5 Mistakes Teachers Make with Their Retirement

1. Thinking all 403(b)'s are the same. – Teachers retirement account options are very different than the 401(K)'s that "for profit companies" contribute to. 401(k)'s are highly regulated to make sure that employees have access to a broad range of investment options and that fees are fair and reasonable. 401(k) participants only have one company to choose from, which means there is no deciding which company you are going to use.

Public school employees contribute to a 403(b) or in some cases a 457. While the account may act very similarly to a 401(k), they do not fall under the same regulation that a 401(k) does. A school district allows multiple companies to come in and become an option for a teacher to contribute to. There is no regulation in place to make sure the providers offer a wide variety of investment options that are low cost and suitable for everyone. Therefore, it is on you to choose and some are great plans with low cost investment options and some are insurance products that are not diversified at all and can limit your growth potential.

2. Not paying attention to costs. – Many of the investment options available to teachers have a very high cost structure to them. Many of the variable annuity options are far more expensive than people realize and these additional costs hurt performance and add up over time. By far, the most common kind of 403(b)/457, is a Variable annuity or TSA (Tax Sheltered Annuity). An extremely common cost structure for a TSA would be an M&E (platform fee) of 1.25% and then internal mutual fund expense of .8% to 1.25% for an all in cost of 2.05% to 2.5% each year.

They next most common type of teachers' retirement account is a 403(b)7. It is very similar to a TSA but it uses mutual funds instead of annuities. While they do not have the high platform fee of a TSA, they very often use an A share mutual fund class which charges you an upfront sales charge of as much as 5.75% and then still has an ongoing internal expense of around .75% - 1.00%. So every time you contribute to your account, you pay the first 5.75% as a commission to the sales person. Depending on market conditions, it could take you a year or two just to get back to the amount you originally contributed.

There are also some fixed or indexed annuity options that will boast no cost. These, however can be the most dangerous because the tradeoff for no cost is usually some type of cap on your performance. For example, in a year when the market is up 10%, your gain would be limited to 3% and then 7% goes to the company, not you!

Reducing costs will add up over time and could save you years of working over the course of your career. Even cutting costs by 1% on an account with $100,000 in it will save you $1,000 per year. If that $1,000/year was invested and made only 6% over a 30 year working career it would total over $100,000!

3. Getting stuck in an investment. – Most of the TSA products have what is called a surrender period. This is basically a period of time where you will be penalized if you want to withdraw your money. Most surrender periods last 6-10 years and can be as much as 5-10% of the account value. If you were to switch schools, districts or careers it may take you as much as 10 years to get all your money transferred to you without penalty.

The other way people get stuck in an investment is by paying the high up front commission. Why are you still paying a commission of up to 5.75%? Commissions are a thing of the past. The point of paying the up-front commission was to get a lower cost over time which means you need to leave it there for 8-10 years to reap the benefits. There is no reason to take the first 5.75% of your investment to pay a sales rep.

4. Not having a financial plan. – Many employees will get a pension and some are even comfortable with how it works. Unfortunately, most do not know how it fits in with the 403b and their retirement goals. It is one thing to know that you're able to retire at a certain age with a certain income, but knowing if it will be enough to provide you a secure retirement is the bigger question. How much do you need to be saving to compliment your pension so that you can retire at your desired age, with the desired lifestyle and not run out of money? By having a financial plan done, you may realize that you are relying too much on the pension and need to start saving more. Working with an expert to develop a financial plan can assist you in realizing your savings in addition with you pension can make your desired retirement age a reality.

5. Not reviewing your 403b plan and options. – Because your school district has multiple plans to choose from, there may be great low cost flexible option available to you. Not getting a second opinion and not switching soon enough are two common traps employees fall into. Just because you may have one of these high cost plans or may be stuck with a surrender penalty is not a reason to do nothing about your situation. There are ways to start making good decisions today that will benefit you down the road. Seek out a second opinion and arm yourself with good questions on the topics discussed above. What are the costs for this product? What are the unseen costs like internal expense ratios? How is the person selling it to you compensated? Is the person selling it a licensed financial advisor and do they adhere to a suitability standard or fiduciary standard? Are they only allowed to sell this one product or are they independent and have the ability to guide you toward the plan that is best for you?

Jim Pilat is with Peak Wealth Management, an independent financial advisor in Plymouth, MI. An Oct 2016 New York Times article title, "Think Your Retirement Plan Is Bad? Talk to a Teacher" pointed out that there are many pitfalls for teachers when it comes to their retirement account options. Jim believes that teachers do a tremendous job looking out for our children, but fears that nobody is looking out for our teachers when it comes to their retirement. His goal is to inspire you to make great decisions so that you can retire with confidence. Do not let your 403b keep you from the retirement you deserve!

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Schedule a no cost no obligation consultation with Jim to evaluate your options and determine if your 403b is helping or hurting your chances to retire confidently.

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