Borrowing Against Your Retirement: More Costly Than You Think

PARTICIPATING IN THE COMPANY'S RETIREMENT PLAN is a smart and important decision. Smart because you are putting away small amounts today for a comfortable retirement later.

As your account begins to grow, it may be tempting to "dip into" your retirement savings by taking a loan against your retirement plan to pay your annual taxes, repair a leaking roof, catch up your everyday pile of bills, and so on. And while the decision to take a plan loan is yours to make, we want to make sure that you consider what it will really cost.

With a retirement plan loan, you pay yourself back the amount plus interest. But the true cost can be shown with the loss in your retirement savings. You lose money when you borrow from your retirement account for several reasons, which are listed below:

- You **lose** making money on the earnings, or compounding of those earnings.
- You repay the loan with **after-tax dollars**.
- There is (typically) an initial set-up and quarterly loan fee.
- Most employees **decrease** or **cease** the amount they are contributing to compensate for the loan payment.
- You may not be paying yourself back the same amount you would have earned if you left the money invested.

To further illustrate the costliness of taking a plan loan, consider the following hypothetical example*: Jane took a $10,000 loan at 7% interest from her retirement account; her account balance before the loan was $20,000. She previously made contributions of $150 per paycheck (including the employer match). Because she had to repay the loan, she decreased her contribution to $50. Additionally, prior to the loan, she was earning a 10% return. Now she will repay the loan over five years. If you take into account loss of interest, compounding, and tax on repayments, the actual retirement plan loan is costing Jane 13.77%! And don't forget about those decreased contributions, which can add up to hundreds of thousands of dollars over many years.

This example is hypothetical and intended for illustrative purposes only.