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FRANK ADVICE ON 401(k) ROLLOVERS

DON’T GET ROLLED ON YOUR ROLLOVER.

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You can get a lot of advice when it comes to rolling over your 401(k). But who does it benefit? Learn the ins and outs of transferring your pretax investments by clicking or scrolling through the information below.

After all, your 401(k) balance may be your largest asset. How those funds perform will be a key factor in your standard of living in your retirement years. So the decision of rolling it over isn’t something you should take lightly.

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To Roll or Not to Roll

The first decision you'll need to make is whether you should roll your 401(k) over into an IRA or just leave it with your former employer's plan. In some cases, especially with smaller balances, you may not have the option to leave it there, but usually the choice is yours.

Most financial institutions, from brokerage firms to banks to insurance agencies to mutual fund companies, would love to help you roll over your 401(k) into their investment products. Be careful to consider whether a rollover is a good strategy or just a sales ploy.

Roll Into Greater Investment Options

One of the biggest benefits of rolling over the funds into your own IRA is that your list of investment options becomes almost unlimited. Instead of the few choices your previous employer selected, you'll be able to invest into a much wider variety of investments.

More choices is usually a good thing, but it isn't always the best thing if you aren't an expert investor. Many financial advisors will be happy to help, but many are more interested in the commissions they'll make and not in the long-term growth of your portfolio. In fact, if they start touting annuities as a great investment option, you should probably run, not walk away from this type of advice. Annuities are among the most expensive investments out there and there's little justification for putting IRA funds into them.

Big Decisions Related to Smaller Rollovers

The size of your rollover may limit the types of financial advisors that can help you. If your balance is under $100,000, you may find that the account is too small for many of the professional, fee-only investment advisory firms or top stockbrokers.

In such cases, you may need to consider whether working directly with a mutual fund company or seeking out a local advisor makes sense. You'll want to check out their fees and commissions, and whether they will actively manage your account or simply invest it into some funds.

Ideally, you'll probably want a fee-based arrangement where there are no large up-front or back-end charges. That way, your advisor has an incentive to grow your account. You can always monitor the results and their services and move elsewhere if necessary.

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If the advisors you find are recommending that you pay a commission to get into some new investments, check out their track record versus the results of the plan options you have with the 401(k). For mutual fund comparisons, check out www.Morningstar.com for their research. Some 401(k) plans have good options that may compete well with funds that a commission-based advisor may offer.

Keep in mind that an advisor may turn out to provide excellent value to you during periods of market volatility. But the most important thing is your net return on the investment. If you don't have the expertise and, just as important, the discipline to successfully manage your own account, then a good professional will likely improve your results net of their cost.

The Big Rollover

If you have built a larger 401(k) balance and now have more than $100,000, you'll want to carefully examine your options. The larger amount should open some more doors to better advisors and it should be easy to find fee-based or fee only advisors to work with you.

Seek out advisors that will regularly report on your investment returns and that will continue to advise you after your initial investments are made. Your investment portfolio isn't like a refrigerator that you can buy and just let it run by itself for a long time. Investment markets are dynamic and you'll need a professional to help you navigate the cycles. A good advisor can also help you determine how much you can spend in retirement without the risk of running out of money.

Don't Get Rolled to Sleep on Costs

Some people think that their former employer will pay their investment management costs if they leave the balance in the 401(k) plan so they can improve their results by not rolling over the account into an IRA. Depending on the size of the employer's plan, there may be some truth to the lower costs, but the more important issue is net investment performance.

If you've had a 401(k) plan through your employer, chances are there has been little to no personal advice provided to you . You were most likely given some investment options, some past performance numbers and left on your own to decide how best to invest. How did you do? Did you measure your investment results and compare them to an appropriate benchmark? Chances are, no.
You now have the opportunity to hire a professional that can improve your performance. It's possible it will cost more than leaving it in your current 401(k), but the key is whether your net results will be better using a professional than what you could earn on your own.

When Not to Roll Over

Generally, it makes sense to move the funds into an IRA account; however, there are situations where you'll want to leave your money in an employer-sponsored plan.

Many 401(k) plans allow you to take loans against your balance and then repay the funds to yourself over a number of years.

While you are employed these repayments are deducted from your paycheck. If you leave an employer and still have an outstanding loan balance, you'll need to arrange to keep making the payments.

If you don't continue paying your 401(k) back, then the plan administrator may declare the loan forgiven and will report the outstanding loan balance as income to you. As such, you'll need to pay income taxes on the amount (even though you don't receive any more money to pay the tax) and you may have the 10% penalty for an early distribution on top of the income taxes.

Between federal and state income taxes and a penalty, you could end up paying 40–50% of the outstanding loan balance within a few months. By making payments on the loan, you can avoid the taxes, end up with a higher balance, and may be able to stretch the payments out over years.

All that said, you can't roll over the 401(k) to an IRA and preserve the loan feature. So, in such cases, it's best to leave your 401(k) with your former employer until you are able to repay the loan. Once the loan is paid, then you can make decisions about rolling it over without any problem.

Now That We're on a Roll, Here's One More Rollover Consideration

If you have a significant amount of your 401(k) invested in your former employer's stock, you may want to check with a tax professional before rolling over to an IRA. If you have a large capital gain, there are special tax rules that could reduce your taxes. Ask your tax advisor about Net Unrealized Appreciation and run the numbers to see whether a different strategy will work for you.

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About the Author

Frank Moore, MS, CFP, started in the investment business in 1983, about the time 401(k) plans started to become popular. Over the years he's helped set up plans at the company level, but his primary focus has been on helping individuals get the most from their plans. His Registered Investment Advisory firm, Vintage Financial Services, can manage an individual's 401(k) assets whether they are held in an employer plan or rolled over into an IRA.