

You can tap your retirement savings, but you should do so with caution

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BY RUSS WILES
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Plenty of people are finding it harder to borrow money these days.

Mortgage dollars are less plentiful, and hefty credit-card balances prevent a lot of people from tapping into new lines of credit.

But there is a last-ditch borrowing option available to millions of workers — those plump, juicy balances inside 401(k) retirement plans.

Although financial advisers discourage the practice, you could justify borrowing from your 401(k) plan in the right circumstances.

Quick cash

One advantage is that such loans typically can be arranged quickly and easily, providing a ready source of cash.

And since you're tapping into your own account, you don't need to qualify for credit.

Plus, the money you spend on interest and principal repayments doesn't go to some impersonal banker. Instead, it heads back into your account.

In fact, interest rates often are lower on 401(k) borrowings than on personal loans or credit cards.

Not everyone has a 401(k) borrowing option, in part because only about 30 percent of workers have 401(k) coverage.

Nor do all plans offer loans, though the vast majority do.

The most cash-strapped individuals wouldn't have much to borrow against anyway. The median 401(k) balance at the end of 2006 was \$66,650, reports the Employee Benefit Research Institute.

That's a midpoint figure, which means half of all participants had less.

Assuming you could take out a 401(k) loan, should you do it?

Generally not.

Philip Stoker and Creg Ostler both took out 401(k) loans a decade ago when they started their Scottsdale investment firm, Stoker Ostler Wealth Advisors. But, in general, they don't view loans as a good idea.

"If we knew then what we know now, we'd be more scared about it," Ostler said. "Some things are best left untouched unless there's an emergency."

Pam Hess, director of retirement research at Hewitt Associates in Chicago, calls loans "one of the

bigger problems associated with 401(k) plans."

Tax trouble

One issue with 401(k) loans is that tax obstacles loom if you miss payments. A default would turn the borrowed sum into a 401(k) distribution, on which ordinary federal and state income taxes would apply plus a 10 percent penalty for recipients under age 59 1/2.

If you quit or lose your job, the loan usually would become payable in full, typically within 30 to 90 days, said Clare Bergquist, a director in the corporate and retirement services unit at Charles Schwab.

Only about 1 in 4 employers allow workers to keep making regular payments once they leave the firm, Hess said.

"Opportunity cost"

And while the borrowed sum would earn an interest yield like any other loan, your retirement account could increase faster if you stuck with stock mutual funds or other growth vehicles. "There's the potential for a huge opportunity cost," Bergquist said.

Worse, many borrowers stop saving in their 401(k) accounts while they repay loans. This robs their accounts of new cash and shakes people of the habit of regular investing, she said.

While 401(k) plans typically don't prevent participants from investing while loans are outstanding, many people have a hard time affording both.

As another drawback, some employers impose fees of \$50 to \$100 or so as an obstacle to taking out loans, Hess said.

It's also worth noting balances in 401(k) and other retirement accounts usually are protected from creditors.

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