borrowing from your future

FACTS ABOUT RETIREMENT PLAN LOANS

Your plan may provide a way to borrow funds if you're caught in an unexpected financial crunch. Here are some things to consider before taking a retirement plan loan.

Benefits of a retirement plan loan

- A loan can help you avoid taking an early withdrawal and incurring related penalties and taxes.
- Interest rates for a retirement plan loan are typically lower than those for other lines of credit, such as a personal loan from a bank or using a credit card.
- There is no credit check and you do not need pre-approval.
- Easy loan repayment options.^
- All repayments are deposited back into your account, including interest.
- If you stop working before your loan is repaid, you may be able to continue making loan payments (depending on your loan agreement).^^

^ Your plan may allow loan repayments by invoice, automatic payroll deduction or ACH withdrawal from a bank account. Please check your Plan Document or SPD for information on available repayment options.

^^ Your plan may have specific loan rules and limitations. Please check your Plan Document or SPD for information on available repayment options.

Drawbacks of a retirement plan loan

- If you are out of work for any reason, making regular payments could be difficult.
- Loan repayments are made with after-tax income. This means that the interest you pay on your loan is taxed twice—once now and then a second time when you withdraw the money from your account at retirement.
- If you miss payments, your loan may go into default.
- There are typically loan application fees and there may be other associated fees.
- If you leave your employer before your loan is repaid, you may need to pay off your loan in full.^^
- Plan loans must be repaid within specified time periods and the repayment schedule may not fit your overall financial plan. As such, loan repayments may become your financial priority or burden, and you may be unable to save for your future. To learn more about this plan provision, please review your Plan Document or Summary Plan Description (SPD).

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taking a loan when life happens

When faced with a sudden cash crunch, it can be tempting to tap into your retirement savings. However, when you take a loan from your retirement plan, it may impact the total amount of money you will have available for retirement.

Lost growth potential

Let's say you need $10,000 to renovate your kitchen so you take out a four-year loan from your retirement plan account to avoid paying early withdrawal fees and taxes. In the short term, the loan has a significant impact on your retirement plan account, because your overall account balance is reduced by $10,000. If the loan is not repaid and if your account earns 7% annually over the next 30 years, you will lose out on over $76,123* in retirement savings.

Even if the loan is repaid, you may miss out on some of the earnings your money could have generated. Over time, those earnings would have stayed in your account and generated their own earnings. This is called compounding and it can have a big impact on your account balance.

Investment earnings during the life of the loan:	$2,601
Investment earnings during the same time period with no loan:	$3,226
The difference in your account in four years when the loan is repaid:	**$625**

This difference continues to compound in your account and in 30 years, you could have **$3,852 more**** by not taking the loan today.

Tax bill

You may want to borrow $20,000 from your retirement plan to purchase a new car. Soon after, you decide to change jobs and leave your current employer. You are unable to repay your loan right away, and it goes into default. If you are under age 59½, the defaulted loan is classified as an early withdrawal, and you could owe a substantial tax bill.

Federal income tax: $20,000 (at a 25% rate)	$5,000
State income tax: $20,000 (at a 5% rate)	$1,000
Federal early withdrawal penalty: $20,000 (at a 10% rate)	$2,000
Total taxes owed†	**$8,000**

While the idea of taking a loan from your retirement plan may seem convenient, it may not be the best decision in the long run. One smart alternative to borrowing from your retirement plan is to build up and maintain an emergency fund. It can help you avoid raiding your retirement savings—or going into debt—to cover unexpected expenses.

* https://investor.gov/tools/calculators/compound-interest-calculator

**The scenario is for a $10,000 four-year loan with bi-weekly payments at a interest rate of 4.5% and a market return of 7%. If loan payments are reinvested at the 7% rate, the returns would equal $2,601. But if a loan had never been taken, the return on the $10,000 over four years would equal $3,226. Subtract the reinvested loan payments ($2,601) from the foregone investment income ($3,226), and the net result is $625. If the $625 is invested for another 26 years at 7% (with bi-weekly compounding), the result is $3,852. This is a hypothetical example and represents no particular investment and does not account for taxes. Individual circumstances may vary.

† This example is for illustrative purposes only. Tax rates can vary based on salary and state of residence. Consult your own advisors.

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