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Living for today has its costs

As more people borrow from 401(k)s, financial experts warn of a future crisis

By KRISTEN D'ANDREA

More employees are tapping into their 401(k) accounts to pay for medical bills, mortgages and credit card debt. Yet, as Americans' retirement lives lengthen, they are becoming no less expensive, causing industry experts to worry about a potential new class of impoverished retirees.

According to Vanguard, one of the nation's largest 401(k) managers, since 2008, there has been a 12 percent increase in the number of workers who withdrew money or took loans against their retirement accounts. A recent report from financial advisory firm HelloWallet found more than one in four workers tap into their retirement funds before retirement.

"Problems in the future, no matter how big, are never as significant as problems today," said Michael Kresh, a certified financial planner with Creative Wealth Management in Islandia. He concedes it is "extremely difficult" for individuals in their 30s or 40s to wrap their heads around what their retirement needs will be 30-something years from now.

If they don't do it now, however, it may be too late.

Only 25 percent of people who reach their 60s have close to an adequate amount of money for their retirement, Kresh said. Twenty-five percent have less than one year of salary put away in their retirement account.

"That doesn't mean anything at 45, but when you're 68 and retiring because you have to, you may look at that scenario and say, 'I can only pay my bills for a year,'" he said.

As other means of retirement security have dwindled, and employers have embraced 401(k)s and other defined contribution accounts, employees have become more active participants in their savings.

"When you have a 401(k), you are completely responsible for determining if you have adequate money for retirement," Kresh said.

MICHAEL KRESH: Only 25 percent of people in their 60s have enough money for their retirement.

With greater control, however, employees are increasingly viewing their retirement accounts as their assets to do with as they please, Kresh said.

Today, "people think of [their 401(k)s] more as a savings account than a retirement account," Kresh said. The danger: "There won't be an employer behind you in your 60s or 70s to give you a pension."

Gregg Schriro, chartered retirement planning counselor and portfolio manager at United Asset Strategies in Garden City, encourages clients not to intrude on their retirement funds unless it's an absolute necessity. Fifty percent of clients are resistant to that advice, while the other half is open to discussing other options from which to pull funding, he said.

For instance, CDs currently earn minimal interest; if individuals break the terms of a CD, it won't affect their earnings significantly. Use of a marginable stock account is another option for a large purchase, and home equity loans are available at nominal 2 to 3 percent interest rates, Schriro said.

Steven Brett also steers his clients to first seek equity from other assets, including the home, taxable accounts, security-based lines of credit and credit facilities. But in some cases, Brett, the president of Marcum Financial Services in Melville, runs through growth projections with clients only to discover tapping into their retirement accounts will not have an impact on their future lifestyle. The key, however, lies in clients' "understanding completely what the future ramifications [of using those funds] will be," Brett said.

If a 401(k) is the only option available, Brett said he would prefer to see clients take a loan against the account versus a withdrawal. Individuals who take distribution from their 401(k) earlier than age 59½ face a 10 percent penalty, as well as federal and state taxes, he said. Employees who borrow money from their plan are required to pay themselves back, plus interest. Each plan may be subject to restrictions regarding how much individuals can borrow.

Brett cautions clients, however, that if they lose their jobs, the loan still must be paid back completely. Another drawback to the loan:

"You pay yourself back with after-tax money and are missing the opportunity for that money to grow on a tax-deferred basis," he said.

Using a retirement plan to solve financial problems – such as paying for kids' college or helping sick parents – is not entirely incorrect. Not knowing the cost of the choice is a problem, Kresh said.

"You can always pay back a loan or save more later on when you're out of the financial doldrums," he said. "But, once you're retired, you're finished. Whatever money you have saved has to last the rest of your life."

The typical household nearing retirement has an average of $120,000 in retirement savings, enough for roughly a $7,000-a-year annuity, according to a recent study by Boston College's Center for Retirement Research.

According to Fidelity Investments, individuals who do not have a pension should have saved eight times their salary by the time they retire. Consulting firm Aon Hewitt says workers will need 11 times their salary saved to pay for retirement costs.

Kresh agrees saving the equivalent of eight times an individual's income may be "cutting it tight." For example, according to the Fidelity guide, someone making $80,000 before retirement would need to save $640,000 in a retirement account. Additionally, medical expenses for a couple age 65 are anticipated to reach $250,000, above and beyond what Medicare pays and excluding the need for a nursing home, Kresh said.

In the example above, an individual would need to save close to $1 million to cover medical and cost-of-living expenses in retirement.

"If you were making $80,000 a year, what is the likelihood you saved $800,000?" Kresh asked. "That's why qualified plans are ones you shouldn't touch. The power of compounding is so strong."