

# DISB Consumer Alert: COVID-19 Related Early Withdrawals from Retirement Accounts

*The North American Securities Administrators Association (NASAA), FINRA and the staff of the SEC's Office of Investor Education and Advocacy have joined together to provide this warning to investors about promoters targeting retirement accounts, as well as to provide a few key considerations for investors thinking of using 401(k) withdrawals or loans to purchase securities. As a member of NASAA, the DC Department of Insurance, Securities and Banking (DISB) is eager to share this information with District residents.*

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## **Be Careful of Fraudsters and other Bad Actors Targeting Your Retirement Savings**

The CARES Act of 2020 provides significant relief for businesses and individuals affected by the COVID-19 pandemic. This includes allowing retirement investors affected by the coronavirus to [gain access to up to \\$100,000](#) of their retirement savings without being subject to early withdrawal penalties and with an expanded window for paying the income tax they owe on the amounts they withdraw.

Unfortunately, unscrupulous promoters have used these CARES Act benefits to encourage investors to take money from their 401(k)s or traditional IRAs, not for current emergency financial needs, but to buy investments (often riskier ones) in an account at a firm the promoter recommends or in the investor's existing [account](#).

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## **Coronavirus-Related Hardship Withdrawals and Loans Under the CARES Act—Terms, Conditions and Intended Benefits**

Ordinarily, if you take a hardship withdrawal from your retirement plan, you permanently reduce your retirement savings balance. In other words, you are not allowed to put the money withdrawn back in the retirement account after the hardship has passed and you must pay income tax on it. Depending on your company's policies, you also might not be able to resume contributing for six months or more. In addition, you must pay a 10 percent penalty if you withdraw funds before reaching age 59½.

The CARES Act provides significant, temporary relief from these provisions, including for individuals who experience adverse financial consequences as a result of COVID-19 related events. The CARES Act allows qualified individuals impacted by the coronavirus pandemic to pay back funds withdrawn from a qualified retirement plan over a three-year period, and without having the amount recognized as income for tax purposes. The new law also

temporarily waives the 10 percent early withdrawal penalty for coronavirus-related distributions (CRDs) made between January 1 and December 31, 2020. In addition, the CARES Act exempts CRDs from the 20 percent mandatory withholding that normally applies to certain retirement plan distributions.

The CARES Act also doubles the ordinary retirement plan loan limits for qualified individuals to the lesser of \$100,000 or 100 percent of the participant's vested account balance. You will not owe income tax on the amount borrowed from the 401(k) if you pay it back within five years. In addition, qualified individuals with an outstanding loan from their plan (meaning a loan taken before the CARES Act was enacted) that has a repayment due between March 27 and December 31, 2020, can delay their loan repayments for up to one year. However, interest will continue to accrue on these delayed payments.

These CARES Act benefits greatly reduce the costs of accessing funds held in retirement accounts, particularly for short term needs, such as severe economic hardship, when the investor expects to return the funds.

Unfortunately, fraudsters and other bad actors are using these CARES Act benefits, which are intended for those facing economic hardship from COVID-19, to promote high-risk, high-fee investments and other inappropriate products and strategies. These include products and strategies that have high fees and costs, are not designed to be temporary and, as a result, are unlikely to provide investors with the intended benefits of the CARES Act, particularly over time.

For additional details on CARES Act loans and withdrawals, please see the [IRS's Question and Answers page at IRS.gov](#).

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### **What You Can Do: Make Sure the Promoter or Investment Professional is Licensed and Look Out for Fraudulent Promotions**

If you are contacted by a promoter or investment professional who recommends that you withdraw money from your retirement savings to invest in securities—either through their firm or in your own self-directed investment account—***be sure to first confirm whether they are licensed to give advice or sell investments***. You can verify the status of investment professionals and find out whether they have a history of customer harm by contacting [DISB](#) or using tools available for free from the [SEC](#) and [FINRA](#).

Also, always be on the lookout for the [red flags of a fraud](#), such as high guaranteed returns and high-pressure sales tactics. Keep in mind that every investment carries some degree of risk. Many investment frauds are pitched as high-return opportunities with little risk. Ignore these so-called opportunities or, better yet, [report them](#) to the SEC, FINRA, or DISB.

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## Factors to Consider Before Selling or Borrowing Against Your Retirement Accounts to Make New Investments in Securities

If you are thinking about withdrawing or borrowing money from your retirement plan(s) for the specific purpose of investing—especially if at the urging of a promoter or investment professional—please first consider these factors:

**You May Pay High Fees to the Promoter.** The promoter may charge you a fee or commission for the investments they are offering. In addition, the promoter or a person or company related to the promoter may impose ongoing costs and fees on the investment. High initial and ongoing fees for retirement investments are a red flag. Ask if there are any up front or ongoing fees or commissions. In other words, ask how much of your money is working for you and how much is going to others.

**It May be Difficult or Costly to Sell the Promoted Investment.** The promoted investments may have fees for early withdrawals or may otherwise make access to your savings costly or difficult. Ask if there are any fees or restrictions on early withdrawal or any sale.

**Selling at Low Prices Locks in Your Losses.** Taking money from your retirement account usually requires you to sell some of the investments in your account—and you might not be able to choose which ones. In many plans, the money is taken in equal portions from each of your different investments. For example, if you have money in four mutual funds, 25 percent of the loan total comes from each of the funds. If you liquidate investments when the market is down or prices are otherwise low, you will lock in losses.

**You May Lose Out on Compounding.** Withdrawing money from a retirement account, even without a 10 percent penalty, can have significant impacts on your future retirement savings because you lose out on the compound growth from any funds you withdraw.

**You May Significantly Increase Your Risk.** When you buy securities with money from a 401(k) loan, you are investing with borrowed funds. While this can increase your buying power, it also increases your exposure to market risk at the very same time you are hoping your investment will increase in value. If the investment sours, including as a result of high fees and costs, you not only stand to lose the amount you invest, but you also might have difficulty repaying the funds withdrawn or loaned within the respective three- or five-year time periods. You further compound your risk if you put your money in higher-risk and higher-fee investments than those available in your 401(k) plan.

### **Eligibility and Availability Are Designed to Address Hardships, Not Increase Investment**

**Options.** The CARES Act relief described above is available to individuals: (1) diagnosed with COVID-19; (2) whose spouse or dependent is diagnosed with COVID-19; or (3) who experience adverse financial consequences as a result of certain COVID-19 related events. You will be required to sign a certification of the reason for the CRD, although your plan administrators are not required to verify such certifications. Your employer might or might not do so. Importantly, your employer may, but is not required to, offer COVID-19-related distributions and loan relief under its plans. Be sure to find out before taking any action.

Always do your research before making any investment decision, including a decision to withdraw or borrow money from your retirement account for the purpose of investing in securities. Know who you are dealing with, be wary of fraudulent investment scams, and be sure you understand how the investment fits into your overall financial plan.

**Report Fraud.** If you believe you have been the victim of a COVID-19 scam, or you have questions about financial fraud, please contact the Department's Enforcement and Consumer Protection Division at 202-727-8000.

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### **Additional Resources**

Use these additional resources to learn more about investing wisely and how to avoid costly mistakes:

- NASAA: [Informed Investor Advisory: Pension Advance Scams](#)
- SEC: [Five Questions to Ask Before You Invest](#)
- SEC: [Look Out for Coronavirus-Related Investment Scams](#)
- FINRA: [Financial Peace of Mind in the Age of Coronavirus](#)
- FINRA: [Tips for Turbulent Markets](#)

*This Alert represents the views of the staff of the Office of Investor Education and Advocacy. It is not a rule, regulation, or statement of the Securities and Exchange Commission ("Commission"). The Commission has neither approved nor disapproved its content. This Alert, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.*

### **DISB Mission**

The mission of the Department of Insurance, Securities, and Banking (DISB) is three-fold: (1) cultivate a regulatory environment that protects consumers and attracts and retains financial services firms to the District; (2) empower and educate residents on financial matters; and (3) provide financing for District small businesses.

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