

401(k) Loans. Good Idea, Bad Idea.

Many 401(k) plans allow for participant loans of up to 50% of their vested account balance. Let's take a look at five reasons for and six reasons against the practice:

Pros

1. **Convenience.** No credit check or long application to fill out.
2. **No restrictions.** Most plans do not place restrictions on what the loan may be used for.
3. **Low Interest rate.** Rate is set by plan and is usually only one or two points above the prime rate.
4. **Interest** is paid back to participants own account.
5. **Up to five years** to repay loan, longer if loan is used to purchase primary residence.

Cons

1. **Opportunity cost.** The interest rate paid back to the plan is often lower than the money could have generated if left untouched in the plan.
2. **Interest is not tax deductible** even if loan is made for home purchase.
3. **Take home pay gets reduced** because 401(k) loans are repaid through payroll deduction.
4. **Reduced retirement savings.**
5. **Harsh penalties** for loan default. Participants who are unable to repay their loan must claim the withdrawal amount as taxable income on their next tax return. Participants under age 59½ will also incur a 10% early withdrawal penalty.
6. **Repayment schedule can change.** If participant's employment is terminated, loan may become immediately repayable or due in 60 days. If not repaid, loan is treated as a distribution with taxes and penalty due.

While it's generally not a good idea to borrow from a 401(k) retirement plan, there are instances when it *may* provide an appropriate financial solution. For example, if you only have two choices; borrow from your 401(k) or withdraw the money prematurely, borrowing is the better option. However, exchanging retirement funds for debt should be resorted to only after other options are exhausted.



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For additional information, contact your PlanTech administrator at (205) 980-1603.

RETIREMENT PLAN DESIGN AND ADMINISTRATION

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