Choices for Your 401(k) at a Former Employer

One of the common threads of a mobile workforce is that many individuals who leave their job are faced with a decision about what to do with their 401(k) account.[1]

Individuals have four choices with the 401(k) account they accrued at a previous employer.[2]

Choice 1: Leave It with Your Previous Employer

You may choose to do nothing and leave your account in your previous employer's 401(k) plan. However, if your account balance is under a certain amount, be aware that your ex-employer may elect to distribute the funds to you.

There may be reasons to keep your 401(k) with your previous employer —such as investments that are low-cost or have limited availability outside of the plan. Other reasons are to maintain certain creditor protections that are unique to qualified retirement plans or to retain the ability to borrow from it if the plan allows for such loans to ex-employees.[3]

The primary downside is that individuals can become disconnected from the old account and pay less attention to the ongoing management of its investments.

Choice 2: Transfer to Your New Employer's 401(k) Plan

Provided your current employer's 401(k) accepts the transfer of assets from a pre-existing 401(k), you may want to consider moving these assets to your new plan.

The primary benefits to transferring are the convenience of consolidating your assets, retaining their strong creditor protections, and keeping them accessible via the plan's loan feature.

If the new plan has a competitive investment menu, many individuals prefer to transfer their account and make a full break with their former employer.

Choice 3: Roll Over Assets to a Traditional Individual Retirement Account (IRA)

Another choice is to roll assets over into a new or existing traditional IRA. It's possible that a traditional IRA may provide some investment choices that may not exist in your new 401(k) plan.[4]

The drawback to this approach may be less creditor protection and the loss of access to these funds via a 401(k) loan feature.

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Remember, don't feel rushed into making a decision. You have time to consider your choices and may want to seek professional guidance to answer any questions you may have.

Choice 4: Cash out the account

The last choice is to simply cash out of the account. However, if you choose to cash out, you may be required to pay ordinary income tax on the balance plus a 10% early withdrawal penalty if you are under age 59½. In addition, employers may hold onto 20% of your account balance to prepay the taxes you'll owe.

Think carefully before deciding to cash out a retirement plan. Aside from the costs of the early withdrawal penalty, there's an additional opportunity cost in taking money out of an account that could potentially grow on a tax-deferred basis. For example, taking $10,000 out of a 401(k) instead of rolling over into an account earning an average of 8% in tax-deferred earnings could leave you $100,000 short after 30 years.[5]

1. In most circumstances, you must begin taking required minimum distributions from your 401(k) or other defined contribution plan in the year you turn 73. Withdrawals from your 401(k) or other defined contribution plans are taxed as ordinary income, and if taken before age 59½, may be subject to a 10% federal income tax penalty.
2. FINRA.org, 2024
3. A 401(k) loan not paid is deemed a distribution, subject to income taxes and a 10% tax penalty if the account owner is under 59½. If the account owner switches jobs or gets laid off, any outstanding 401(k) loan balance becomes due by the time the person files his or her federal tax return.
4. In most circumstances, once you reach age 73, you must begin taking required minimum distributions from a Traditional Individual Retirement Account (IRA). Withdrawals from Traditional IRAs are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. You may continue to contribute to a Traditional IRA past age 70½ as long as you meet the earned-income requirement.
5. This is a hypothetical example used for illustrative purposes only. It is not representative of any specific investment or combination of investments.

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