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IMPACT OF THE SUBPRIME DEBACLE ON RETIRMENT PLANS

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the ripple effect

The subprime effects began to surface in the fall of 2006 with an increase in home foreclosures. When interest rates adjusted, numerous borrowers were unable to make their mortgage payments. It is expected that interest rates will continue to adjust in 2008. The effects of the subprime crisis could ripple out to retirement plans. While it is too early to know for certain how subprime adjustments will affect retirement plan savings; they are expected to influence participant loans, employee contributions, and participation.

increase in loans

Retirement plans with loan provisions could experience a spike in participant loans. Unfortunately, mortgage companies saw an opportunity to market unconventional loans to borrowers who did not qualify for market interest rates. These borrowers typically had poor or no credit history and were unable to provide documentation as proof of enough income to support their monthly payments. Despite the riskiness involved, mortgage companies continued to underwrite these loans. Now, these borrowers might be tempted to dip into their retirement nest egg in hopes of keeping a roof over their heads. The ramifications of prematurely withdrawing funds from one's retirement account may include postponing retirement if savings will fall short of the needed funds. Individuals who planned on retirement at a certain age may now be looking at additional years in the workforce. In addition, payback of the loan will be with after tax dollars, which will be taxed again when distributed.

decrease in employee contributions

Employee contributions could decrease dramatically due to the pressures of increasing mortgage payments taken out by individuals who don't have the income to support the increase in their mortgage payment. Participants with increasing mortgage obligations will have to adjust their monthly budgets in order to keep their homes. One consideration would be to postpone voluntary retirement saving through employer-sponsored plans such as 401(k) and 457(k) plans. The decision to decrease employee contributions, although done for an immediate need, could result in delaying retirement due to the lack of funds. Additionally, for employees in employer sponsored plans offering a match could leave free money on the table if their contributions fall below the specified percentage to receive the full match.

lower participation in voluntary plans

Studies indicate that employee participation rates in voluntary retirement savings plans, such as 401(k) and 457 plans are low and the subprime effects could decrease this rate even more. As borrowers find ways to meet their mortgage payment obligations retirement plan participation could seem less important due to the long time horizon. For younger employees, it may be easier to postpone saving in order to meet the immediate needs of the monthly budget. Also, retirement plans that don't have automatic enrollment could see enrollment drop significantly more due to subprime troubles.

Summary

The subprime crisis will affect retirement plans. To what extend and how they will be affected; only time will tell. The effects of the subprime debacle will continue to play out in 2008, and we could be looking at a long road ahead. Despite the difficult times the subprime crisis may create (or has created), retirement plan participants need to continue saving and investing money for retirement. The alternatives may be working longer than expected or lowering retirement income expectations.

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