Taking a loan from your retirement plan

Think before you act
Many people consider retirement plan loans an easy way to access money they’ve saved. In fact, taking a loan from your retirement plan is often a simple and inexpensive process. But doing so can put your future savings in jeopardy. Before taking a loan, be aware of the pitfalls.

**How Loans Work**

Typical retirement plans allow you to borrow up to half your vested balance, up to $50,000. Your employer may restrict the reasons you can take a loan, such as to pay for medical or education expenses, prevent eviction or buy a first home. Some may allow you to take a loan for any reason. The loan generally must be paid back, with interest, over five years. Loan payments are deducted automatically from your paycheck.

**The Pros**

What makes them attractive is that while you do pay interest on the loan, the rate is relatively low, and you actually pay the interest to yourself. It’s almost like adding a little boost to your savings. But, at the same time, it’s possible you could be earning more from your investments than the interest you’re paying. That’s what they call a lost opportunity.

Having loan payments automatically deducted from your paycheck makes repayment simple, but it also reduces the amount of your take-home pay. If this smaller paycheck causes you to reduce the contributions you’re making to your retirement account in order to increase your take-home pay, you’ll be hitting your future savings with a double whammy.

Obtaining a loan from your retirement plan is usually quick and convenient. There are no credit checks or applications — often a simple form or phone call, or even a few clicks online, will do the trick.
The Cons

There are serious potential consequences to consider before taking a loan. First, when you remove retirement savings from your account, you’re taking away its ability to compound. It’s exactly this compounding effect that makes tax-deferred saving so attractive in the first place. Reducing your compounding potential can have a significant impact on your savings in the long run.

In addition, loan fees are taken directly from your account, further reducing its potential to grow.

The money you use to repay the loan is taxed twice. Loan repayments are paid back to the plan after tax and join the pre-tax money already in the plan. The money you used to repay the loan will be taxed again upon withdrawal from a traditional retirement plan account.

Failure to repay the loan can have financial consequences, too. You will owe income taxes as if you had taken a distribution from your plan account. And you’ll pay a penalty if you’re younger than age 59½ because your defaulted loan will be considered an early withdrawal.

If you have an outstanding loan balance and either leave your job or are terminated, you’ll have to pay the loan back immediately or it will be considered in default. If you happen to be terminated involuntarily and are no longer earning income from your job, the timing of the payback, taxes and penalties can be quite unfortunate.

It’s important to know that not all plans offer loans. You can find a copy of your plan’s loan policy on the Personal Savings Center website at [www.standard.com/retirement](http://www.standard.com/retirement). If your plan does allow loans, you may use Personal Savings Center to model various loans and calculate your loan payments to see if taking one makes sense for you.

Borrowing from your retirement plan may cost more than you think, especially when you factor in your account’s lost growth potential. Consider what happens when a 35-year-old worker with a retirement account balance of $60,000 borrows $30,000 at an interest rate of 5 percent to be paid back over five years. Assume the worker normally contributed $500 a month to the account, but during the loan repayment period he can only afford to make after-tax loan payments of $566.14 (including interest).

As shown in the figure below, if the account’s investments grew by an average of 8 percent annually, he would potentially give up almost $343,000 at retirement by taking the loan.
The Standard is the marketing name for StanCorp Financial Group, Inc. and its subsidiaries. StanCorp Equities, Inc., member FINRA, distributes group annuity contracts issued by Standard Insurance Company and may provide other brokerage services. Third-party administrative services are provided by Standard Retirement Services, Inc. Investment advisory services are provided by StanCorp Investment Advisers, Inc., a registered investment advisor. StanCorp Equities, Inc., Standard Insurance Company, Standard Retirement Services, Inc., and StanCorp Investment Advisers, Inc. are subsidiaries of StanCorp Financial Group, Inc. and all are Oregon corporations.