Roth of Delaware.***

Investment Options

It's also important to consider the types of investment options you have with either type of IRA because some are inherently more risky than others. If you anticipate having other sources of income in retirement and you want to try to maximize growth, you may want to invest in the type of account holding more stocks because they tend to have more potential for higher returns.

If you don't anticipate having many income streams in retirement and are more risk-averse, you may want to look at investment options holding more conservative types of investment, such as treasury bonds and money markets.

> ***Pro tip: Most experts agree that, by the time you retire, you should have somewhere between nine and 11 times your salary—or, even better, 25 times your current expenses—in retirement savings.***

5 Steps to Rolling Over Your 401(k)

Congratulations! Now that you've made the decision to roll over your 401(k), follow these five steps to ensure you don't leave a penny behind.

1. Don't cash out.

Unless you're experiencing an emergency and need the money urgently, resist cashing out before you're 59½ to avoid penalties.[8] If you do withdraw funds prior to age 59½, you'll not only owe income tax on the withdrawal, but you'll also be subject to an added 10 percent early distribution penalty tax.[9]

> ***Putting it into perspective: If you were to take $10,000 out of your 401(k) instead of rolling it over into an account earning 8 percent tax-deferred earnings, your retirement fund would end up short by more than $100,000 over a 30-year period.[10]***

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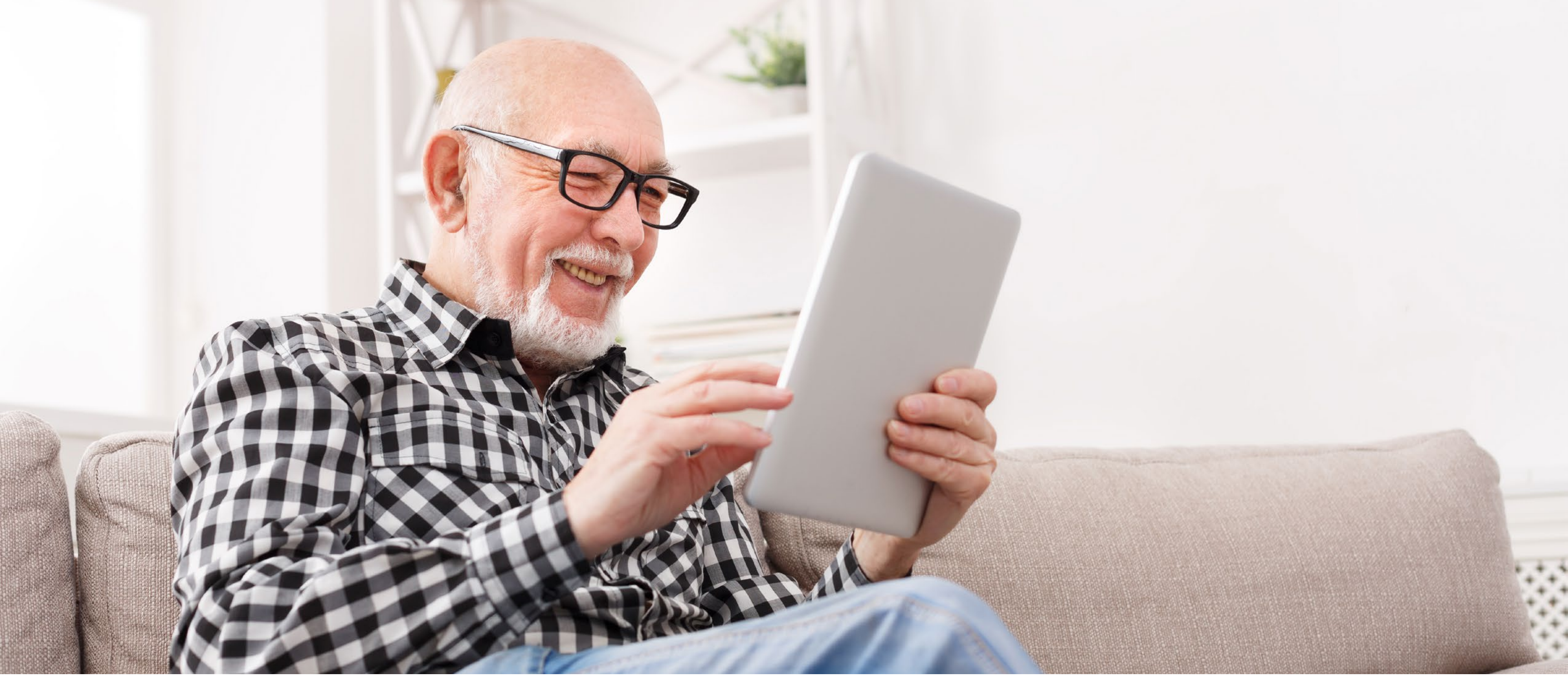

2. Choose the right rollover.

If you're retiring, a good rule of thumb for choosing which IRA is right for you is to answer the following question: **After you retire and begin drawing money from your investment accounts, will your tax rate increase from what it is now?**

Yes:	No:
Consider a Roth IRA, because withdrawals are tax-free and you won't owe the IRS when you need to begin drawing an income.	The traditional IRA might be better, because high earners often move to a lower tax bracket in retirement. Taking the upfront tax deduction while you're still working will allow you to cope with the income tax hit well into retirement when your tax rate is lower.

If you're switching jobs and aren't sure whether to roll your current 401(k) into your new employer's plan, roll it into an IRA, or to leave it where it is, remember that you have 30 days by law to choose what you want to do—so seek out a trusted financial advisor to determine your best option based on your income, lifestyle, and retirement goals.

3. Open a new account.

Set up a new account before requesting your 401(k) rollover to avoid issues with the IRS. If you wait to open a new account until after you've made the decision to disburse funds from the old account, you run the risk of unnecessary tax consequences. Your former plan administrator should give you the option to send a check to the new plan account or transmit the funds electronically.

4. Have funds direct deposited.

To avoid the possibility of withholding penalties or income tax liability, be smart and stick with a **direct rollover** in which funds are distributed directly from one plan to the next.

Avoid the **indirect rollover**, in which funds are distributed to you rather than the new plan trustee, usually by cutting you a check. These funds are subject to a 10-20 percent withholding penalty depending on the type of retirement plan. In addition, you only have 60 days to fund another retirement account before it's considered a cash withdrawal and subject to income tax (and other) penalties.

5. Choose your investments.

Carefully research and pick the types of funds that your money will be invested in. If you find yourself getting overwhelmed with investments to choose, seek the help of a reliable and trusted financial advisor.

> ***Pro tip: If you're investing for the long-term goal of retirement, focus on investing in stocks, which provide the most solid chance of generating returns that outpace inflation. Then, add in some bonds or cash to lower the volatility of your portfolio.***

Frequently Asked Questions (FAQ)

What do I need to know about fees and minimum balances?

Before you roll over your old 401(k) into an IRA or other 401(k) account, you should take a careful look at the fine print—specifically the types of retirement account fees and minimum balances you have to maintain. Some IRAs require you to deposit a minimum amount of money to open an account or to take advantage of premium account management services. Here are some words to look out for if you're concerned about hidden fees:

- Trading commissions
- Management fees
- Mutual fund transaction fees
- Expense ratios

Don't be afraid to shop around for the best offers and lowest fees. Why? Although fees might appear insignificant individually, when combined over time they add up. That being said, low fees don't mean you're getting the best deal or the highest quality solution, so be sure to do plenty of research and talk with a trusted advisor to lock down the solution with fees that give you exactly what you need. Also, make sure that your financial institution provides you with a full, written disclosure of fees before you commit to invest your 401(k).

For example, if you decide to leave your account open with a former employer, you might be required to keep a balance of $5,000—or the company could require you to roll it over into another account. Likewise, if you keep a balance of less than $1,000 in your 401(k), your employer can cash you out and send you a check, according to FINRA, a not-for-profit organization authorized by the U.S. Congress to protect investors.[11] If this happens, your check will be about 30 to 40 percent lower than your investment because of fees and penalties.

Remember: Savings accounts such as 401(k)s and IRAs are about more than having the means to move comfortably into retirement. They also have certain tax benefits that you want to work for you—not against you.

> ***Putting it into perspective: If your portfolio was up 5 percent for the year but you paid 1.5 percent in fees and expenses, your actual return is only 3.5 percent.***

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How do I choose a financial institution?

Prior to 1933, deposits made at your local financial institution were not covered against losses by the federal government. Natural disasters, bank holdups, and financial disasters—such as the stock market crash of 1929—could all put your savings at risk.

Thankfully, with the creation of the Federal Deposit Insurance Corporation (FDIC), Americans have had solid peace of mind in the instance that a bank, savings, or loan institution fails. In fact, FDIC reports that "no depositor has ever lost a penny of insured deposits since the FDIC was created in 1933."[12]

In short, look for FDIC-insured financial institutions to cover your deposit accounts, including traditional IRAs and Roth IRAs, up to $250,000 with certain stipulations.

> ***Putting it into perspective: If you have two IRA accounts totaling $300,000 at the same bank, you're only insured for $250,000 if the bank fails. In this case, it may be wise to split your investment accounts among two or more financial institutions provided they are insured by the FDIC.***

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It's also a good idea to do a little research and inquire with the financial institution as to what kind of cybersecurity measures they have in place to protect you against cybercriminals and online fraud. Additionally, low (or no) monthly fees and robust, easy-to-use online account management features are major perks.

Most importantly, choose an institution that is going to put you and your unique needs first. Here are some questions to ask when choosing a financial institution:

- What is the institution's value proposition? What does it offer that its competitors don't?
- How good is the institution at managing investment portfolios? Is there a lot of management turnover?
- Does the institution answer your questions clearly and promptly by phone, snail mail, or email?
- Does the institution make it easy for you to set up and enroll in its retirement accounts?

These are all important questions to consider when shopping around for a financial institution to safeguard and manage your hard-earned retirement nest egg for long-term growth and sustainability.

How long can I leave rolled over assets in my new plan?

You're required to take **minimum distributions** from your account no later than April 1st of the year after you turn 70½. Some plans may require that you take money out sooner, so it's best to check with your plan administrator on specific rules.

Do I have to report my 401(k) rollover when I file taxes?

Absolutely. Make sure your old 401(k) plan administrator mails you an IRS Form 1099-R in time for you to file your income taxes. This document will indicate to the IRS the amount of the rollover and whether it is a taxable or non-taxable distribution.

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Get Started: Roll Over Your 401(k) with TDECU Wealth Advisors

The decision to roll over your 401(k) means taking a deep dive into your employment goals, tax obligations, long-term retirement plans, and more. It also requires doing some background work to choose a transparent, customer-oriented financial institution to entrust with managing your hard-earned retirement savings.

TDECU Wealth Advisors can help you manage your current income, set goals, and plan for your retirement. We'll work with you to create a completely customized approach that balances bonds, stocks, mutual funds, and other investment and savings options. We understand the benefits and challenges of the investment decisions you're facing, and we're here to help you plan for your future.

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About TDECU Wealth Advisors

TDECU Wealth Advisors (TWA) is focused on putting TDECU members first, and—as a financial cooperative—all financial planning services are available to all TDECU members. We're not your typical investment and retirement planning solution; we're focused on getting you to your right place financially.

With more than 100 years of combined experience, TWA professionals are proactive, strategize for the best results and, above all, are committed to your success for the long term. TWA has helped thousands of people build their financial futures, so if you're serious about your financial well-being, we would be honored to help you too.

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