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How to manage a 401(k) left at a former employer

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When you leave a job, you may wonder what will happen to the money in your former employer's retirement plan—and what action (if any) needs to be taken.

First and foremost, the dollars you contributed to the account from your paycheck (and the investment growth they created) are yours to keep—you don't lose them when you change jobs or retire.

So, at the very least, you'll want to confirm where the money is held and how to contact the plan provider. This information will make it easier to keep track of your retirement savings and will come in handy when you eventually decide to withdraw the funds or roll them over.

It's important to note that while the dollars you personally contributed are yours to keep, it doesn't mean the entire balance in the account belongs to you. If you were lucky enough to work for an employer who matched some or all of your retirement account contributions, their contributions may or may not be yours for the taking.

That's because your employer's matching contributions may be subject to a vesting schedule, meaning you have to work there for a certain length of time in order to be entitled to their contributions. An easy way to determine how much of the balance is yours is by looking at the balance breakdown on your account statement. This should show both the vested and invested balances.

So what should you do with the money in the plan that does belong to you? It's important to first make sure you understand what your options are and how you can make the most of this opportunity without triggering any unintentional taxes or penalties. With this understanding, you'll be able to determine which option works best for you and your financial plan.

What are your options?

Option 1: Withdraw the money as a lump sum

When you cash out of a retirement account, the money is sent to you directly. This means that you can deposit the funds in your bank account and spend the money however you'd like. But you won't be able to spend it all. That's because, generally speaking, your employer plan will be required to withhold 20% as a prepayment of federal income taxes, and you may be subject to a 10% penalty if you weren't at least age 55 when you left that job.[1] What's more, you may end up owing even more money to the IRS when you file your taxes, depending on your income level.

Option 2: Leave the money in your plan

If your former employer's plan allows, you may choose to leave your retirement savings in the plan after you leave your job. However, keep in mind that you'll only retain the portion of your account that is fully vested—meaning any employer contributions that are subject to a vesting schedule may be forfeited if you haven't met the required service period.

If you are considering this option, be sure to review the plan's rules regarding account balances, fees, and ongoing access. This option may be convenient as long as you are satisfied with the plan's investment options, fees, and services. However, you may face different terms than you did as an active employee. For example, there may be additional account fees. Moreover, some plans may require former employees to move their assets if the account balance falls below a certain threshold (e.g., $7,000), in which case your balance may be "forced out" (rolled over to an IRA in your name). If your vested balance is low enough (e.g., below $1,000), your previous employer may cash out your account and send you a check in the mail. If not quickly rolled over to an IRA or your new employer's plan, this could result in the same taxes and penalty mentioned above in Option 1.

Option 3: Roll over to your new employer plan

If you've moved to a new job and are eligible to participate in their 401(k) plan, you may be able to roll your existing account into the new plan. While the money would be cashed out of your previous employer's plan, you won't be subject to the taxes and penalties described above (Option 1) as long as the funds are transferred directly to the new plan. This means the dollars will be able to maintain their tax-deferred status in the new plan until they are distributed in retirement.

Another potential benefit of this option is that you may be able to delay Required Minimum Distributions (RMDs) from these assets for as long as you are still working for the employer. To qualify for the "still working" exception, you must still be employed by the company sponsoring the plan, and you cannot own more than 5% of that company. The exception only applies to assets held in your employer's retirement plan, but you may be able to roll other retirement assets into this plan to also include them.

While the IRS permits employers to accept most retirement accounts as rollovers into their plans, they aren't required to do so. Additionally, some employer plans may accept only certain types of accounts as rollovers. So, you'll want to confirm your new employer's rollover rules prior to initiating the transaction.

Option 4: Roll over to a Traditional IRA or Roth IRA

Similar to rolling your 401(k) account from a previous employer's plan to a new employer's plan, rolling it into a Traditional IRA allows the funds to maintain the same tax-deferred status. And, if you roll a Roth 401(k) from a previous employer into a Roth IRA, the assets will continue to grow in a tax-free environment.

You also have the option to roll a Traditional 401(k) into a Roth IRA. However, this is considered a "Roth conversion" and is a taxable event. The tax burden of a Roth conversion is based on the taxable portion of your Traditional IRA or 401(k), which is the amount in excess of any nondeductible (after-tax) contributions. While a Roth conversion is a taxable event, you won't incur the 10% early withdrawal penalty because it is still considered a rollover.

How to choose

When choosing between these options, you should carefully consider your circumstances, with guidance from a financial advisor. With this in mind, here are some general thoughts.

Option 1 (withdrawing the money as a lump sum) can be an expensive decision. First, this will generally be considered a taxable distribution, turning the account balancing in taxable income subject to prevailing local, state, and federal income taxes, and (in most cases) a 10% early withdrawal penalty. Perhaps even more significantly, withdrawing funds will reduce your portfolio's tax-deferred investment growth potential. Outside of extreme financial hardship, these costs can be prohibitive.

By contrast, the other three options allow your investment assets to remain invested in a tax-advantaged account—either the current plan, your new employer's plan, or in an IRA—avoiding the risk of a large tax bill and potential penalties. When choosing among these three options, you may want to weigh these variables:

1. **Investment options:** 401(k) plans often have a more limited set of investment options than IRAs.
2. **Fees and expenses:** Fees may be lower with one plan provider versus another. Consolidating assets may lead to a lower fee "breakpoint," lowering investment costs.
3. **Account services:** A 401(k) provider may offer tools and/or advice for account holders, but these services may only be available to active employees.
4. **Required Minimum Distributions (RMDs):** As noted above, a "still working" exception may apply to assets held in your current employer's 401(k) plan, allowing you to defer RMDs beyond your normal Required Beginning Date.
5. **Loan provisions:** You may be able to borrow from your 401(k) account held at a current employer; such loans must usually be repaid (or be treated as distributions) shortly after separation of service.
6. **Creditor protection:** Most 401(k) accounts are protected by the Employee Retirement Income Security Act (ERISA), meaning that creditors generally cannot seize 401(k) funds to satisfy debts, including in bankruptcy proceedings. IRAs are not protected by ERISA, so their protection against creditors depends on state laws. However, IRAs are generally protected in bankruptcy (up to a limit).

Even if you do leave a balance in a former employer's 401(k) plan, you will not be able to make further contributions to that plan as a former employee. Therefore, to continue meeting your savings goals, you should prioritize setting up a retirement account with your new employer as soon as possible—especially if it allows you to begin getting a matching contribution from your new employer. You may also want to establish payroll deductions and automated investment processes to make sure that your hard-earned savings are put to work as quickly as possible. One framework for prioritizing your savings account contributions is the CIO "Savings waterfall" outlined in this report: Where should I put my savings?: The 2025 savings waterfall worksheet.

Important to note: Please be aware that this report discusses only a few of the considerations that are associated with retirement plan rollovers. For instance, at a certain age, some retirement accounts are subject to mandatory distributions each year which have certain tax implications that must be considered. What's more, retirement plan provisions and details vary drastically from one plan to the next, so it is imperative that the details that are specific to your plan and situation are seriously considered before determining what you will do with a previous employer's retirement plan. For further considerations not discussed in this report including the special tax treatment if your plan holds appreciated employer stock, please see UBS's IRA rollover guide. And to make sure your actions are aligned with your overall financial situation, please work with your financial advisor throughout the decision-making process.

[1] Generally, the amounts an individual withdraws from a 401(k) before reaching age 59½ are called "early" or "premature" distributions and are subject to a 10% early withdrawal penalty. If an individual separates from service during or after the calendar year in which they attain age 55, distributions from the employer's plan (but not from IRAs) are exempt from the 10% early distribution penalty. For other exceptions to the 10% early withdrawal penalty, please visit the IRS's website here.

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