THE Advisor

IMPORTANT NEWS FOR YOUR FINANCIAL AND PERSONAL FUTURE

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Check on CalSTRS and CalPERS 1

What's So Great about 403(b) and 457 Plans? 2

What about Taking Out the Money? 2

Which Is Better - a 403(b) or a 457 Plan? 3

Retirement Plan Comparison Chart 4

What to Look for in a Plan 5

CTA Retirement Savings Plan 5

403(b) or 457 - Why Not Both? 6

Be Informed about Fees 6

Sally Low-Fee vs. Susie High-Fee: A Comparison 8

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You Have the Power to Make Good 403(b) and 457 Plan Decisions

The good news for educators is that you have access to voluntary retirement savings plans – 403(b) and 457 plans – to help supplement your CalSTRS or CalPERS pension. But in order to take advantage of them, you need to take action.

Here are some tips to make the most of the retirement savings opportunities available to you.

Check on CalSTRS and CalPERS

Your first step is to get an estimate of your CalSTRS or CalPERS pension. Why? Because you may be surprised to find that your pension is unlikely to provide all the income you will need in retirement. Getting an estimate of what you can expect will help you figure out how much more you need to save to help ensure you'll be able to support your desired lifestyle in retirement.

CalSTRS is a guaranteed benefit, but it will not replace 100% of your preretirement income. In fact, the median percentage of final compensation paid as a pension benefit to members hired before Jan. 1, 2013, is about 53%. For those hired on or after Jan. 1, 2013, it is 47%.* It's also important to keep in mind that your CalSTRS earnings do not qualify you for Social Security benefits at retirement. So you will not receive Social Security unless you are eligible due to a spouse's earnings or earnings from another job on which you paid Social Security taxes. (Even then, your benefit could be reduced due to the Windfall Elimination Provision or Government Pension Offset.)

The average CalPERS member receives 50% or less of their pay in retirement.** CalPERS members *do* pay Social Security taxes and can expect to receive Social Security benefits. However, given uncertainty over future Social Security benefits, you should still consider voluntary retirement savings plans.

So, what can you expect?

- Go to *CTAinvest.org* and click on the CalSTRS/CalPERS tab at the top of the page. The articles include important information about your CalSTRS or CalPERS benefit, along with links to calculators on their sites.
- Or go directly to CalSTRS at *www.calstrs.com* or CalPERS at *www.calpers.ca.gov.*

* Source: "Sustaining Retirement Security for Future Generations: Funding the California State Teachers' Retirement System," CalSTRS, February 2013.

** Source: CalPERS, *www.calpersresponds.com/myths.php/myth-pensioner-percentages.*

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Now that you know what you can expect from CalSTRS or CalPERS:

1. Figure out how much more you may need to save using the "How Much More Do I Need to Save for Retirement?" calculator at *CTAinvest.org.*

2. Watch the video, "Why Participate in a 403(b) or 457 Plan?" at *CTAinvest.org.*

3. Contact your district to find out how to sign up for your 403(b) or 457 plan, or how to increase and/or change your contributions if you already participate.

What's So Great about 403(b) and 457 Plans?

403(b) and 457 plans offer tax-advantaged ways to save for retirement:

- Your contributions are made on a pretax basis, which means your take-home pay is reduced by less than the amount of your contribution. For example, suppose your gross paycheck is $4,022 a month. If you contribute $300 a month to your 403(b) or 457 plan, the net reduction in your paycheck would be only about $232, assuming a federal income tax rate of 15% and a California state tax rate of 9%.* So you put away $300, but it costs you only $232.

- Your contributions and earnings grow tax-deferred, which means your money can grow faster than it would in a comparable taxable account earning the same rate of return.

- Your contributions to a 403(b) or 457 plan DO NOT affect your CalSTRS or CalPERS pension calculations.

- The contribution limits are much higher than those allowed in individual retirement accounts (IRAs), so you have an opportunity to save more for retirement.

What about Taking Out the Money?

You will pay ordinary income taxes on your withdrawals once you retire, but it may be that you will have had many years of tax-deferred growth in the meantime. In addition, you may be in a lower tax bracket once you retire and are no longer earning a steady paycheck.

It's important to understand that if you take premature withdrawals from a 403(b) plan, you may have to pay a 10% federal tax penalty in addition to income tax (California taxes and penalties may apply as well). There is no penalty (although ordinary income taxes will apply) on premature withdrawals from a 457 plan, but you cannot take withdrawals unless you retire, leave employment or have an unforeseeable emergency (see more information below).

Note that different rules apply to Roth 403(b) and Roth 457 plans (see comparison chart). Contributions are made on an after-tax basis, but they offer the potential for tax-free distributions in retirement. Learn more about Roth 403(b) and Roth 457 plans at *CTAinvest.org*.

* Estimate is based on the assumptions shown and will vary for different individuals. Note that CTA does not give tax advice. Consult your tax advisor for information specific to your situation.

Which Is Better – a 403(b) or a 457 Plan?

Your district may offer both a 403(b) and a 457 plan. The plans are very similar in many ways:

- Both offer tax advantages.
- Both have the same annual contribution limits.
- Both offer similar investment options. 403(b) plans offer mutual funds through 403(b)(7) custodial accounts, fixed annuities, equity indexed annuities and variable annuities. 457 plans generally offer similar investments, but also may include other options, such as collective trust funds and commingled funds. It's important to compare the investment options available in each plan, along with the plan fees and expenses. To find more information about fees and expenses for 403(b) plans, go to *www.403bCompare.com*. This site allows you to review the information available from different vendors. For 457 plans, you will need to request information from your district. Ask for a list of fees and expenses for the various investments available.
- Both can be rolled over into another 403(b), 457 plan or 401(k), if rollovers are accepted by the new plan, so that you can continue your tax-deferred savings if you transfer to another district or take another job. You also have the option of rolling the balance into a rollover individual retirement account (IRA) if you leave your job.
- Both may allow you to take a loan from your account, but this option depends on your district's plan.

The differences?

There are a few minor differences between 403(b) and 457 plans, including the way the assets are held, but the main differences are these:

- Distributions from a 403(b) plan while still employed (called in-service distributions) are allowed only on hardship if you are under age 59½. But your plan may allow you the flexibility of taking in-service distributions without penalty once you are age 59½. And, you can take distributions without penalty if you are at least age 55 when you leave service.
- Distributions from a 457 plan are not allowed while you are still employed except in the case of an unforeseeable emergency. According to the IRS, unforeseeable emergencies might include imminent foreclosure on, or eviction from, your home; major medical expenses; and funeral expenses.
- There is no tax penalty imposed on 457 plans. So you can leave your job at any age and take the money out without penalty.
- With a 403(b) plan, you may face a 10% federal tax penalty if you take a nonqualified distribution. So, for example, if you leave your job, are not at least age 55 and you take money out of the plan, you will probably owe a 10% federal tax penalty and a state tax penalty as well. This penalty also applies if you take out a loan and can't pay it back.

So, choosing which plan is better for you will depend on a number of factors. If you expect to work beyond age 59½ and would like the flexibility of taking in-service distributions, the 403(b) plan may seem more attractive. If you prefer the ability to take the money out without penalty if you leave your job before you turn age 55, the 457 plan may be a better option. But these are not the only considerations. You should also compare the product offerings and vendors available in each plan to see if the investments offered by one are more suitable for you than those offered by the other.

Retirement Plan Comparison Chart

	401(k) (for comparison only)	403(b)	457	Roth 403(b)	Roth 457
Who is eligible?	Employees whose employers offer the plan (private employers, some nonprofit employers)	Employees of nonprofits such as public schools and some hospitals, charitable organizations	State and local government employees	Employees of nonprofits such as public schools and some hospitals, charitable organizations	State and local government employees
Pre-tax contributions?	Yes	Yes	Yes	No	No
Limits on employee contributions (2015)	Up to $18,000	Up to $18,000	Up to $18,000	Up to $18,000	Up to $18,000
Age 50+ catch-up contributions	$6,000	$6,000	$6,000	$6,000	$6,000
Other catch-up	No	Yes – 15-year rule*	Yes – final 3-year provision**	Yes – 15-year rule*	Yes – final 3-year provision**
Distributions while still employed (in-service distributions)	Only on hardship if under age 59½	Only on hardship if under age 59½	Only on account of unforeseeable emergency	Only on hardship if under age 59½	Only on account of unforeseeable emergency
Distributions without tax penalties	• Retirement after age 55 • Death or disability • Payments after age 59½ • Lifetime annuity or installments • Rollover to other qualified plan or IRA	• Retirement after age 55 • Death or disability • Payments after age 59½ • Lifetime annuity or installments • Rollover to other qualified plan or IRA	• Termination of employment at any age • Death or disability • Unforeseeable emergency • Rollover to other qualified plan or IRA	• Age 59½ and hold account at least five years • Death or disability • Rollover to other qualified plan or IRA	• Termination of employment at any age (however, ordinary income taxes may be due if not a qualified distribution, generally after age 59½ and hold account at least five years) • Unforeseeable emergency (however, ordinary income taxes may be due if not a qualified distribution) • Death or disability • Rollover to another designated Roth account or Roth IRA
Distributions with penalties	10% prior to age 59½, except as above	10% prior to age 59½, except as above	None	Same as 403(b)	None
Required minimum distributions	April 1 following the year participant reaches age 70½	April 1 following the year participant reaches age 70½	April 1 following the year participant reaches age 70½	Same as 403(b)	Same as 457
Tax treatment of distributions	Ordinary income tax	Ordinary income tax	Ordinary income tax	Tax-free if qualified distributions	Tax-free if qualified distributions
Rollovers allowed to other plans	• Yes – to 401(k), 403(b) or 457 plan (allowed but not required) • Yes – to IRA	• Yes – to 401(k), 403(b) or 457 plan (allowed but not required) • Yes – to IRA	• Yes – to 401(k), 403(b) or 457 plan (allowed but not required) • Yes – to IRA	To another designated Roth account, but only by direct rollover (allowed but not required)	To another designated Roth account, but only by direct rollover (allowed but not required)

* Eligible employees with 15 or more years of full-time service may be able to contribute up to $3,000 more for five years, or a maximum of $15,000.

** Employees may be eligible to defer up to two times the contribution limit in effect for the final three years of service. Employees cannot participate in the 3-year catch-up and the 457 plan age 50+ catch-up during the same tax year.

THE Advisor

What to Look for in a Plan

Here are a few things to look for when deciding which plan is better for you.

Target-date funds. Does the plan offer low-fee target date funds? These may be a good choice if you want a diversified investment option and don't want to deal with creating your asset allocation (the way your money is divided among stocks, bonds and more conservative assets) and changing it as your risk tolerance, timeline or goals change. (Diversification cannot guarantee a profit or protect against loss in a declining market.) Target-date funds are designed to be an all-in-one solution. You simply choose one fund with a target date that closely matches your anticipated retirement date. The fund automatically adjusts each year; generally, the farther out the date, the more aggressively the assets will be invested. So, for example, a 2035 target-date fund is likely to have a much higher percentage of its assets in stocks than a 2020 target-date fund. Over time, a target-date fund's manager will reallocate the fund's holdings – from asset classes with the potential for higher returns but higher volatility to those with potentially lower returns but also lower volatility. It is important to note that target-date funds do not guarantee that you will reach your savings goals by the target date. Like all mutual funds, the performance of target-date funds will depend on the market.

Diversified core mutual funds. If you prefer to build your own asset allocation, there should be a core group of mutual funds of different asset classes from which to choose. There should be sufficient funds so that you can construct a diversified asset allocation. For example, there should be at least one stock (equity) fund, one bond fund and one conservative choice, such as a money market fund.

CTA Retirement Savings Plan – New!

CTA is offering a new endorsed 403(b) plan that is well-managed, offers low-fee and high quality savings options. The plan will follow a fiduciary standard which means all recommendations are made solely in the interests of plan participants. The plan will be offered through your school districct via payroll deduction as required by law. A national independent investment advisory company will recommend high quality investment options based on their track record of performance, fees and stability. There are no insurance products or extra fees (front or back end fees). Watch for more information on enrollment opportunities. Plan opens February 2016 and must be offered by your school district.

Low-fee options. Fees are an important consideration when choosing your investments. High fees will chip away at your earnings (see chart on page 8 for an example). So compare the costs between the 403(b) and 457 plan investments available to you. Perhaps the 457 plan offers no-load mutual funds (funds that do not charge sales fees), but the 403(b) plan does not, or vice versa. Or the 403(b) plan offers passively managed funds, which tend to have lower expense ratios than actively managed funds, and the 457 plan does not. Information about expense ratios should be available at *403bCompare.com* for 403(b) plans and through the plans' documents for 457 plans.

Online or call center advice or a local agent or representative? Find out if the plan or vendor offers unbiased advice – that is, investment advice that is not influenced by sales commissions that may be paid to the advisor. Some plans or vendors offer online help, such as risk tolerance questionnaires that generate asset allocation models based on your answers. Others may offer phone consultations with a registered investment advisor who is working in a fiduciary capacity. That means the individual is ethically and legally obligated to give you the best advice for your situation regardless of how it affects their own. Plans that provide online or call center advice may be lower in cost because they don't pay commissions to local representatives.

403(b) or 457 – Why Not Both?

If you find that your 403(b) and 457 plans both offer attractive options and features, you are not limited to one or the other:

- You do not have to max out one plan before you can contribute to the other.
- If you have a 403(b) and 457 plan available to you, you can contribute the maximum annual amount to both plans. In 2015, you could contribute $18,000 to a 403(b) and $18,000 to a 457 – that's $36,000 in tax-deferred money.
- If you are age 50 or older, you can add another $6,000 to each, for a total of up to $48,000 a year.

Of course, not many educators can afford to sock away that much money. But just think – if you are nearing retirement – say, within three years – and you were able to max out contributions to both a 403(b) and 457 for those three years and earn an average annual return of 6% after fees and expenses, you'd have nearly $150,000 more in your retirement kitty. (Note: There are also special catch-up provisions for 403(b) and 457 plans – see the comparison chart on page 4.)

Be Informed about Fees

All investments have fees. However, the more you understand about how the fees are charged and what they are, the better informed you will be when making investment decisions. Fees can have a tremendous impact on the amount of money you can accumulate for retirement.

- **Mutual funds** may charge a front-end (when you buy) or back-end (when you sell) sales charge or "load." Mutual funds also have expense ratios, which is the total of the fund's operating expenses expressed as a percentage of the fund's average net assets. Generally, passively managed funds (index funds) have lower expense ratios than actively managed funds. Here are some examples:

  Investor Shares – 0.17% (passively managed)
  Vanguard Diversified Equity Fund – 0.41% (actively managed)
  Investor Class – 0.22% (passively managed)
  Fidelity Corporate Bond Fund – 0.45% (actively managed)
  Fidelity Worldwide Fund – 0.96% (actively managed)

  Sources: Vanguard.com, fidelity.com. Website accessed November 17, 2014.

Note that an actively managed fund may be worth the extra cost if the fund manager consistently outperforms the fund's benchmark index. However, that may be difficult to do over the long term.

- Compared to mutual funds, the cost of a **fixed annuity** investment is more complex. One major component of the cost is the "spread" between the amount the insurance company earns by investing your contributions and the amount it credits to your annuity. The "spread" is not transparent in that it may not be specifically disclosed, and it may vary considerably from year to year and insurer to insurer. However, surrender fees are transparent – make sure you understand the surrender fee schedule before choosing a fixed annuity. Finally, fixed annuities may charge an annual contract fee.

- **Equity indexed annuities** are technically considered fixed annuities, but they link the return to a specific index. These types of annuities are generally difficult to understand and also have high fees and surrender charges. The Financial Industry Regulatory Authority (FINRA) (*finra.org*) has even issued an Investor Alert, warning investors about the complexity of equity indexed annuities due to the various ways they are indexed as well as caps on what you can earn.

- **Variable annuities** may charge a boatload of fees, including a mortality and expense fee, administrative fee, maintenance charges and surrender fees. There are also fees for optional features you may not really need, such as a living benefits rider, death benefits and lifetime withdrawal benefits. Be sure you understand all the fees involved in a variable annuity. In many cases, you may be able to invest directly in mutual funds through a 403(b)(7) account or a 457 plan that are similar to the investment options available in a variable annuity, but at lower cost.

CTA is working hard to protect the guaranteed pension benefits you've earned and deserve, but it's important for you to take command of what you can control – participation in voluntary retirement savings through a 403(b) or 457 plan. Visit *CTAinvest.org* to learn more.

Typical Fees*

Type of Fee	Variable Annuity	Mutual Fund in a 403(b)(7) or 457 Account	Fixed Annuity
Sales charge	Varies	Varies	Rarely
Operating/administrative expense	0.15% of value or flat fee of $25-$30	0.0-1.0%/year	Costs and profit for issuer affect the interest rate and payout rate
Expense ratio of funds/subaccounts	0.5-1%/year	0.5-2.43%; Average 1.47%/year	N/A
Mortality and expense fee	1.25%	N/A	N/A
Trading costs	Vary	Vary	N/A
Surrender fees	6% to 0% after 6 years	N/A	6% to 0% after 6 years

* Fees are provided for example only. Fees will vary depending on your district's plan, the vendor and type of investment. Sources: Securities and Exchange Commission, www.sec.gov; Investment Company Institute "Trends in Mutual Fund Fees and Expenses," www.icifactbook.org; 403bCompare.com; fixedannuitiesprosandcons.com.

Sally Low-Fee vs. Susie High-Fee: A Comparison

To see how dramatically fees and expenses can affect your 403(b) or 457 plan account, take a look at two hypothetical retirement plan investors. Susie High-Fee was talked into a variable annuity by the insurance company rep who came to her school. She selected a large-cap stock subaccount from among the choices available through the variable annuity.

Sally Low-Fee used the resources available at *CTAinvest.org* and investigated all the fees and investment options. She selected a large-cap stock mutual fund for her 403(b)(7) account.

Sally Low-Fee

Large-cap index fund
in a 403(b)(7) account

Year	Balance at the end of year:*	If sold**
1	$3,788	$3,788
3	$12,101	$12,101
5	$21,424	$21,424
7	$31,879	$31,879
9	$43,605	$43,605
11	$56,754	$56,754
13	$71,502	$71,502
15	$88,040	$88,040

Susie High-Fee

Large-cap index subaccount
in a 403(b) variable annuity

Year	Balance at the end of year:*	If surrendered**
1	$3,756	$3,568
3	$11,765	$11,177
5	$20,484	$19,460
7	$29,976	$28,777
9	$40,310	$39,101
11	$51,560	$51,560
13	$63,808	$63,808
15	$77,142	$77,142

* Reflects gross return minus expense ratio and minus $24 annual administration fee on the 403(b)(7) account.

** Assumes the investment is sold/surrendered within the 403(b) or 457 account and the balance rolled into another investment within the plan rather than distributed at retirement. The 403(b)(7) account has no back-end sales load. The 403(b) variable annuity has a surrender fee schedule reflected in the "if surrendered" balance.

Assumptions:

- Both investments earn a gross (before fees) average annual rate of return of 6% and both participants contribute $3,600 a year. Rates of return are for illustration only and based on currently available information at 403bCompare.com. Your returns will vary. No taxes are taken into account.
- Sally's index fund charges an annual administration fee of $24 and has an expense ratio of 0.10%. There is no back-end sales charge.
- Susie's subaccount has no annual administration fee. There is an annual 1.25% mortality and expense fee, the expense ratio is 0.41% and there are surrender charges of 5% in years one through five, 4% in years six and seven, 3% in years eight and nine, and 2% in year 10. The surrender fee applies once the contract begins (not annually) and disappears in year 11.

IMPORTANT NOTE: CTA does not give tax, legal or investment advice. You should meet with your tax, legal, and/or investment advisor to determine the best fit for your situation.