2009

401(k) Debit Card: Valuable Asset or Another Way to Deplete Retirement Accounts

Andrew O. Furuseth

Follow this and additional works at: http://scholarship.law.unc.edu/ncbi

Part of the Banking and Finance Law Commons

Recommended Citation
Available at: http://scholarship.law.unc.edu/ncbi/vol13/iss1/16

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.
I. INTRODUCTION

In July 2008, Senator Charles Schumer and Senator Herb Kohl proposed legislation to ban 401(k) debit cards. 401(k) debit cards allow borrowers to use a debit card to withdraw funds from a predetermined portion of their 401(k) account. The plan administrator and current laws treat each withdrawal as an individual 401(k) loan. Senator Kohl described the cards by saying, “[t]hese debit cards allow participants to use his or her retirement savings to make everyday purchases like buying a cup of coffee.” In addition, the Senate Special Committee on Aging conducted a hearing to examine the cards and other issues affecting individuals’ retirement accounts. The proposed legislation sparked a new wave of attacks on the cards in the press. One commentator described them as “economic poison.” ReservePlus, the only current 401(k) debit card, has failed to make a profit; but if the ban became law, the company would never recover their investment or losses accrued.

1. S. 3278, 110th Cong. (as introduced in Senate, July 17, 2008).
3. See Rod Garcia, Practitioner Debate Virtues of Pension Plan Loan Credit Cards, 72 TAX NOTES 19 (stating the IRS analyses the loans under section 401(k) and they are not prohibited under ERISA) (1996).
5. Hearing, supra note 2.
Part II of this note will examine the development and current legal status of 401(k) debit cards. Part III will analyze the positive and negative attributes of the 401(k) debit cards. Part IV will briefly examine the proposed legislation and its affect on 401(k) debit cards. Part V will analyze other possible legislative reforms for both 401(k) debit cards and other forms of 401(k) withdrawals.

II. THE HISTORICAL AND LEGAL FRAMEWORK OF 401(K) DEBIT CARDS

The idea of using a card to access the balance in a 401(k) plan has been around for some time. In 1993, a Nobel Prize winning economist, Franco Modigliani, and an industry insider, Francis Vitagliano, created a system to handle 401(k) card transactions and were granted a patent. Banc One teamed up with Modigliani and Vitagliano and proposed creating the card. It appears, however, congressional pressure stopped Banc One before the cards were issued to consumers. In 2004, newspapers declared ING was close to announcing plans to create 401(k) debit cards. ING later decided not to produce the cards. While banks and individuals proposed 401(k) debit cards for the past fifteen years, they were not made available to consumers until ReservePlus.

9. See infra Part II.
10. See infra Part III.
11. See infra Part IV.
12. See infra Part V.
15. Id.
16. Kary Wutkowski, Lawmakers Seek to Ban 401(k) Debit Cards, REUTERS, July 16, 2008 (“A decade ago, the mere idea of this legislation was enough to get companies to abandon this reckless practice”).
19. Hearing, supra note 2 (statement of Bruce Bent, Chairman, The Reserve, during questioning by Sen. McCaskill that the cards have been offered for seven
The basic concepts of a loan from a 401(k) plan are important to understand before one can properly examine the 401(k) debit card. A 401(k) is a tax-deferred savings plan. Specifically, qualified contributions by an employee, employer or both are exempt from taxation as income to the employee at the time of contribution. The principal and any interest earned will not be taxed until the money is withdrawn. However, if money is withdrawn prior to the employee reaching 59 1/2, tax must then be paid on the withdrawals at the marginal tax rate as ordinary income plus a ten percent penalty. The benefit of the plan is deferred taxation, which allows tax-free wages to be invested, tax-free interest to be reinvested, and postponement until retirement of tax payments on the income previously earned and contributed to the account. The government provides this tax benefit to encourage employees to save for retirement. When difficult times occur for the employee 401(k) loans may be needed.

The Internal Revenue Code governs 401(k) plans and all loans against these plans. Multiple agencies share regulatory authority over 401(k) plans. The value of the loan cannot exceed the lesser of $50,000 or one half of the present value of the 401(k). In addition, the terms of the loan must require repayment within five years. Finally, the loan must be repaid with even payments over its life. If a person defaults on the loan, the unpaid balance is then treated as a taxable withdrawal from

years).

22. Id.
25. Hearing, supra note 2 (Sen. Herb Kohl stated, "[t]he bottom line of today's hearing is that 401(k) and similar defined contribution plans were created to ensure that people would have adequate savings for retirement.").
26. § 72 (p).
29. § 72 (p)(2)(B).
30. § 72 (p)(2)(C).
the 401(k). The administrators of the loans may also impose their own rules. Typically, a small transaction-based fee is charged on 401(k) loans. In addition, the interest charged is traditionally around the prime rate plus one or two percent. The interest charged on these loans is paid back into the 401(k) plan and is not kept by the administrator of the loan. In other words, the employees are loaning themselves money and paying themselves interest. In addition, some administrators and employers limit the availability of the loans based on the employee's need. For instance, some administrators only allow loans for legitimate hardships, while others may have not required any specific reason for a loan. Many administrators require that an employee pay back a loan within thirty to ninety days following termination of their employment. If this does not occur, the employee defaults on the loan and must pay the tax as if the employee took an early withdrawal.

There is no specific law governing 401(k) debit cards, therefore they are regulated by the same principles as traditional 401(k) loans. They are subject to the same five-year payback requirements, same limits on the amount of money that can be loaned, and same amortization schedule. ReservePlus, the current provider of 401(k) debit cards, established rules governing the operation of the cards. Unlike traditional 401(k) loans, which are paid directly to the employee, a 401(k) debit card is created when

31. § 72(p)(2)(C).
32. Christine Dugas, 401(k) Loans Come with Caveats, USA TODAY, Oct. 12, 2008, at 9A.
33. Id.
35. See Dugas, supra note 32 (stating the most common needs are medical expenses and student loans).
36. Id.
37. Id.
38. Id.
39. See Garcia, supra note 3 (stating the IRS analyses the loans under section 401(k) and they are not prohibited under ERISA).
40. Hearing, supra note 2 (showing Bruce Bent, Sen. Charles Schumer and Sen. Claire McCaskill disagreeing about whether or not 401(k) debit cards encouraged saving).
an amount requested by the employee is given to an outside company and placed in a qualified money market account. At this point, the administrator of the employee sponsored plan charges its normal fees for a 401(k) loan. The money in the money market, however, is not yet a loan; rather it is merely an invested portion of a 401(k). The cash is then accessed by the employee through a debit card. The debit card transaction creates the loan. The interest then begins to accrue and the five-year time limit begins. The administrator of the debit card, ReservePlus, begins to charge an additional 2.9%-3.5% fee on the amount loaned. This amount is a fee, so while it is added into the borrower’s payments, it goes to the administrator, not back into the plan like the interest payments. Following termination of employment, ReservePlus allows the employee to continue to make payments on amounts borrowed using the debit card until the statutory five year limit expires.

III. POSITIVE AND NEGATIVE EFFECTS OF 401(K) DEBIT CARDS

A. The Benefits of 401(k) Debit Cards

The primary justification for the card is that it increases employee participation in 401(k) programs. Nobel Prize winning economist Franco Modigliani claimed that cards linked to 401(k) plans encourage people to build up their savings, because their retirement assets will be more liquid. In 2004, Lawrence Summers, then president of Harvard University and the former United States Secretary of the Treasury supported the cards, citing

41. Id.
42. Id.
43. Id.
45. Hearing, supra note 2 (statement of Bruce Bent, Chairman, The Reserve).
46. Schifrin, supra note 44.
the belief that easier access to 401(k) funds would increase the likelihood of savings. Chairman of The Reserve, the company presently offering the debit cards, Bruce R. Bent, stated his company saw increased participation in 401(k) plans by those who were offered 401(k) debit cards. In addition, Mr. Bent claims that people are not only more likely to participate, but also saving more money. These claims suggest that Dr. Modigliani was correct, and increased availability of funds increases participation in a 401(k) program.

In addition, supporters of the 401(k) debit cards suggest that a consumer is better off with a 401(k) debit card by avoiding traditional credit card debt. Mr. Modigliani believed that "a 401(k) card would give workers the chance to repay costly credit card debt, often bearing interest rates above 20 percent, with lower-cost funds from their own savings." The problems of credit card debt and high interest rates continue today with the Federal Reserve reporting that the amount of revolving consumer credit was at $969.9 billion as of July 2008. Interestingly, when the cards were proposed in 2004, some credit card companies fought them. One reason suggested for their opposition was credit card companies’ fear that 401(k) debit cards would suppress the interest rates they could charge. If consumers had the opportunity to loan themselves money at a lower interest rate, the credit card companies would lose customers or be forced to lower their rates.

The structure of a 401(k) debit card may also save consumers money if they lose their job. With a traditional 401(k) loan, repayment is due within thirty to ninety days if the borrower

50. Vise, supra note 13.
51. Hearing, supra note 2 ("What we are finding statistically is more people are willing to participate because they feel the access, to access their -- the money that’s available to them.").
52. Id. (testimony of Bruce Bent, Chairman, The Reserve) ("At the end of the day, participants accumulate greater overall retirement savings using the ReservePlus service over conventional loan processing.").
55. Vise, supra note 13.
56. See id. ("What about the chance for people to replace those high-interest-rate credit cards? The major credit card companies lobbied hard to derail the concept.").
57. See id.
becomes unemployed.\textsuperscript{58} A 401(k) debit card loan does not become immediately due following termination of employment.\textsuperscript{59} The loan from a 401(k) debit card maintains its original terms and therefore, based on the statutory time limit, the borrower has five years to pay the loan back.\textsuperscript{60} A borrower may face substantial hardships following loss of employment, so it is difficult to expect a borrower who has already been forced to withdraw money from a 401(k) to then repay the loan immediately. In fact, many of the guides advising against 401(k) loans cite payback terms that require repayment following termination of employment as a reason not to take out a 401(k) loan.\textsuperscript{61} Therefore a person who has lost his job, is unable to repay the loan immediately, and has a 401(k) debit card instead of a traditional loan would not pay income tax on the loan nor would they face the 10\% penalty when the defaulted loan is treated as an early withdrawal.\textsuperscript{62} So while a borrower will likely pay more in fees for a 401(k) debit card, the borrower may save money in the long term if the borrower’s employment is terminated while a loan is outstanding.

Consumers who use a 401(k) debit card instead of a traditional 401(k) loan may also benefit because the money stays in a qualified plan until it is spent.\textsuperscript{63} In a traditional 401(k) loan, the administrator transfers the funds, in a lump sum, from the plan to the consumer. Therefore, any interest this money earns before being spent is subject to taxation. In the case of the 401(k) debit card, the administrator transfers the funds from the 401(k) plan, to a money market account which remains a qualified part of the plan.\textsuperscript{64} This means the tax on the interest earned in the money market account before the funds are withdrawn is deferred.\textsuperscript{65} In

\begin{thebibliography}{99}
\bibitem{58} Robert Reeves & Pamela Villarreal, 401(k) Loans = Retirement Insecurity, NATIONAL CENTER FOR POLICY ANALYSIS, No. 615, Apr. 25, 2008.
\bibitem{59} Hearing, supra note 2 (testimony of Bruce Bent, Chairman, The Reserve).
\bibitem{60} Id.
\bibitem{61} Reeves, supra note 58.
\bibitem{62} See Hearing, supra note 2 (Bruce Bent testified that loan terms do not change following termination of employment).
\bibitem{63} See id.
\bibitem{64} See id.
\end{thebibliography}
addition, the money market account may gain more interest than a traditional checking account, the likely depository of a 401(k) loan.\textsuperscript{66} One drawback of the money market account is that it may earn less interest than a traditional 401(k) loan, but the fact that the money continues to accrue interest tax-free is a major benefit over a traditional 401(k) loan.\textsuperscript{67}

Finally, those supporting the debit card claim that the average 401(k) debit card loan is less than the average 401(k) loan.\textsuperscript{68} The founder of ReservePlus testified before Senate Special Committee on Aging that, "the average loan balance for participants in plans utilizing ReservePlus is approximately 30% less than the average loan balance for all plan participants, i.e., $4800 versus $7000."\textsuperscript{69} Senator McCaskill countered, "I am not aware that the advantages of credit cards and debit cards have led to savings. Every experience I've had in my life is counterintuitive to that."\textsuperscript{70} It seems that the senators are thinking in terms of traditional credit and debit cards and not in terms of 401(k) debit cards. Mr. Bent claims people borrow less because the borrower only borrows what they need, while the other money stays in the plan and continues to gain interest.\textsuperscript{71} The Senators proposing the ban and the Federal Investment Regulator Authority declared their goals were to lower the use of these loans.\textsuperscript{72} Therefore it would appear that all parties involved support the ends, but not the means.

\textsuperscript{66} ERIC TYSON, PERSONAL FINANCE FOR DUMMIES 182 (Wiley Publishing Inc.) (2006) ("If you consistently keep more than a few thousand dollars in a checking account, get the excess out. You can earn more in a savings or money market account.").
\textsuperscript{67} Financial Industry Regulatory Authority, supra note 65 (from 1926-2007 average money market return was 3.7 percent versus average large capital stock return was 10.4 percent).
\textsuperscript{68} Hearing, supra note 2 (Bruce Bent testified to lower loan balances of participants).
\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{72} See Hearing, supra note 2 (Testimony of Sen. Herb Kohl); Financial Industry Regulatory Authority, supra note 65.
The most common complaint about 401(k) debit cards is the ease with which they allow consumers to borrow money from their retirement. Senator Schumer said his legislation banning 401(k) debit cards, "will protect people's nest eggs from companies peddling debit cards that can deplete retirement savings with a simple swipe." Others agree and find spending retirement funds with a debit card to be reckless. The mixed messages the card may send was best summarized by representatives of the Heritage Foundation and Retirement Security Project who stated, "because we believe that ease, convenience, and minimization of transaction costs can have a significant effect on behavior, we worry that a debit card for 401(k) borrowing might function as an effective behavioral strategy for dissaving rather than saving." The argument makes clear that lowering the effort needed to acquire a loan, in this case by streamlining the process with a debit card, may make consumers more likely to borrow from their 401(k) plans. It is not necessarily the card, but the ease of borrowing that troubles so many people.

The second major complaint about 401(k) debit cards is the cost to the consumer. The 401(k) ReservePlus debit card charges 2.9% to 3.5% as an administrative fee and a two dollar fee for cash advances. In addition, most administrators of 401(k) plans charge a fee that often ranges from $50 to $75 to transfer the money to

73. Special Committee on Aging, supra note 4.
74. See Davis, supra note 7 ("Allowing workers to borrow easily from their retirement accounts is at best reckless and at worst financially destructive."). During Congressional hearings, Sen. Claire McCaskill said, "I think the consuming public is going to confuse credit cards and access to these savings, because it feels and walks like a duck." Hearing, supra note 2 (Sen. Claire McCaskill's questioning).
76. See Robert C. Newton, Commentary: The 401(k) Debit Card, or Debt Building Card? Part 2, THE DAILY RECORD OF ROCHESTER, Mar. 3, 2008, available at http://www.401ktalk.com/Data/Documents/03-08/03-08-03-08-newton.pdf (stating that "Ease and flexibility would not be a good thing in the real world for most participants. Readily available funds more likely lead to impulse buys or other non-emergency purchases that may not be in participants' best interests.").
77. Hearing, supra note 2 (statement of Bruce Bent, Chairman, The Reserve).
the ReservePlus account. These fees have prompted the Securities and Exchange Commission (SEC) to set up a page on their website warning consumers about fees associated with 401(k) debit cards. The Financial Industry Regulatory Authority (FINRA) also warned consumers about the fees associated with 401(k) debit cards, which are higher than traditional 401(k) loan fees. When compared with other forms of credit, however, the fees are typically much lower than a consumer could receive from a credit card company. So while there are fees on 401(k) debit cards, their relative harm depends on whether they are compared with credit cards or traditional loans, which have higher fees or traditional 401(k) loans, which have lower fees.

A final critique of 401(k) debit cards is that their use may result in a large loss in future earnings due to a small loan. According to Senator Gordon Smith, a consumer who takes out $30,000, in two separate loans, and repays them on time will have $40,000 less at the time of retirement. Factors that help to contribute to the large deficiency: the rate of interest charged on the loan compared with the interest rate accumulated on the savings, the amount of time for interest earned to compound and the decrease in the contributions while repaying a 401(k) loan. A young person who takes out a loan, pays a low interest rate and does not contribute to his 401(k) while paying off the loan suffers the greatest loss of future earnings. These types of losses are dramatic and demonstrate why borrowing today will cost consumers later. Warnings from the SEC and FINRA both refer to the long-term consequences a 401(k) debit card loan will have.

78. Id.
80. See Financial Industry Regulatory Authority, supra note 65.
81. See David & Iwry, supra note 75 (stating 401(k) loans and debit cards could reduce the need for higher interest debt).
82. Margaret Price, Feeling Pinched? It's No Time to Crack The Nest Egg, CHRISTIAN SCIENCE MONITOR, Aug. 18, 2008 (“taking even short-term loans from a retirement plan can leave a lasting dent in a nest egg”).
84. See id. (testimony of Dr. Christian E. Weller).
85. See id. (testimony of Dr. Christian E. Weller).
IV. PROPOSED LEGISLATION

On July 17, 2008, Senators Schumer and Kohl introduced legislation to amend the Internal Revenue Code to ban 401(k) plan administrators from making loans through credit cards or intermediaries. The bill also limits to three the number of 401(k) loans a person can have at any one time. The bill effectively eliminates the use of debit cards; debit cards use a card or intermediary to make the loans and give customers the ability to make more than three individual loans. The bill was likely proposed too late in the year to pass during 2008, however it will likely form the basis for any future legislative efforts.

The legislation is vague. It fails to give a legal definition of an intermediary. While credit cards are clearly banned what is the effect on a debit card? Does this ban ReservePlus’s scheme of processing the loans for other companies? The answers to these questions are unknown and could place 401(k) administrators in jeopardy. Administrators are unlikely to produce innovation if the legality of such practices are in doubt. In addition, if the planed

---

86. U.S. SEC, supra note 79; Financial Industry Regulatory Authority, supra note 65.

87. Lieber, supra note 49 (citing Vanguard research which found “a [thirty-five]-year-old with a $20,000 balance who takes out two loans in [fifteen] years ends up with about $38,000 less at age [sixty-five] than someone who never borrows, all things being equal.”).

88. S. 3278, 110th Cong. §1(a) (as introduced in Senate, July 17, 2008) (“A trust shall not constitute a qualified trust under This section if the plan makes any loan to any beneficiary under the plan through the use of any credit card or any other intermediary”).

89. S. 3278, 110th Cong. §2(a) (as introduced in Senate, July 17, 2008) (“shall not apply to any loan made after the date of the enactment of this subparagraph if, immediately after such loan is made, the number of outstanding loans from the plan to the participant or beneficiary exceeds [three]”).

90. See Andrea L. Ben-Yosef, Bill to Limit Plan Loans, Debit Cards Seen by Practitioners as Good Policy, 91 BNA BANKING REP. 111 (2008).

91. See S. 3278, 110th Cong. (as introduced in Senate, July 17, 2008).

92. See supra notes 40-43 and accompanying text.
legislation were to ban ReservePlus' scheme, it would have financial consequences on consumers.\textsuperscript{93} Congressional testimony demonstrated the large costs people incur when borrowing even minor amounts from 401(k) plans, any additional interest earned is valuable in the long term.\textsuperscript{94}

While the legislation will be successful at eliminating debit cards, it may create unintended consequences. First, the legislation provides no incentive for a person to limit loans to the amount of money they need immediately. One benefit of the 401(k) debit card is that it allows borrowers to take out small loans when a borrower needs the money.\textsuperscript{95} Theoretically this leads to the lower loan amounts for participants in the ReservePlus program.\textsuperscript{96} The bills terms limiting participants to three loans, encourages people to take out as much money as they believe they might need, instead of the amount of money they actually need. Currently ninety percent of plan administrators limit borrowers to three or less loans at a time.\textsuperscript{97} However, the lower outstanding loan balances from ReservePlus may show this is not the best policy.

In addition, the legislation does not address many of the concerns raised by those skeptical of the cards. Senator Kohl stated, "we are also concerned about the high fees many plans charge their participants. These fees can significantly reduce the amount of savings Americans have when they retire."\textsuperscript{98} These concerns have been repeated by experts.\textsuperscript{99} Yet the proposed legislation makes no mention of fees. The Senators placed no limit on the amount a plan could charge in interest, origination fees, or any other fee structure. If enacted The Reserve could immediately

\textsuperscript{93} See supra notes 62-67 and accompanying text.
\textsuperscript{94} See hearing, supra note 2 (testimony of Dr. Christian E. Weller).
\textsuperscript{95} See id.
\textsuperscript{96} See id. (statement of Bruce Bent, Chairman, The Reserve) (stating Reserve Plus loans are smaller than traditional 401(k) loans).
\textsuperscript{97} Ben-Yosef, supra note 90.
\textsuperscript{98} Hearing, supra note 2 (Testimony of Sen. Herb Kohl).
\textsuperscript{99} David & Iwry, supra note 75 ("excessive fees and expenses might be viewed as a form of "leakage" to the extent that they eat away at plan account balances"); id. ("In addition to these finance charges, there may be set-up fees, annual fees and cash advance fees—so individuals should think long and hard before they sign up.").
offer tradition 401(k) loans with the same fee structure as the present 401(k) debit card plan.

Similarly, the legislation does nothing to address the concern that consumers may take out loans for lattes or other expenses that might be viewed as frivolous. The congressional hearing began with a reference to such purchases. Congressional testimony highlighted two different policy concerns related to frivolous spending; the actual items purchased and the ease of access to 401(k) retirement funds. Senator Schumer demonstrated the frivolous spending issue when he stated flat panel televisions should not be funded by a 401(k) loan. The proposed legislation does nothing to address this issue. Senator Schumer also raised the ease of access issue stating, “when you can just use it as a credit card, it’s a lot different than if you have to go through a whole lengthy process to do it.” Mr. Bent testified that with a few clicks a person could set up a 401(k) loan without justification and Senator Schumer responded that, “maybe we shouldn’t allow that either.” With modern technology traditional 401(k) loans will likely become easier to request and receive, making the loans only marginally more difficult to receive without the ease of the debit card.

Some commentators also feel there should be some justification for loans from a 401(k) account. Mr. Gannon, from the FINRA, condemned the debit cards because “consumers can use the funds for any purpose and usually don’t have to explain why they need the money or how they intend to spend it.” The legislation, however, does nothing to address these problems. A person who desires a flat panel television can easily set up a onetime loan from a company, without a justification, and buy the television.

100. Hearing, supra note 2 (statement by Sen. Herb Kohl).
101. Id. (statement by Sen. Charles Schumer).
102. S. 3278, 110th Cong. (as introduced in Senate, July 17, 2008).
104. Id.
Finally, the proposed legislation does nothing to address the problem people have when their employment is terminated and they have an outstanding 401(k) loan. The 401(k) debit cards is one of the few instruments that allows consumers to pay the loan back over the five year period rather than the shortened thirty to ninety day period. Numerous news articles, governmental warnings, and advisories from organizations discussed these abbreviated repayment schedule as a concern for consumers. Yet the proposed legislation does nothing to address this problem. Without 401(k) debit cards, an employee considering leaving or switching jobs would be forced to go to the private market for a loan, even though she may have substantial savings available in a 401(k) plan. While this result will certainly limit the number of loans, it may also force more people to pay penalties to withdraw funds from their 401(k) plans and they will be less likely to repay the loans.

V. ALTERNATIVE PROPOSALS

The proposed legislation designed to ban 401(k) debit cards will likely be successful at banning the cards, but it is probably not the best legislation to solve the problems highlighted during Congressional hearings and by experts in the field. Part IV detailed the shortcomings of the proposed legislation. This section will propose legislation which might be more effective at regulating the industry and bringing about the desired goals of experts and Congress.

The first reform should be to the fee structure of 401(k) debit cards. It is clear that hidden fees may be a problem for consumers. In fact, the Senators struggled to understand the fees associated with the 401(k) debit cards, even after written

---

106. Dugas, supra note 32 (discussing the taxation of loan proceeds when default occurs).
107. See Hearing, supra note 2 (Testimony of Bruce Bent, Chairman, The Reserve, comparing the shortened period for traditional 401(k) loans and the five year limit for 401(k) debit cards).
108. Financial Industry Regulatory Authority, supra note 65; see Dugas, supra note 32.
109. U.S. SEC, supra note 79; Dugas, supra note 32.
testimony had been submitted to them.\textsuperscript{110} If United State Senators, with staffs and written testimony struggle to understand the fee arrangements, it can be expected that many employees may not understand the fees associated with such loans. The first step should be to promote clear information about the fees associated with these loans. Such legislation would be not unprecedented. Currently the Department of Labor has regulatory authority overseeing 401(k) plan administration and fees.\textsuperscript{111} In 2007, the Defined Contribution Fee Disclosure Act was proposed, which would require 401(k) administrators to declare what fees they were charging and what fees those they invested with were charging.\textsuperscript{112} Congress could extend this to include 401(k) loan fees, which would include 401(k) debit card loans. This would give employers and employees the data necessary to compare plans and allow the market to correct any excessive fee structures. Currently, even Mr. Bent testified that he could not compile the average fees charged on 401(k) loans.\textsuperscript{113} Proposals to force clear reporting of fees and publishing of these fees would do more to solve the problems of excessive fees than the proposed legislation which fails to address the issue.

To better address the challenges of 401(k) debit cards, Congress could enact legislation to limit the value of 401(k) debit card loans on a trial basis, while the benefits and faults of the debit cards are more thoroughly examined. After extensive testimony and discussion, there is still debate about whether the cards encourage employees to save more money and whether the cards lead to lower amounts of borrowing from 401(k) plans.\textsuperscript{114} If these two facts are true, the debit card loans may be better than traditional 401(k) loans, the theory originally advocated by Dr. Modigliani.\textsuperscript{115} Congress could also allow 401(k) debit card loans to

\textsuperscript{110} Hearing, supra note 2 (Sen. Charles Schumer and Sen. Claire McCaskill repeatedly asked about transaction fees and fees which went directly the employer, neither of which exist).

\textsuperscript{111} JOHN J. TOPOLSKI, CRS REPORT FOR CONGRESS, H.R. 3185: THE 401(K) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007 (Apr., 24, 2008).

\textsuperscript{112} S. 3278, 110th Cong. (as introduced in Senate, July 17, 2008).

\textsuperscript{113} Hearing, supra note 2.

\textsuperscript{114} Id. (showing Bruce Bent and Sen. Charles Schumer and Sen. Claire McCaskill disagreeing about whether or not 401(k) debit cards encouraged saving).

\textsuperscript{115} Vise, supra note 13.
go forward by limiting the amount of money that could be loaned through them. In 2004, when the cards were proposed, ING set a limit of $10,000 on loans.\textsuperscript{116} A similar limit would permit the cards to be tested and more data to be collected, without allowing people to empty their savings. In 2004, Alicia Munnel, director of the Center for Retirement Research at Boston College, withdrew her opposition to testing the cards once a limit was imposed.\textsuperscript{117} The solution may be more palatable to Congress and plan administrators; giving the administrators more flexibility while still regulating the practice. Limiting the value of loans from a 401(k) debit card would allow additional research while exposing the public to less of a perceived risk.

Legislation could also provide more time for terminated employees to repay 401(k) loans, an issue identified during the Congressional hearing.\textsuperscript{118} The proposed legislation not only ignores this issue, but exacerbates it by banning one of the few products that gave employees time to repay loans following termination of their employment.\textsuperscript{119} During the Congressional hearing on Saving Smartly, the Retirement Security Project offered two suggestions to alleviate the problem. “First, the former employer could allow outstanding loans upon termination of employment to continue to be repaid. Second, the former employer could allow or require outstanding loans to be rolled over to the plan of a new employer.”\textsuperscript{120} While the proposals call on action by administrators, Congress could propose legislation that achieves the desired goals. First, Congress could mandate that outstanding loans be rolled from one employer’s plan to the new employer’s plan if possible. While this legislation would require portability and cohesion between providers, it would eliminate the need for ninety-day payment limits.

\textsuperscript{116} Hansell, \textit{supra} note 13 (“The card will have a credit limit of $10,000.”).

\textsuperscript{117} Vise, \textit{supra} note 13 (“Alicia Munnel, director of the Center for Retirement Research at Boston College, said the new retirement card is ready to be tested in the marketplace. Her initial concerns that the card would drain 401(k) savings have been addressed in part by the imposition of the $10,000 maximum on what can be borrowed.”).

\textsuperscript{118} See supra notes 58-67 and accompanying text.

\textsuperscript{119} Hearing, \textit{supra} note 2 (Bruce Bent testified his card provided more time to repay loans compared with traditional 401(k) loans).

\textsuperscript{120} Id. (testimony of Mr. Iwry).
A better alternative, the government could require all plans that make 401(k) loans to accept payments from terminated employees. The Reserve is able to accept payments from terminated employees so there is little reason to believe others would be unable to overcome any administrative difficulties. Requiring administrators who make loans to continue to accept payments from former employees may be easier to implement than shifting loans between plans. Moreover it would allow employees who do not find employment with an employer who offers a 401(k) plan to continue to repay their loan. This solution allows more money to be paid back into 401(k) plans and fewer penalties to be paid by consumers.

VI. CONCLUSION

Debit card access to 401(k) retirement funds, as offered by the Reserve, has benefits and drawbacks, as do all 401(k) loans.\textsuperscript{121} The primary benefits have been ignored or misunderstood by many commentators. The cards do charge higher fees than some 401(k) loans; however, without better reporting of the fees charged, it is impossible to make a broad comparison.\textsuperscript{122} In addition, if the debit cards are banned, there may never be enough evidence to confirm or refute the theories of Dr. Modigliani.\textsuperscript{123} Early evidence suggested the cards had the desired effect of increasing investments in 401(k) plans.\textsuperscript{124} In addition, the cards seem to be leading to smaller loans, something Congress desires.\textsuperscript{125}

These benefits and drawbacks of 401(k) loans and 401(k) debit cards will likely be heightened by the current economic conditions. In November 2009, the country experienced the largest percent change in consumer credit since 1998.\textsuperscript{126}

\textsuperscript{122} See Newton, supra note 76.
\textsuperscript{123} See supra notes 49-53 and accompanying text.
\textsuperscript{124} Hearing, supra note 2 (statement of Bruce Bent, Chairman, The Reserve).
\textsuperscript{125} Id. (statement of Bruce Bent, Chairman, The Reserve, during questioning by Sen. Claire McCaskill that the cards have been offered for seven years).
Individuals searching for credit may turn to 401(k) loans. The economic downturn has also led to layoffs and high unemployment rates. The recent job losses should highlight the importance of correcting the thirty to ninety-day pay-back period most 401(k) loans require following termination of employment. Some companies matching 401(k) contributions cut the programs in response to the economic problems. Matching contributions encouraged many participants to enroll and experts predict potential new enrollees will be less likely to enroll in the plans due to the diminished matching contributions. The increased liquidity offered by 401(k) debit cards increases enrollments in the plan. Changing the law during these tough economic times will likely increase the benefits and drawbacks any modifications to the current policy will cause.

The proposed legislation banning 401(k) debit cards may create more problems than it solves. The legislation ignores many areas of concern which were raised by Congress. If Congress wishes to consider 401(k) loan reform, it may be best to propose a more comprehensive bill that does not focus solely on 401(k) debit cards. Instead, the legislation could attempt to cure the ills of all 401(k) loans instead of attacking one variety. The proposals made in this note, could be more effective at curing the problems of high, hidden fees. In addition, eliminating the requirement that loans be repaid when an employee is terminated, possibly the toughest time to repay a loan, would allow more money to be returned to a 401(k) account and eliminate needless tax penalties. Legislation that includes these reforms and allows 401(k) debit cards to be used on a trial basis while more
information is collected may be more effective at curing the ills of 401(k) loans than the current version of 401(k) loan legislation introduced by Senators Kohl and Schumer.

ANDREW O. FURUSETH