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Socially Responsible Credit™

If something sounds too good to be true, it probably is. That's the unfortunate reality of 401(k) loans and "free" vacations getaways.

Both seem like a great deal... until you do a little research.



When it comes to 401(k) loans, people often think 'I'm just borrowing from my own savings and paying myself back the interest on the loan. No harm, no foul. Right?' Not so fast!

The reality is that borrowing against your 401(k) is a bad idea. Here are some of the key reasons why:

High application and maintenance fees for small-dollar loans

There are typically maintenance and application fees associated with 401(k) loans.

Most plans will charge a loan origination fee that is typically between \$75 and \$100, along with a \$25 annual maintenance fee. That means on a \$1,000 loan, you're potentially paying 10% in fees before any interest is paid.

Paying after-tax dollars into a pre-tax plan = double taxation

Speaking of interest, you will also need to pay interest on a 401(k) loan, which is typically prime rate plus 1%. You'll pay that interest back to yourself; however, you'll do it with after-tax dollars. If you're in a 25% tax bracket, a \$10,000 loan with an interest rate of 5% mean you'll have to earn \$625 in pre-tax dollars to pay back the \$500 in interest, which you'll be taxed on again upon withdrawal at retirement age. Essentially, \$125 is unnecessarily going to Uncle Sam.

401(k) loans must be repaid shortly after employment termination

A [Wharton School study](#) found that about 40% of 401(k) savers borrow from their plan in a given five-year period. Historically, 86% of those who change jobs with outstanding 401(k) loans failed to repay loans in the 60 days required by law. In 2018, Congress lengthened this repayment time, but the loan repayment schedule is still dramatically shortened from the loan's original five-year repayment term.

Paused or limited contribution

Some 401(k) plans don't allow participants to contribute to their 401(k) with an existing loan. Even if that isn't the case, participants may reduce or eliminate contributions while repaying their loan. This can be especially damaging if there's an employer matching program in place.

There's a 10% federal tax penalty on defaulted loans

For participants under the age of 59½, hardship withdrawals and defaulted 401(k) loans are subject to a 10% federal tax penalty.

Loss of potential investment gains

The money borrowed is losing all investment gains, which often can be larger than the interest on the loan itself. Because of the power of compounding interest, the younger you are when taking a loan, the greater the loss of investment gains. Using market averages, a \$10,000 loan repaid in five years would cost you \$2,474.39 in lost investment gains earnings. That might not seem like a big deal, until you account for power of compound interest.

Over the course of 30 years, that \$10,000 401(k) loan could cost you \$24,898.94 in future earnings. That's a lot of nice beach vacations!

The Take Away...

Next time you are considering taking a loan or withdrawal from your 401(k), consider taking a loan from Kashable instead.

Kashable offers low-cost loans that are automatically repaid via payroll deduction. Upon approval, funds will be received via direct deposit within 3 business days. You can register and apply online using the link below. The application process is fully transparent and only takes minutes!

Register for Kashable at www.kashable.com!

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