Retirement accounts provide protection against creditors

Most investors understand the significant tax benefits of using their qualified retirement accounts — such as their 401(k)s, IRAs and Roth IRAs — to build long-term wealth. But did you know that these types of accounts also provide creditor protection?

One of the lesser-known benefits of retirement accounts is this — Federal statues offer retirement accounts special treatment when subject to the claims of creditors. This creditor protection can be a valuable tool in the event of a legal liability, personal injury lawsuit, or bankruptcy. Accounts that receive special protection include 401(k) plans, pension plans, profit sharing accounts, SEP IRAs, SIMPLE IRAs, 403(b) plans, 457 plans, traditional IRAs, and Roth IRAs.

It is important to understand how federal and state laws affect these rights. Each type of qualified retirement account is subject to a specific jurisdiction and offers varying degrees of security.

Account protection from creditors

Employer-sponsored retirement accounts — such as 401(k)s, pension plans, and profit sharing accounts — are governed by federal laws outlined by the Employee Retirement Income Security Act of 1974 (“ERISA”).[1] These types of plans have unlimited protection in the event of bankruptcy and other legal liability. Most 403(b) and 457 plans also provide the same unlimited protection.

Employer-sponsored IRA accounts — such as SEP IRAs and SIMPLE IRAs — have unlimited protection for bankruptcy under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”),[2] while state laws define the how non-bankruptcy liabilities are handled.

Traditional IRAs and Roth IRAs are protected for bankruptcy up to $1,512,350[3] under this Act as of 2022. (This protection limit is updated every three years, so will be updated sometime in 2025.) Again, state laws dictate the rules for non-bankruptcy liabilities.

Note that the creditor protection offered for both ERISA plans and IRA-based accounts are only available in the event of bankruptcy and certain legal liabilities. They do not apply to an ex-spouse’s claim pursuant to a divorce proceeding, taxes and penalties due to the Internal Revenue Service, federal criminal fines, or wrongdoing against the retirement plan itself.

Quick reference guide

Type of Account	Bankruptcy protection	Legal liability protection
401(k)s	Unlimited protection1	Unlimited protection1
Pension plans	Unlimited protection1	Unlimited protection1
Profit sharing accounts	Unlimited protection1	Unlimited protection1
SEP IRAs	Unlimited protection2	Regulated by state
SIMPLE IRAs	Unlimited protection2	Regulated by state
403(b) plans	Unlimited protection1	Unlimited protection1
457 plans	Unlimited protection1	Unlimited protection1
Traditional IRAs	Aggregate protection up to $1,512,350 (2022)2	Regulated by state
Roth IRAs	Aggregate protection up to $1,512,350 (2022)2	Regulated by state

1. Based on ERISA guidelines | 2. Based on BAPCPA guidelines

Account withdrawal protection from creditors

Furthermore, withdrawals from an ERISA retirement plan can retain an enhanced level of creditor protection depending on the destination of the withdrawal:

- Funds deposited to another employer's ERISA plan maintain unlimited protection for both bankruptcy and legal liability.
- Funds deposited to an IRA account consisting solely of rollover funds maintain unlimited protection for bankruptcy, but not for legal liability (this is determined by state laws).
- Funds deposited to an IRA account which includes non-ERISA contributions (a "comingled" IRA) are protected for bankruptcy up to the $1,512,350 until March 31, 2025. Legal liability is subject to state laws.
- Funds withdrawn as cash distributions are no longer protected against claims.

Each state has its own regulations for dealing with non-bankruptcy claims. For example, Illinois law provides unlimited protection against legal liability for traditional IRAs and Roth IRAs (as well as for any qualified retirement account not covered by ERISA). Be aware that most states do not endow "inherited IRAs" with creditor protection.

Understanding exactly which assets are protected from specific types of creditors — and which are not — is a critical component to the construction and maintenance of your comprehensive financial plan. It is important to remember that the concepts above are guidelines based on current laws, which of course, can change over time, and that every individual's financial planning needs are unique. If you have any questions about how your specific retirement accounts are impacted, please contact your wealth advisor.

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1. Employee Retirement Income Security Act of 1974 (ERISA).

2. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

3. https://www.thebankruptcysite.org/exemptions/federal.html