

THE BENEFIT BULLETIN

FAST FACTS ABOUT RETIREMENT PLANS

The following article contains general plan facts and is intended for informational purposes only. To ensure that your plan contains specific provisions outlined in this and future articles, please contact your third party administrator or plan ERISA attorney.

Plan Loans

Ideally, participants will not access their retirement funds until they retire, allowing them to grow continuously. However, this is not an ideal world! In an emergency, the funds in a 401(k) plan may be available in the form of a participant loan, if the document provisions are drafted to allow the option of participant loans.

Retirement plan loans are generally easy to obtain and are not associated with a lot of expenses. Participants repay the loan interest to themselves, which is typically preferred to paying interest to a commercial lender. Additionally, if a participant's credit score is low, it may be easier and cheaper to borrow from their retirement plan rather than from a commercial lender.

Giving employees the option to borrow from their 401(k) accounts can also increase participant contribution rates because the participants have the security of knowing that their money is available "just in case". On average, a participant in a plan that offers loans appears to contribute 0.6 percentage points more of his or her salary to the plan than a participant in a plan with no loan provision. Also, about 20% of employees eligible for a plan loan have one, and the average outstanding loan balance is approximately \$6,300.

Loan Basics (if allowed by Plan)

- Participants can borrow up to 50% of their vested account balance, not to exceed \$50,000.
- The loan must be repaid over a five-year repayment period (or less). The one exception is for a loan that is a mortgage for a primary residence. For this type of loan, the repayment period may be longer.
- The interest rate will be determined on the day the loan is taken. While interest rates vary, the most common is the "prime rate" plus one percent. The current "prime rate" can be found in the business section of the newspaper.
- Loan repayments are processed through payroll deduction.
- There is no penalty for paying the loan off early.
- Plan loans usually have a minimum amount requirement, typically \$1,000.
- Loans are secured exclusively by the participant's vested account balance, so there is no additional collateral required.
- The purpose for the loan can be limited or unlimited, depending on the plan language selected.

Generally, borrowing from a 401(k) isn't the best idea. Nevertheless, it does provide participants access to their retirement account (within limits) without incurring the 10% early withdrawal penalty required for distributions prior to age 59 ½.

If you would like to consider adding a loan provision to your plan document, please contact your third party administrator or plan ERISA attorney.

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