Boomer Angle™

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401(k) Rollovers, Yes or No?

If you just left a company where you had a 401(k) chances are that you are wondering about rolling your 401(k) over into an Individual Retirement Account (IRA). It's an important question.

There's a great deal of money involved in rollovers and a lot of financial professionals who want to help you manage the process. In 2013 alone, $358 billion was rolled-over into IRAs (Financial Research Group and Cerrulli Associates). The allure of all these new accounts for financial professionals is so great that 401(k) rollovers are currently under scrutiny from financial regulators because of reports of unscrupulous behavior from some financial advisors.

While rolling over your 401(k) may be a good idea, there are many variables to consider to make a prudent choice which is in your best interest. Here is some background to get you up to speed on rollovers and help you protect yourself. Note that this information applies not only to 401(k)s but also to other employer retirement savings plans authorized by The Employee Retirement Income Security Act (ERISA) including 403(b)s and 457s.

With whom are you doing business?

Know with whom you are dealing. Any financial professional offering to roll-over a 401(k) to an IRA is either a representative of a Registered Investment Advisory (RIA) firm or a representative of a brokerage company.

Representatives of brokerage companies are required to offer investments which are merely 'suitable' for the client but which could include products or solutions which are less than ideal. Brokerage representatives are compensated by commissions based on sales or other sales-incentivized mechanisms.

Representatives of Registered Investment Advisory firms, like Bucks County Financial Planning Group, are legally required to place your interests ahead of their own and act in your best interests whenever they provide any financial service. This is called offering 'fiduciary advice.' RIAs are typically compensated for advice as a percentage of the value of the account and are not compensated based on sales of any kind.

Happy people have the courage to embrace their insecurity. They know it will always be there, as long as mankind is mortal, and that to experience it is to feel the true, rough essence of real life.

- Dan Baker,
from What Happy People Know

The U.S. Labor Department feels the fiduciary approach is so important that they are expected to shortly propose rules requiring that any financial professional facilitating a 401(k) rollover must act "in the client's best interest". But that is only in the future. For now, representatives of RIAs are the only professionals who must act in the client's best interests.

Why rollover your 401(k) to an IRA

Investment Choices -IRAs, hands down, usually offer a much broader range of investment options. This includes, not only thousands of mutual funds, stocks, or bonds but access to managed portfolios and a wide range of alternative investments. 401(k)s are usually constrained by a limited range of investment options negotiated by your company. This is the most common reason people cite for doing a rollover.

Control – 401(k)s may be at risk when the company is facing financial difficulties such as bankruptcy. Companies can merge or be bought out, causing major changes to the plan. With an IRA rollover the owner does not have to keep track of the company or worry about these issues.

A personal advisory relationship - When you rollover to an IRA you can establish a one-on-one relationship with an advisor who legally has to act in "your best interest." You also have the option to simplify and integrate all of your other financial affairs by consolidating them with one financial advisor and one organization.

Fees - Fees are a mixed bag. On one hand, 401(k)s have extra administration fees that may not be clear to many account holders in addition to standard mutual fund expenses and fees. IRAs may have higher investment expenses and fees and will typically have either advisory fees (for RIAs) or sales charges for brokerage companies.

Lastly, one may rollover a 401(k) to an IRA simply to make a clean break with the former employer.

Why you may not want to rollover your 401(k).

Creditor Protection- ERISA protects 401(k)s from creditors. IRAs, on the other hand have no such federal protection although they may be protected on the state level. Unfortunately, only eight states offer creditor protection with California offering limited protection. A very recent Supreme Court ruling on June 12, 2014 further limited creditor protection for an inherited IRA. If you have an heir who is a doctor, lawyer or in another profession which is susceptible to litigation you need to consider this issue carefully before taking any action.

Early withdrawals or loans - As a rule, you really do not want to spend down your retirement savings before retirement. If you must, however, 401(k)s are generally have better options. 401(k)s allow penalty-free withdrawals (you still pay income tax) as early as 55 years of age. With a IRA you must wait until you are 59 ½. 401(k)s usually offer the option of loans. IRAs do not.

Special Situations

Company stock – If your 401(k) contains a large amount of company stock, before doing a rollover, explore a special tax-advantaged strategy called the Net Unrealized Appreciation option which gives unique tax treatment to company stock in 401(k) plans.

In general, beware of anyone who makes blanket recommendations promoting rollovers without a reviewing your specific financial situation and the issues listed above. Know with whom you are dealing and do your homework.

BoomerAngle™

Life Planning, Retirement Planning and Financial Planning for the Boomers and beyond.

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Financial Planning and Investment Advisory Services offered through Bucks County Financial Planning Group Inc., a fee-only Registered Investment Advisor.

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