MAINSTAY CAPITAL MANAGEMENT LLC

401(k) Debit Cards
(9/17/08)

A new option recently introduced as a part of many 401(k) plans is the "401(k) debit card." This card allows an employee to borrow from their 401(k) savings with a swipe of a card at a merchant, or as a cash advance at an ATM.

Different than a normal banking debit card, the 401(k) debit card creates a loan to yourself from the money you have in your retirement account. The account requires you to set aside part of your account to a stable, money market account, from which the loan dollars will be withdrawn.

General information for 401(k) plan participants on debit card loans:

- Tax law limits your loans to the lesser of $50,000 or 50% of the value of the plan. Keep in mind if you do not pay the money back you will have to pay tax on the withdrawal and may be subject to an early withdrawal penalty.
- Repayment of the loan interest will be with after-tax dollars, which will be double taxed when withdrawn from the account. Also, the interest you pay is never deductible, even when used for otherwise deductible purposes such as purchasing a residence.
- The plan may allow for longer repayment if made for the purchase of a primary residence. Otherwise, repayment must be in five years or less on each loan.
- The amount you set aside to borrow will not be invested in the markets and this may hurt portfolio performance over time.
- Presently loan repayments must be made by the participant direct to the lender and are not available as a payroll deduction. If you fail to make payments for three months the loan will be deemed a distribution and subject to income taxes and potentially an early distribution penalty.

Specifically, for your plan there are things you should look out for:

- Be aware of the fees and interest rate your card will charge. Read the plan disclosure documents to find out how interest is charged, cash advance fees, annual fees, and set-up fees. The interest rate you pay may be based on a floating rate such as 'prime', but will also include additional interest paid to the loan vendor.
- Know if there are any changes to loan repayment terms if you leave your job.
- Your employer may have a limit on the number of loans that can be outstanding at one time. The plan may also require a loan to be paid back in full prior to allowing any repaid funds to be borrowed again. This is known as a non-revolving line.
- An employer may have tougher loan limits or repayment provisions than the general rules stated above.

It is important to remember that this source for a loan should not be the first option for cash needs. The opportunity cost of borrowing from long-term savings can have an adverse impact on the future value of your retirement nest egg.