RETIREMENT PLAN
Update

Wealth Management

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Your Challenge, Our Solutions™

Borrowing from your retirement plan—not always the best option

Before taking a loan from your retirement plan, consider the possible drawbacks to borrowing.

Many retirement plans allow participants to borrow from their plan accounts. You may have taken a loan in the past or may be thinking of doing so soon. On the surface, a plan loan might seem to make financial sense. After all, you are only borrowing from your own retirement account and repaying yourself. However, with the exception of an emergency when you have no other resources, taking a plan loan may not be the wisest thing to do. In fact, there are several drawbacks to borrowing from your retirement plan.

Zero tax advantage

Pretax salary deferrals are tax-advantaged, in that they are taken out of your pay before federal income taxes are calculated. That's not the case with repayments on your loan, which you make with money that has already been taxed. And when that money is distributed to you at retirement, you'll pay taxes on it once more.

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Missed potential earnings

A plan loan reduces the size of your account balance, leaving you with less money invested on your behalf for your future. It is true that you will repay the loan with interest, but that interest could be less than the return your plan investments would have earned had you not taken the loan. If you borrow money when the stock market is in a growth period, the missed earnings potentially could be substantial.

Lower contributions

If you cut back on your regular plan contributions while repaying your plan loan, you would reduce your potential earnings even further. The reality is that stopping contributions even for a year or two could have a negative impact on how much money will be available to you for your retirement.

Potential repayment issues

If you leave your employer while still owing money on your plan loan, you will typically face a choice: repay the entire outstanding amount or allow it to become a distribution. If you can't afford to repay the loan in full and opt for a distribution, you will have to pay regular income taxes on the outstanding balance. In addition, if you are under age 59 1/2, you may owe an early withdrawal penalty equal to 10% of the loan balance.

See plan loans as a last resort

Your retirement plan is intended to provide you with future benefits so that you can enjoy your retirement. That's why it's not good to regard the money in your retirement plan as a funding source that you can turn to whenever you need cash. Instead, look for other alternatives—a short-term loan from your bank or credit union, for example. Or, better yet, consider building an emergency fund so that you can have a financial cushion to fall back on when faced with a sudden expense.

If you would like some help with managing your finances, consider working with a financial advisor. Together, you can map out a strategy for putting your financial life in order.

Near retirement? It may be time to revisit your investment and financial strategies

As you get closer to retiring, it may be a good idea to revisit your investment and financial strategies to make sure you're still on track for a secure retirement.

Even if your retirement is still several years away, it's always helpful to revisit your investment and financial strategies as well as your timetable for retirement to make sure they still make sense. After all, changes in your life and the broader economy can upend certain assumptions you made about your retirement.

Here are some issues that you, as a pre-retiree, should consider, including employment security, an emergency savings account, the decision to save more, deciding when to take Social Security retirement benefits and whether retirement plan portfolios are sufficiently diversified.

Your employment security

The U.S. economy is in a constant state of flux. Some industries are adding jobs while others are reducing their workforces. Job losses and reduced hours and wages are always a possibility. And while it may be difficult to assess your future job security, it may make sense to look for additional sources of income. Do you have a skill or talent that can generate extra income? The key is to save and invest what you earn from part-time work.

Create an emergency fund

If you don't have an emergency fund and you are still employed, give some thought to creating one. An emergency fund helps you deal with unanticipated expenses without having to use a credit card or borrow from your retirement plan. Try to aim to save enough money to cover three to six months of expenses.

Decide when to take Social Security benefits

You can start collecting Social Security retirement benefits as early as age 62, but you won't be eligible for the full benefit amount. You may want to consider delaying Social Security benefits for as long as you can afford to do so. You also can postpone signing up for Social Security until after full retirement age (FRA)—the age at which you'll be eligible for full benefits—in which case your benefit increases (8% per year up to age 70 for those born in 1943 or later).

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FRA is based on the year in which you were born. To see how this works, let's assume you were born in 1960. Here are the numbers:

Age 62	Receive 70% of your monthly benefit (the minimum amount)
Age 65	Receive 86.7% of your benefit
Age 67	Receive 100% of your benefit
Age 68	Receive 108% of your benefit
Age 69	Receive 116% of your benefit
Age 70	Receive 124% of your benefit (the maximum amount)

Try to save more

If you have a job and an emergency fund, you should attempt to increase the amount you save. Living below your means involves cutting down on discretionary expenses. Look for places where you can reduce your spending.

Ensure that your investments are sufficiently diversified

Diversification[1] is an important investing strategy that involves spreading your money among a variety of funds or portfolios that hold different investments in different asset classes. The thinking is that spreading out your investments helps you manage risk in your portfolio since one asset class may rise at the same time as another declines. However, the severe volatility in the stock market has forced many investors to revisit how they allocated their investments. You may need to reevaluate your asset allocation[1] in light of your particular risk tolerance, time frame and investment goals. Are you taking on more investment risk than you are truly comfortable with? As you move closer to your anticipated retirement date, you may consider it prudent to focus on asset preservation rather than asset growth.

Reach out to a professional

Laying the groundwork for a successful retirement can be time-consuming and sometimes stressful. As with so many aspects of retirement planning, you may find it helpful to work closely with an experienced financial professional.

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1. Diversification and asset allocation do not ensure a profit or protect against losses. Investing in mutual funds involves risk, including loss of principal. Mutual funds are offered and sold by prospectus only. You should carefully consider the investment objectives, risks, expenses, and charges of the investment company before you invest. For more complete information about any mutual fund, including risks, charges, and expenses, please contact your financial professional to obtain a prospectus. The prospectus contains this and other information. Read it carefully before you invest.