Graystone
Consulting

Your Financial Future

Tips and insights to help you reach your goals

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Managing Debt without Tapping Retirement Savings

If a retirement plan offers loans and hardship distributions, it's for a good reason: Financial emergencies happen. However, touching your savings before retirement can have costly, unanticipated consequences. Understanding the downside of these withdrawals is important if faced with making this type of decision. And a proactive plan for managing debt can help prevent you from ever having to.

A safety net, not a trampoline

While retirement plan loans and hardship distributions provide a potential safety net in a true emergency, these options should be considered a last resort. Here's why:

- **Taxes and interest.** You must pay the loan back with interest. The interest will not be tax-deductible and will be taxed when distributed later from the plan.
- **Missed growth opportunities.** Assets taken out of your plan lose out on the potential benefits of compounding and long-term market returns.
- **A smaller paycheck.** As you repay your loan, your paycheck will be reduced by the repayment amount.
- **Forced repayment.** If you leave your job, voluntarily or otherwise, any outstanding loans may need to be repaid immediately or at an accelerated rate.

> "Planning ahead can help prevent the need to borrow in the future."

Debt management alternatives to consider first

These other sources for funding can prevent you from having to tap your retirement assets today or in the future.

- **Bank loans.** Depending on interest rates, you may want to take a personal loan or, if you're a homeowner, a home equity loan.
- **Payment plans.** Consider working with your debt collector. For example, if you have medical expenses, you may be able to work out a manageable plan with the healthcare provider.
- **Debt consolidation.** Your lender may help you consolidate your debts at lower rates.
- **Debt management.** The National Foundation for Credit Counseling can connect you with accredited debt counselors who can, for a small fee, help you consolidate debt, negotiate with creditors, and rebuild your credit.
- **Low-interest credit card.** You might qualify for a low (or no) interest credit card. Just be sure to read the fine print.
- **Emergency fund.** Create an emergency fund that can cover expenses for at least six months. Start by making payments to yourself each month as you would any outstanding balance.

Make an informed choice

Planning ahead can help prevent the need to borrow in the future. Still, unexpected life events can interfere with even the best plans. Your financial advisor is a great resource to help clarify the pros and cons if faced with making such a weighty decision. ■

Rules for accessing money before retirement

If your plan offers hardship distributions:

- You must demonstrate an immediate need, such as funeral or certain medical expenses, and show that you have no other way to pay.
- You cannot borrow more than the amount of the expense.

If your plan offers loans:

- The maximum amount you can borrow is generally 50% of your vested plan balance, not to exceed $50,000.
- If you leave your job and outstanding loans are not repaid, they are taxed as ordinary income (and may be subject to the 10% early distribution penalty tax).
- Repayment generally must be paid within five years in substantially equal amounts, paid at least quarterly. Loans taken for purchasing a primary residence, however, do not have to be repaid within five years.

Rules vary by plan, so contact your financial advisor to learn more.

Are you part of a retirement duo?

For many, retirement planning is a team sport. Only problem—sometimes only one player is on the field or both are playing but don't fully understand the rules. If you're envisioning a retirement for two, an effective way to win is to make planning decisions together—transparently, proactively, and collaboratively.

Saving for two

A number of scenarios can influence how you plan for the future—some intended, others not.

- **Employment status.** A job layoff or termination can mean not only a loss of income, but an immediate loss of contribution opportunities to a retirement plan.
- **Employment benefits.** Both partners may work, but only one has access to a company retirement plan.
- **Health status.** One partner may have serious health issues that prohibit employment.
- **Lifestyle choice.** Choosing to care for children or aging parents full-time or to be self-employed can limit one's opportunities to save in a retirement plan.

Whatever the circumstance, open communication is essential.

Set your game plan

It's important to understand what victory looks like. After all, if one of you is content with a simple and frugal retirement lifestyle and the other is intent on travel and leisure, which future are you saving for? Here are some questions to answer together to help you stay aligned and save enough.

- What are your hopes, must haves, and fears about retirement?
- When do you want to retire—e.g., as early as possible or work as long as you can?
- Where do you want to live—e.g., downsize, move away, stay?
- How do you want to spend your time—e.g., relaxing, socializing, part-time work, community activities?
- If you both have a retirement plan, are you collectively saving enough?
- If only one of you has a retirement plan, are you adjusting your savings rate to account for the other?
- Have you taken inventory of the different retirement plans each has held at different jobs over the years?

A Morgan Stanley Financial Advisor can help you address your specific situation and set a strategy. With the right plan in place, you and your partner can form a winning retirement team. ■

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