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Optimizing Your Former Employer's Retirement Savings Plan

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In order to make the most of your retirement savings in your former employer's plan, you need to act sooner rather than later. This is particularly true if you have recently changed your job, have become disabled, or are nearing 59 ½. It is necessary to understand what options you have and the inherent advantages and drawbacks of each option. If you are eligible for distributions, there are generally four possible options. The differences in these four options generally relate to increased fees and expenses, tax implications, investment options, and penalty-free withdrawals.

Leave funds in plan

The simplest choice one can make is to just leaves those funds in their former employers 401(k); however, that's not necessarily the most responsible. There are still benefits though, such as the possibility of tax benefits for company stock in the account at withdrawal. If you need cash for short-term liquidity, a 401(k) provides the opportunity to take a loan. The drawback to leaving assets in a former employer's plan is the restriction that comes with it. Once you've retired you can no longer make contributions to these plans. This is unlike an IRA which, under the SECURE Act, now gives the option to keep making IRA deposits even past the age 70½. To make matters worse, your employer 401(k) does not give you the same broad investment options as an IRA does, possibly limiting your diversification and potential returns.

Rollover to an IRA or a new employer's plan

This naturally brings us to the choice to roll your savings into an IRA, the most widely appealing strategy. The aforementioned benefits – increased investment options and the new liberty to continue contributing past the age of 70½ – are the real cash cows of rolling over to an IRA. Contributing in your 70s may seem unusual, but it can be done strategically to lower your income tax once you start taking RMDs so long as you still have earned income. To delve a bit deeper into the strategy, a husband and wife could take their distribution and subsequently deposit $7,000 each to lower their income and the corresponding income tax. It is noteworthy that the increased investment options demand more due diligence on the individual investors part. The investment expenses and account fees may be higher, and there will not be a fiduciary prudently monitoring the cost and quality of the investment options. It may be wise to consult a financial professional to provide assistance in making the most of the wide variety of additional investment options. Also, if you are joining a new company that offers a retirement plan,

rolling savings to the new employer's plan should be considered. Like an IRA rollover, this will also maintain the tax-deferred status of your savings, and you can continue to make contributions.

Pull all your savings out

The final option one has is to cash out their savings and close the retirement account. This will give you immediate access to your funds, but that is likely the only upside. Most retirees avoid this move because those funds are obviously meant to last through their retirement, and having those assets immediately available can make it difficult to responsibly ration them. In addition, you are going to lose a hefty chunk of your savings due to taxes that were deferred when you made your contributions, as well as higher taxes the year those funds are pulled out because you will likely be bumped up to a higher tax bracket. You will also lose access to a powerful tool for financial appreciation - tax-deferred growth. Also remember that distributions are included in your taxable income. Federal and state income tax rates vary depending on income level and which state you are in.

As always, make sure to consult with a financial professional before making any major financial decisions regarding your retirement plan.