

Where To Find Emergency Cash – Continued....
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3. Look to your life-insurance policy

If you have an insurance policy that includes a savings or investment component, such as whole or universal life, its cash value grows with each premium you pay. (A term life-insurance policy is less expensive to purchase but has no cash value, just a death benefit.) After a few years, most insurers will allow you to borrow up to 95 percent of the policy's cash value at reasonable interest rates, with no tax due on the proceeds. In general, though, borrowing against a policy with cash value is a relatively economical solution in an emergency. It's important to remember, though, that the money you take from your policy won't be there for your heirs when you die.

4. Tap your retirement fund as a last resort

Many employers allow 401(k) plan participants to withdraw money from those programs before age 59 only in certain "hardship" situations, such as to pay medical expenses, to avoid eviction or foreclosure, or to cover college tuition or funeral expenses for a close relative.

But hardship or not, the IRS imposes a 10 percent penalty on early 401(k) withdrawals on top of the income tax that you have to pay on the distribution. So if you're in the 33 percent tax bracket, a \$10,000 withdrawal from your 401(k) could cost you more than \$4,000. And that's not counting the \$50,000 or so in compound interest that you would probably earn by leaving that money in retirement savings for the next 20 years.

Generally, the rules for a traditional IRA are similar to those governing 401(k) plans except that the 10 percent early-withdrawal penalty is waived if the money is needed because of a hardship. And you can take as much as \$10,000 out of your IRA penalty-free once in your lifetime to cover a down payment on your first home. However, given the tax implications and loss of retirement savings, tapping an IRA early isn't a good idea. A Roth IRA is easier to dip into as long as it has been funded for at least five years. You can withdraw money in emergencies or for a first-time home purchase tax- and penalty-free.

Borrowing against your 401(k) plan, if allowed by your employer, is another option. A bit more palatable than a straight withdrawal, it is nonetheless frowned on by many financial experts. Usually, the loans are limited to \$50,000 or 50 percent of your vested balance, and they must be repaid within five years at an interest rate about a point above prime. Those are pretty good terms, and you're essentially paying yourself back, so the interest is actually going back into your own portfolio.

The downside, though, is significant. If you lose your job or leave voluntarily, you have to pay the loan back in full or be in default, in which case you would owe income tax and the 10 percent penalty on the unpaid amount. That's an expense you don't need when you are trying to deal with an unexpected crisis.

Moreover, by reducing your 401(k), even temporarily, you will have less money quietly compounding for your retirement. And while you'll be paying yourself interest, it will probably fall short of what you'd have earned had the loan money remained in the 401(k). A \$50,000 loan in your 40s could set your retirement savings back by as much as two years.