White Lighthouse Investment Management

Ten Considerations When Evaluating a 401(k)* Rollover

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Deciding whether to leave a 401(k) with a former employer or roll it over to an IRA is not a simple decision and several factors come into play. If you see our advice regarding your options, it is important that you understand that as your investment advisers, we have a conflict of interest with respect to your decision. Since you pay us a fee that is a percentage of your assets under our management, and presumably, we would be the managers of your new Rollover IRA, such as a rollover would benefit our firm financially through a higher asset management fee.

With that in mind,, what other considerations do you have to make when deciding whether to rollover or not your 401(k)? Below are some of the most important issues you should consider.

1. **Will you have the ability to take penalty fee withdrawals at age 55 if you keep the money in the 401(k)* footnote all qualified plans?** Generally, retirement plan distributions made before you turn 59 ½ are subject to a 10% early withdrawal penalty. However, there is an exception from this penalty for distributions from 401(k) if your separation from service happens in or after the year you reached age 55. The penalty exception does not apply to distributions made from an IRA.
2. **What type of investment options are offered by my former employer's plan?** With the exception of larger employers, 401(k) investment options tend to be limited to a small number of funds. When this is the case, it is easier to build a well-diversified and customized portfolio in an IRA than in a 401(k).
3. **Will I lose access to institutional shares if I rollover my 401(k)?** Most 401(k) plans offer mutual fund institutional shares. Institutional shares are available to large investors and can carry significant lower fees than retail mutual fund shares. The higher cost of retail mutual fund shares negatively impacts portfolio performance. Institutional mutual fund shares are

generally not available through IRAs, although your investment advisor may have access to institutional shares. We use low cost ETFs in our IRA portfolios, which generally carry lower fees than mutual funds. ETFs are generally not an investment option offered by 401(k)s, although this is starting to change.

4. **Is there a difference in creditor protection between a 401(k) and an IRA?** Although this is a matter of state law, in general, 401(k)s have greater creditor protection than IRAs. 401(k)s generally have unlimited protection both against lawsuits and bankruptcy. IRAs are only protected against bankruptcy, and even then, the protection is limited to $1.2 million (adjusted annually by inflation). Some of this risk can be mitigated by rolling over the 401(k) to a Rollover IRA instead of a Contributory IRA. A Rollover IRA does not allow new contributions and my rolled back into a 401(k) if your new employer's plan allows it.
5. **Will my former employer limit my access to my 401(k) after I leave the company?** If you had access to your 401(k) through your firm's employee portal during the length of your employment, your access may be limited after you lose access to the employee portal.
6. **Are there any differences in penalty-free early distributions between 401(k)s and IRAs?** In general, the same early distribution penalty exceptions apply to 401(k)s and IRAs, such as certain health care expenses, IRS tax debts, due to permanent disability, etc. They do differ in the age 55 separation from service exception mentioned in question 2, which is only available through 401(k)s, and the education exception available only through IRAs. This IRA exception allows for early distributions made to pay for certain relatives' qualified education expenses.
7. **Will I lose my ability to roll over the funds to a new employer 401(k) if I roll over my old 401(k) to an IRA?** Generally no, as long as you do not commingle your rollover IRA funds with other contributory IRA funds. In order to preserve the ability to rollover your IRA to a new employer's 401(k), Rollover and Contributory IRAs must be kept separate.
8. **Does an IRA rollover impact Roth IRA conversions?** Possibly. When you make a Traditional IRA to Roth IRA conversion, the amount of the taxable conversion depends of the proportion of your IRA balance that came from deductible Traditional IRA contributions. The amount of the conversion allocable to non-deductible contributions will be converted tax free, and the rest (deductible contributions and account earnings) will be taxable. If you have multiple IRAs, they are counted in the aggregate and you are not allowed to choose which IRA to convert. If you roll over your 401(k) to a Traditional IRA, the amount rolled over will be counted as a deductible IRA contribution for purposes of calculating the tax on a Roth conversion. If you later want to make a Roth conversion and you had non-deductible IRA contributions, a higher proportion of this conversion will now be taxable.
9. **What investment guidance will I receive if I keep my old 401(k)?** If you leave your money in your old 401(k), your investment guidance may be limited. You should find out what investment management resources, if any, your employer offers to former employees. Additionally, in most cases, your employer will not allow an independent advisor to manage your 401(k) investments. This inability to manage your 401(k) investments with ease internally or externally can be potentially problematic.

10. **How do 401(k) and IRA fees differ?** Some employers, but not all, charge quarterly management fees to former employees who leave their 401(k) with them. You should compare those fees, and the services provided by your former employer in exchange for those fees against the fee and services provided by your investment advisor with respect to your Rollover IRA.

As you can see, the decision to rollover a 401(k) is not an easy one, with many factors to consider. If after careful consideration you decide that a rollover makes sense for you, the next step is to find out what kind of products your investment advisor recommends for your IRA. Not all advisors are fee-only, paid exclusively by you, or have to put your best interest ahead of their own. Some advisors will have incentives to sell you commissioned products that may not be appropriate for an IRA. Examples of these products include expensive and usually inflexible annuities or certain investments that generate UBIT (Unrelated Business Income Tax), which may result in you having to pay income tax on your IRA investments, partially denying one of the biggest benefits of an IRA, the benefit of tax deferral.

**These considerations are illustrative not comprehensive, and they apply to IRA rollovers, not just from 401(k)s but also from other qualified plans, such as 403(b)s, Keogh plans, money purchase plans, etc. Other factors that may impact this decision include Net Unrealized Appreciation considerations, concentrated positions in employer stock in the qualified plan, risk that the rollover will not be completed within the 60-day period to be qualified, etc.*