

Depleting the Nest Egg

Although it's not new, a plan that lets workers tap into loaned 401(k) funds with a debit card is drawing heaps of critics -- and possibly legislation. Experts believe such access will remain fairly limited, as plan sponsors will decline to sign on to anything that has the potential to harm a retiree's standard of living.

By Paul Gallagher

It isn't often that a financial institution refuses to comment -- multiple times -- about one of its services, yet that's exactly the position that New York-based Reserve Solutions has taken with regard to its ReservePlus service.

Perhaps that's because ReservePlus is a controversial program that issues debit cards attached to 401(k) loans.

While some express grudging support for the convenience offered by ReservePlus, its critics are numerous, saying that what passes for convenience is a slippery slope to a depleted nest egg. The program from Reserve Solutions, a subsidiary of The Reserve, has drawn sharp criticism from financial analysts, the Securities and Exchange Commission and Congress, which is considering legislation to quash such plans.

At its heart, ReservePlus allows workers to receive loans against their 401(k) plans -- up

to \$50,000 or 50 percent of the plan's value, whichever is less -- by setting aside the funds in a money market account, from which the user can withdraw funds through a debit card.

The plan, which is only offered through Reserve Solutions, has been in existence since 2003 and David Young, the program's director, told financial columnist Liz Pulliam Weston there are "several thousand" participants.

Given the controversy surrounding the plan and the conservative nature of HR departments, Weston says she doesn't think the program is going to set the world on fire.

"My feeling is that it's still sort of a novelty," she says. "Automatic enrollment [in plans] has gone mainstream, but I don't see this as going mainstream."

The financial author and syndicated columnist pens a regular column for MSN. In a Febru-

ary column for the Web site, Weston noted that the program does have its advantages, including the ability to repay a loan balance within five years after parting ways with an employer, as compared to the usual 90-day requirement.

"It's got some pretty big disadvantages, but if you're going to allow participants to take out loans, giving them the option to pay it back over time if they lose their job is a huge plus," says Weston, who lives in Los Angeles.

Rather than through payroll deductions, repayment can be made via an automatic checking account deduction, personal check or online payment.

When used casually, as with any other plastic card, those payments can add up.

Recently, the SEC issued a bulletin warning consumers that such 401(k) "debit" cards were, in fact, credit cards against

funds that must be repaid. If borrowers fail to repay the loan within five years, or if they miss three consecutive months of payments, that loan will be treated as a 401(k) distribution, and taxes will be assessed on the balance. If the borrower is under 59 and one-half years old, they'll also get slapped with a 10-percent penalty for early withdrawal.

In addition, there are also charges associated with the program, including a \$75 setup fee, annual maintenance fees from \$25 to \$50, and a \$2 fee for cash advances. Borrowers also must pay interest on the withdrawn funds, at the rate of the prime rate plus 2.9 to 3.25 percent.

In July, the U.S. Senate Special Committee on Aging, chaired by Herb Kohl, D-Wisc., held a hearing to consider ways to reduce "leakage" from 401(k) funds, from loans or cash-outs. Of particular interest to the commission was the use of 401(k) debit cards, and after the hearings, Kohl was joined by Sen. Charles Schumer, D-N.Y., in announcing that they will introduce legislation prohibiting the use of such debit cards.

In his testimony before that committee, Bruce Bent, founder and chairman of The Reserve, noted that money borrowed from a 401(k) still earns interest by being placed in such a money-market mutual fund until the money is withdrawn via the debit card. He also said that the average loan balance is \$4,800 for those using the debit card, compared to \$7,000 for others who take loans against their 401(k)s.

Even though the debit-card system puts the unused loan balance into a money-market fund, such funds earn significantly less than the mutual funds or stocks in which most 401(k) accounts are invested, says Lori Lucas, from Callan Associates' Chicago office. That's just one of the disadvantages of the plan.

"People tend to favor stable value funds which have higher yields over money-market accounts, so that's concerning to me," says Lucas, an executive vice president of defined contribution for the investment consulting firm.

Even if the program offers the sort of liquidity some workers may want from a 401(k), and they don't intend to spend the full sum allocated for the loan,

Lucas says, the untouched money still lags behind in earning potential, compared to the 401(k).

"We see this inertia happening all over the place, even in self-directed brokerage accounts," she says.

Lucas says she doesn't anticipate that 401(k) debit cards will become a popular option for workers, because most plan sponsors are not eager to provide workers with easy access to such funds.

On the contrary, she says providers are usually concerned with preventing leakage from younger workers who terminate employment with a company and cash out of their 401(k) plans, altogether.

Despite some positive views of a 401(k) debit card program, Weston agrees the best advice for those who might be interested in the program is to search for an alternative source of funds.

"Leave your retirement money alone," she says. "In most cases, there are better ways to finance whatever you want to finance than dragging money out of your 401(k)."