PERSPECTIVES

A Series of Purchasing Power Viewpoints on Industry Topics

PURCHASING POWER

Short-Term Financing Needs – 401(k) Loan or Employee Purchase Program?

For most Americans, 401(k) plans are a primary retirement vehicle for their golden years. Today, more participants in defined contribution plans are adopting positive savings behaviors than in past years and are increasing their contributions, rebalancing their accounts and feeling confident about their retirement planning[1].

While 401(k) activity for many employees is taking this positive turn, for others it's just the opposite – they are borrowing against their 401(k). Almost 30 percent of 401(k) savers today have an outstanding loan against their account[2].

Why the high rate of outstanding loans? There are generally no restrictions on how a 401(k) loan can be used. Some borrowers are using the money to pay for college or medical expenses or to consolidate or pay off higher-cost credit card debt. Many employees today fall in the 'financially fragile' category (40 percent are living paycheck to paycheck[3]) and don't have savings available to fall back on for other high-ticket items they need, so the 401(k) becomes a source of funds.

With 401(k) loans, employees are borrowing from themselves but still have to pay interest. Most plans set the standard interest rate at prime plus an additional one or two percent. Unlike the interest paid to a bank, employees eventually get their money back in the form of qualified disbursements at or near retirement. The interest they pay back into their 401(k) plan is tax-sheltered. However, when employees borrow from their 401(k) plan, it disrupts their dollar cost averaging process which has the potential to significantly lower long-term results. Plus, if the employee leaves the company or is terminated, their 401(k) loan must be repaid in full, normally within 60 days. If the plan participant fails to meet that deadline, a default is declared and penalty fees and taxes are assessed.

We believe there's a better alternative.

There is a way to preserve 401(k) savings while still being able to fund some unexpected expenses. An employee purchase program through Purchasing Power provides a means for workers to obtain items they need without dipping into their financial future.

Through Purchasing Power, workers can enroll in online education courses and acquire a variety of household items including computers, appliances and furniture via payroll deduction. Employees pay over a 12-month period with no fees or ballooning interest. Purchasing Power is an option to keep employees from borrowing against their 401(k), getting caught in the minimum payment trap with credit cards, or incurring long payment terms, high interest and penalty fees.

And don't just take *our* word for it. Our customers say that's the way it works.

According to a survey of 2,000+ Purchasing Power customers, 71 percent report that having access to Purchasing Power makes them less likely to consider their 401(k) or other alternatives for short-term financing needs, and 94 percent agree that our program helps reduce financial stress and pressure.

Utilizing employee purchase programs to obtain much-needed products and service items allows employees to ensure that they are utilizing their 401(k) plan for what it is meant to be – savings for their retirement.

For more information about Purchasing Power, please contact us at:
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71%

of Purchasing Power customers report they are **less likely** to consider their 401(k) or other alternatives for short-term financing needs.

Source: 2011 Customer Survey

[1]2011 Mercer Workplace Survey.
[2]MSN Money Partner, "401K Loans On the Rise," June 7, 2011.
[3]Benefits Pro, "Fewer Employees Living Paycheck to Paycheck," Amanda McGrory, August 16, 2012.