Don't Borrow from Your Retirement Fund

Ric Edelman

With many lenders canceling home equity lines of credit due to declining real estate values, consumers are turning elsewhere for loans. Some are unwisely tapping their 401(k) accounts.

Fidelity and T. Rowe Price both report an increase in borrowing from retirement accounts, according to the Washington Times. In a February CNN viewer poll, 51% of respondents said they have tapped into their 401(k)s to pay bills.

And Reserve Solutions Inc., a New York firm, is marketing a debit card that consumers can use at ATMs to withdraw money from their 401(k) accounts.

If you are tempted to borrow from your 401(k) fund, don't. Here's why:

1. If you quit your job, you must repay the loan in full within 90 days. Otherwise, taxes and a 10% penalty occur.
2. The loan costs 7% for most workers. Eighty percent of plans also charge origination fees and others expenses.
3. The loan is not really a loan. Rather, to get your money, you must sell your shares in the plan — if stock prices are down, you sell at low prices. When you put the money back into the plan, prices could be much higher.
4. You don't "pay yourself back." Instead, you invest money to restore your account value back to its former level, using money that you could have used to increase your account value.
5. The money you use to repay the loan is taxed twice — meaning you pay up to $1.80 for each dollar you borrow.
6. While the loan is in force, your money is not growing — costing you huge sums that will dramatically reduce your retirement nest egg. A 2008 study by T. Rowe Price shows that a $10,000 loan will reduce your balance at retirement by $100,000.