What Happens to Old 401(k)'s? - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 294. Thanks for tuning in. This is Tom Mullooly from Mullooly Asset Management. Today we want to talk about something that I think kind of gets swept under the rug and a lot of people lose track of things. What I'm talking about is that retirement account that you had at your first employer or maybe your second job or maybe the first three jobs that you had. The economy has been pretty good the last few years and so there's a lot more upward mobility than there was say 10 years ago. 2008 I think a lot of people felt lucky to hang onto their jobs. That continued into 2009 and 10 but over the last few years as the economy has improved, it's provided opportunities for people to increase their income by taking a new job or to move into a different kind of position and when that happens, unfortunately there may be money left behind or lost in the sauce.

I'm talking about 401k accounts or retirement plan money dollars that you may have left behind. I found an interesting article that we'll link to in the show notes written by Angela Antonelli in Forbes. Pretty lengthy headline, Easy Way to Avoid Lost Billions in Retirement Savings, but We're Not Doing It and this is very true. I can tell you on a personal basis that we do this for our clients. They'll come in and they'll say, "Oh, I've got three 401k accounts that have been sitting around for 10 years from old jobs. I never did anything with them. I get a statement once a quarter or sometimes once a year and I forget about it. I'm too busy. I got stuff going on and it's not a whole lot of money. I don't know what to do with it and the accounts seems to be okay. It doesn't appear to be losing money so I don't know really what to do."

You have options. The one thing that we remind all of these folks is that most of the money that's in these old 401ks is your own money. This is money that you had taken out of your paycheck while you were working at an old job at an old company and so this is your money. There may be a company match in there, there may be some market gains in there, but the bulk of that money is probably your own contributions that came out of your pocket on a pretax basis. What happens when you leave a job, take a new job? What happens to that old retirement account? There are actually provisions now, they've been around since 2006 that allow previous employers to terminate small retirement accounts.

Just to kind of clear them off the books because it's a cost for employers to keep small accounts for inactive or former participants, employees. They can clear them off if the balances are less than $5,000. Now, even if you've got 401k with $800 that can be rolled over and it can be rolled over to a couple of places. It can be rolled over into your current 401k. Most, but not all 401k plans allow rollovers from previous employers. Most of them do, and that's great. It's a great way to consolidate all of these accounts. There is some paperwork involved and it does take a little bit of time and a little bit of legwork.

You can also roll this money into an IRA. Understand that the rules change when money goes into an IRA. 401k you can usually borrow against if you need it. You can't take the money out while you're still employed. With an IRA things kind of change. You can take the money out of course, but you do have to realize that if you're under age 59 and a half, since this is really money that's been designated for retirement, you will be subject to a 10% penalty.

So if you take $10,000 out of your plan, it will be $10,000 reported as taxable income, as if you earn that in a salary. Plus, if we're using $10,000 as a figure, you'll have an additional $10,000 as a 10% penalty for withdrawing prior to age 59 and a half. You need to understand there are some rules out there and they're the rules that are designed to keep you focused on this is money that's actually designed for retirement and not to be used as a safety net or a piggy bank or something like that.

So in 2015 alone, participants in retirement plans lost $92 billion in retirement savings. That's a lot of money. $92 billion in retirement savings due to cash outs where they were forced to take distributions after changing jobs. After they went from one employer to the next. This actually impacted 5 million Americans with small accounts. This is a lot of people with a lot of money that's just sloshing around. The balances, whatever they are, $800, $200, $4,000, these can be rolled over into your new employer plan most of the time. The process is a little cumbersome. Clients of ours, we've helped them do this. We help them gather the paperwork so that they can do this and it becomes a tax free transfer or rollover into the new plan. The problem is if you take the money into your own possession, you're going to have taxes and you're going to have penalty.

So what happens to a lot of people, they leave a job and in the first 60 days they're going to get notified by their previous employer, "Hey, you've got this money in the plan. If you don't do anything, we're just going to cut a check to you," and it will be net after taxes are withheld. Then of course you're going to have penalty. Doesn't really make sense to do that when you could roll this money over into an IRA or into your new company plan, but the way the system is set up now, it really punishes workers because they've decided to move on with their career. They're either getting a better job or more income, but now it creates extra work, extra legwork for them to move this money in an expedient manner. They've got to do this usually within 60 days and so if you've got less than $5,000 if you don't act quickly, you can find that this money gets paid out to you after tax. That's a problem.

According to the article, again, we'll link to this in the show note, 54% of participants with small account balances take the cash within the first 12 months despite having to pay taxes and penalties, and I thought this was really interesting, nearly eight in 10 participants cash out by year seven. It's really pretty interesting to see. You've got these small balances, a lot of people will say, "Oh, you know, I didn't really know I could roll that money over. I didn't know what the consequences were, so I just took the money out and I went on a trip." Or, "I took the money out because we were buying a home or we took the money out. What happens is a lot of people wind up either spending the money or they just lose track of it.

So the article went on to talk about auto portability as a solution. I don't really want to get into that. What I want to stress is, what a lot of people forget is that a gigantic portion of this money that's in these retirement accounts is your own money. It came out of your paycheck. You should really have the ability to retrieve this money and be able to control it a little better than the way the system is set. So the employee benefit research Institute, EPRI, they found that if they started employing auto portability where you could just automatically use a clearinghouse and move this 401k account from one plan to the next, it would reduce leakage by quite a bit.

They did a 40 year simulation and they found that they could reduce leakage by 156 billion. Now 40 years is a very large sample study and it's a simulation so it's not real time. However, to back this up, a study done in 2013 by the same outfit found that one large employer that already offers a portability service was able to reduce leakage by 50% below industry average. That's really big. The Department of Labor requires that plan sponsors take steps to locate the owners of what they call lost accounts. Now this is why you get a letter almost immediately after leaving an old job because they want to move on with these assets. That's very important. They want to clear this off the books.

It's important to keep this all in mind when you're doing this, this money that is just kind of sloshing around, we've heard people say, as I mentioned earlier that they, "Well it was only a couple of thousand dollars so I had tax taken out and then we used the money for a trip," or, "I was buying a home and so I just used that money as the down payment on my house." This isn't really what retirement savings is about and we have gotten into some lengthy conversations with clients about this. When you're in your twenties and possibly even into your thirties this may go against what's accepted as basic financial planning, but just hear me out.

If you graduate from college and you are trying to pay down your student loans and you're trying to save for a home, it's yes, important to think about retirement. However, we see a lot of instances where people are over withholding money in their paycheck in their mid twenties, late twenties and they are digging themselves a bigger hole because they are trying to sock money away for an event that's going to happen in 40 years. So it's important that we recognize that you need to start saving early for retirement and of course we've done podcasts and videos and blog posts about the longer you can let your money compound, the better your returns will be, but we also have to use a little bit of common sense.

If you've got limited income in a first job or even a second job, as you're moving up the ladder, you have to take care of yourself first, so the first thing you need to do is put together that safety net. If you don't have money in an emergency savings account, you need to stop what you're doing right now and build up that reserve. You can't really think of your retirement account as an emergency fund. If you work for a company and you're putting money into a 401k, yes, you could do a loan, but what happens if you take a loan out and then later on you need more money? You're really in a jam and you're paying back a 401k loan.

First things first. You need to have that emergency safety net to cover you in the event that there's going to be some kind of situation where you're going to need a couple of thousand dollars immediately. We've all seen these headlines where they say more than 50% of Americans don't even have $1,000 socked away. Don't let that be you. First things first, you got to work on your safety net.

The second thing you need to do is start tackling debt like student loans. If you've got credit cards, you need to tackle that and maybe change some of the habits that you have.

The next thing you need to do is if you're planning on buying a home, you need to start socking money into that. After those things are begun, not completed, after they're begun, this is when you need to start thinking about putting a certain percentage of your money away for retirement. It's okay if you start with a number like one or two or 3% of your income. If your employer matches a certain amount, you certainly want to do whatever's necessary to get the employer match because that is literally free money that the employer is giving you through this account and any money that goes into a 401k will usually be vested automatically, meaning you own it 100%.

Need to put priorities first. Got to have that emergency safety net. You've got to start tackling debt, whether it's student loans, credit cards, whatever. Then you need to start, if you're going to be putting money away for a house, then you need to start doing that in earnest in a big way and once those things are begun, then you can start talking about putting money away for retirement and start with a number that you're comfortable with. Start with an amount that you can definitely do without crimping your lifestyle.

In a previous podcast, one of the things that we covered was taking your annual increase, if you are fortunate enough to get a raise and saving 50% of that. So if you get a 5% raise, then you want to take two and a half percent or half of that raise and plop it into your retirement account. You can do these things through payroll in most cases, but this will help kind of keep things focused. You need to be working on that. We are still surprised when people come to us and we see situations where they've got $10,000 you know, they're not quite 30 years old, they've got $10,000 in a 401k, but they've got credit card debt, they've got student loan debt. They haven't saved anything for a house. I mean, they're just upside down in their financial picture. So we need to really focus on that.

If you've got old 401k accounts or old retirement plan accounts from a previous job, speak with your advisor about getting this money consolidated either into your current 401k account at work, or it can be rolled over tax-free into an individual retirement account with a broker. These are things that really... We look at this as stuff we do every day here at Mullooly Asset Management. This may be a one time event for you or for someone you know.

Things to keep in mind as we head into the new year with a good economy, we want everyone to continue to increase their standard of living, but don't leave money behind and it's money that came out of your paycheck that's rightfully yours.

That's going to wrap up episode number 294. Thanks again for tuning in. Speak to you again soon.