



# *Reinventing* Retirement®

## Retirement Plan Loans: Borrowing from the Bank of You

© 2011 Knollan, Inc.

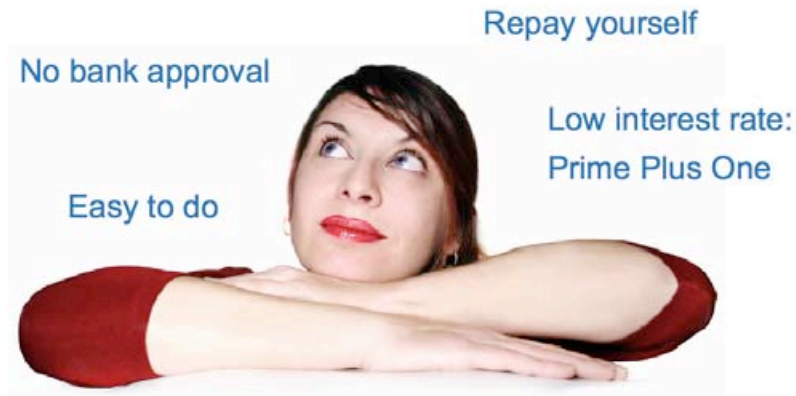
Welcome to our Fifteen Minute Finance presentation on Retirement Plan Loans. When you need money, you often think of borrowing from a bank. But there are other options available, including borrowing money from yourself. Most workplace retirement plans allow you to borrow from your own account. Although this may be appealing, it's important to realize that there are some clear disadvantages as well as advantages to borrowing from your account.

Here to help flesh out these ideas are John and Sue. They are a hypothetical couple that we use to help bring life to the strategies discussed in each of these presentations. Their ages may change from one presentation to another to suit the situation. Remember: Not all the details discussed here may pertain to your plan or your situation.

## Reinventing Retirement®

### Plan Loans: Worth Thinking About

#### APPEALING ASPECTS



Sue: Hey, John, I was thinking that we could take a different approach to paying for that kitchen renovation we're planning. You know how we were thinking of getting a home equity loan for \$20,000? What if I borrowed the money from my 401(k) plan account? That way, I wouldn't have to go through the whole bank loan review process. We wouldn't need to have any credit checks done. And we wouldn't even need to say why we want the money. It seems pretty easy. And then when I repay the loan, I'd basically be paying myself back by putting the money back into my retirement account. What do you think, John? Does it sound like a good plan?

John: Yeah, Sue. I think I'm following you. It all sounds pretty good to me.

Sue: Yeah, but to be honest, I do have some concerns.

John: O.K. Sue, don't keep me in suspense. What are they?

## Reinventing Retirement®

### Plan Loans: Worth Thinking About

#### SOME DRAWBACKS

Repay with after-tax dollars = double taxation

5-year repayment term, except for a primary residence

Minor fees – application, maintenance

Repay with level payments throughout the loan period



2

Sue: John, I thought you'd never ask! O.K. Here are some of my concerns about taking money out of my account as a loan. First, the repayment term is quite short. It's just five years. That could mean higher monthly loan payments, which might mean we have less money available for other expenses. There are also some minor fees involved: First, a loan application fee and then a small annual loan maintenance fee. When I repay the loan, I'll need to repay it in level payments through payroll deduction throughout the term of the loan. And one thing that we should really think about is that because we'll repay the loan with regular after-tax dollars, and the money in the account was initially deferred from my salary before tax was taken out, when I eventually withdraw from the account for good, I'm going to have to pay taxes on the same money again. That's called double taxation.

## Reinventing Retirement®

### Plan Loans: More Food for Thought

#### Things to consider:

- Minimum loan: \$1,000; Maximum loan = 50% of your account balance or \$50,000
- Don't miss a payment or loan will be in default after grace period
- If you leave your job, loan balance due in 60 days, or taxable distribution
- 10% penalty if under age 59½, except 457 plans.
- If you die, loan balance treated as distribution

3

John: Wow, Sue. This doesn't seem quite so straightforward or such a sure bet any more. Let's look more closely at the rules...

I see there's a \$1,000 minimum loan and you can borrow up to half of your account balance, or up to \$50,000. If you miss a payment and don't pay within the grace period, which is the next calendar quarter after a payment is missed, the loan will be in default and considered a distribution. Oh, here's another rule to be aware of. If you leave your job, you'll have to repay the balance of your loan in 60 days or you'll have to pay taxes on it as a distribution from your account. And if you're under age 59½, you'll owe a 10% early withdrawal penalty. Also, if you die, the loan balance will be treated as a distribution from the plan and will be taxed, which means less money will be distributed to your heirs.

## Reinventing Retirement®

### Plan Loans: Pros & Cons – Summary

#### ADVANTAGES

- Borrow for any reason
- No credit check
- Low interest rate
- Less paperwork
- No immediate taxes due
- Pay interest to yourself



Sue: O.K. So, I guess we need to think about this some more before rushing into action. There may be as many reasons NOT to borrow from my account as there are reasons to borrow from it. On the plus side, I can borrow for any reason and there's no credit check needed. The interest rate is low. There's less paperwork. There aren't any taxes due right away because the loan isn't considered a taxable distribution from the plan. And I pay interest to myself instead of to a bank.

## Reinventing Retirement®

### Plan Loans: Pros & Cons – Summary

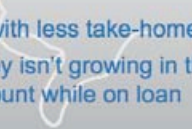
#### ADVANTAGES

- Borrow for any reason
- No credit check
- Low interest rate
- Less paperwork
- No immediate taxes due
- Pay interest to yourself



#### DISADVANTAGES

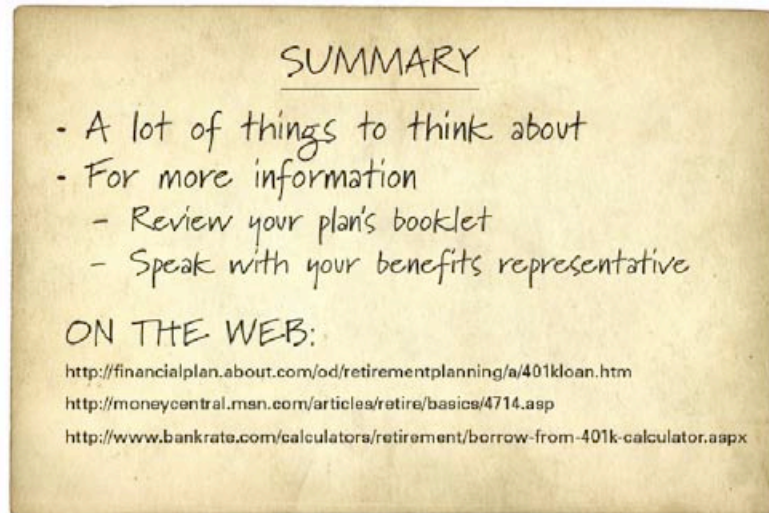
- Fees
- Interest is not tax-deductible
- Maximum 5-year repayment period
- Difficult to keep up with plan contributions while repaying loan
- Left with less take-home pay
- Money isn't growing in the account while on loan



5

John: And if I can quickly list the drawbacks, there are some fees involved, the loan interest isn't tax-deductible, unlike a home equity loan, you'll need to repay the loan in full within five years. That may limit us financially, and especially, it could make it harder for you to keep up with your contributions to the retirement plan while you're repaying the loan. At the very least, you'll have less take-home pay. And there's another really important aspect, which is that the money you borrow won't be earning a possible return and growing, like it could be if it was in the account and fully invested. Over the course of time, those lost earnings could add up quite a bit.

## Reinventing Retirement®



Sue: There really are a lot of things to think about when considering taking a loan from your retirement plan. To get more information about retirement plan loans, I'm going to review the booklet that summarizes the plan's features.

John: You can also talk with your employer's benefits representative for details on current fees and the interest rate. And the Internet has some good articles and calculators.

Sue: That sounds like a plan, John!

Reinventing  
Retirement®

Thank you

©2011 Kmotion, Inc. All rights reserved.