

# **PENSIONS, 403B'S, IRA'S, ROTHS...EXPLAINING THE OPTIONS AND WHY YOU NEED TO GET IN THE GAME**

Presented by:

**Brad Barnett, MS, AFC<sup>®</sup>, CPFM, FAAC<sup>®</sup>**

James Madison University

Associate Vice President for Access & Enrollment Management

Director of the Office of Financial Aid & Scholarships

NASFAA Immediate Past National Chair

## SESSION DESCRIPTION

We have our fair share of acronyms in financial aid, but we're not alone. When thinking about retirement you may have access to 403b's, 401a's, 401k's, 457's, or even IRA's. Then there are traditional versions and Roth versions, and in some instances you may even have access to a pension. This session will discuss the importance of investing for your own retirement, as well as how many of these various accounts work.

## EXPERIENCE

- AFC® and CFPM
- Teach two personal finance classes each term at JMU
- Maintain a small case load of clients being counseled for personal finance issues and concerns
- Over the years have taught personal finance workshops for faculty and staff at JMU

WHY THIS IS IMPORTANT

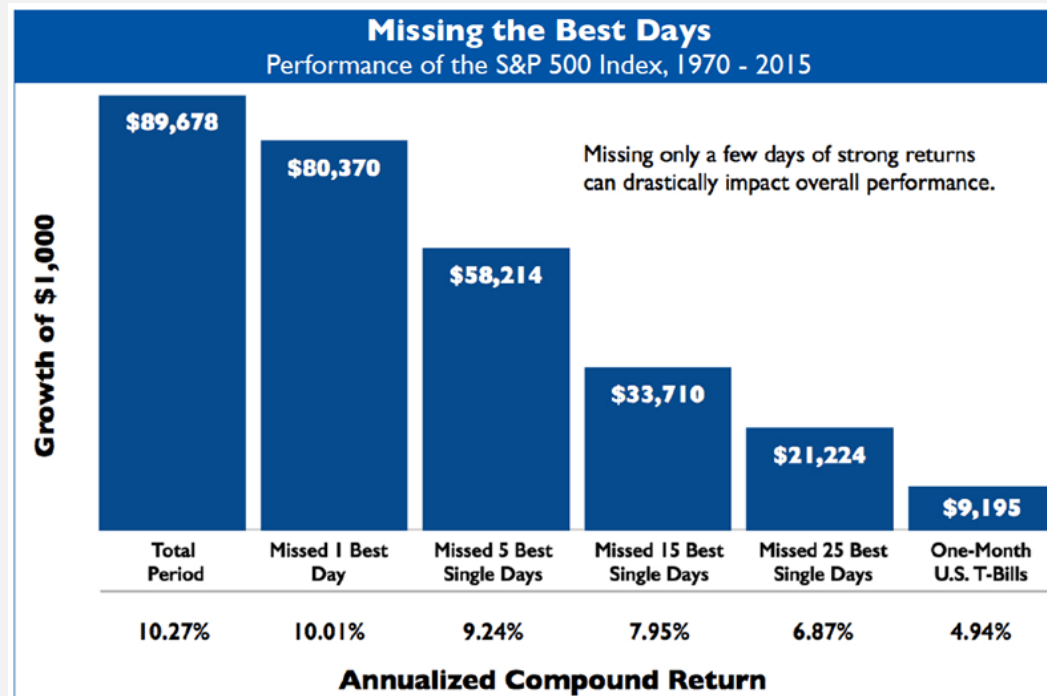
## WORKING LIFETIME

- Eventually....you'll stop working
- How will you place your income
- Social Security...not the answer
- Time is a big factor in how well you can prepare for retirement...don't waste it as it's one thing you can never get back after losing it

# INFLATION RISK

- This why you should care about accumulating assets for retirement
- Inflation has averaged an annual increase of 3.1% per year from 1913 – 2020 (by decade)
- Look at what inflation has been recently!
- Utilize the Rule of 72 to determine the inflation growth of money
  - Estimate 3% annual inflation
  - $72 / 3 = 24$  (it will take 24 years for prices to double at 3% rate of inflation)
  - \$25,000 spent on items today will cost \$50,000 in 24 years
  - In another 24 years you will need \$100,000 to keep the same standard of living you had 48 years earlier at \$25,000

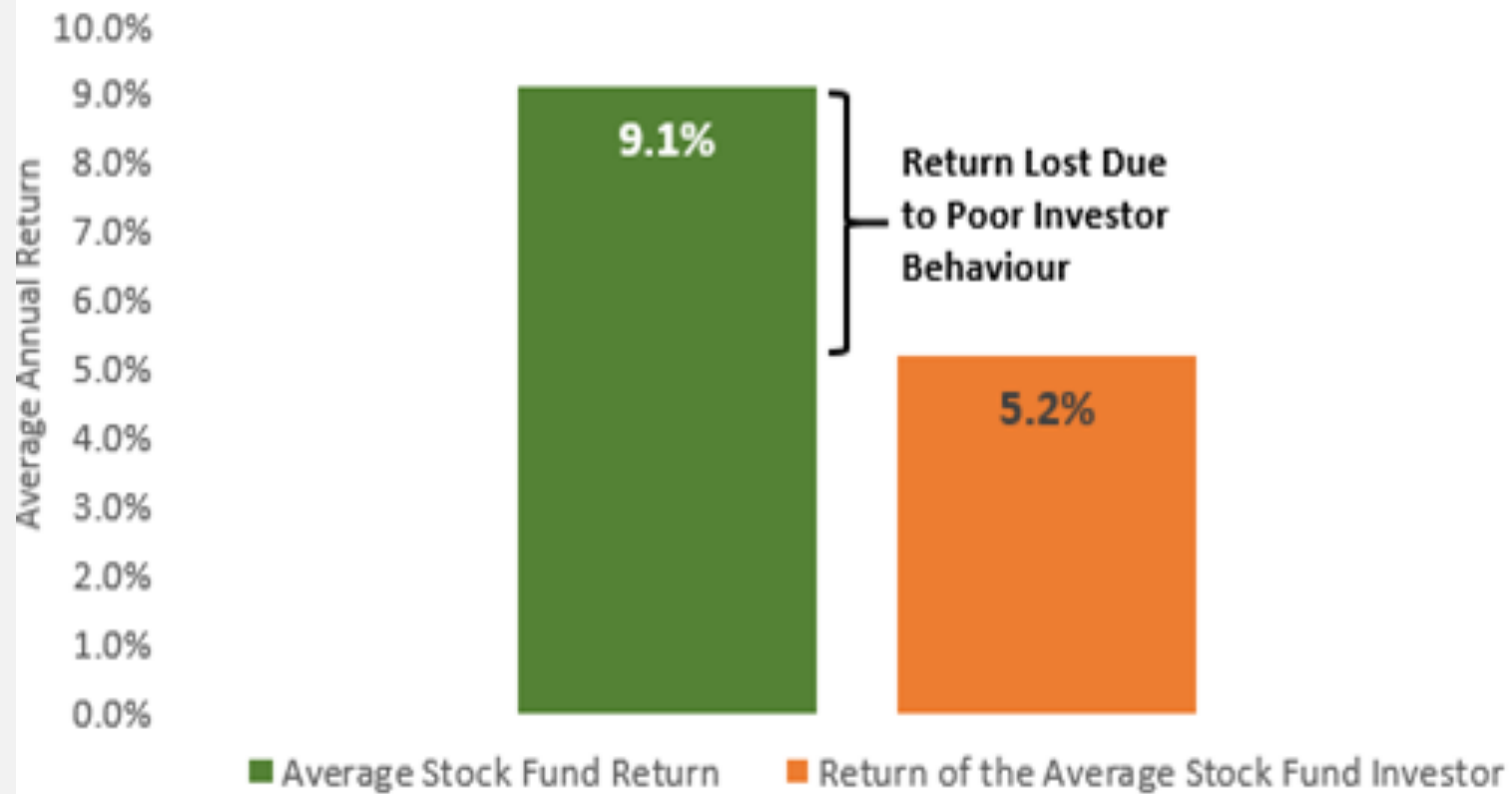
# WHY SAVING FOR RETIREMENT EARLY IS IMPORTANT?



SOURCE: CRSP, Bloomberg, Standard & Poor's Index Services Group, Morningstar.

## Average Stock Fund Return vs. Return of the Average Stock Fund Investor

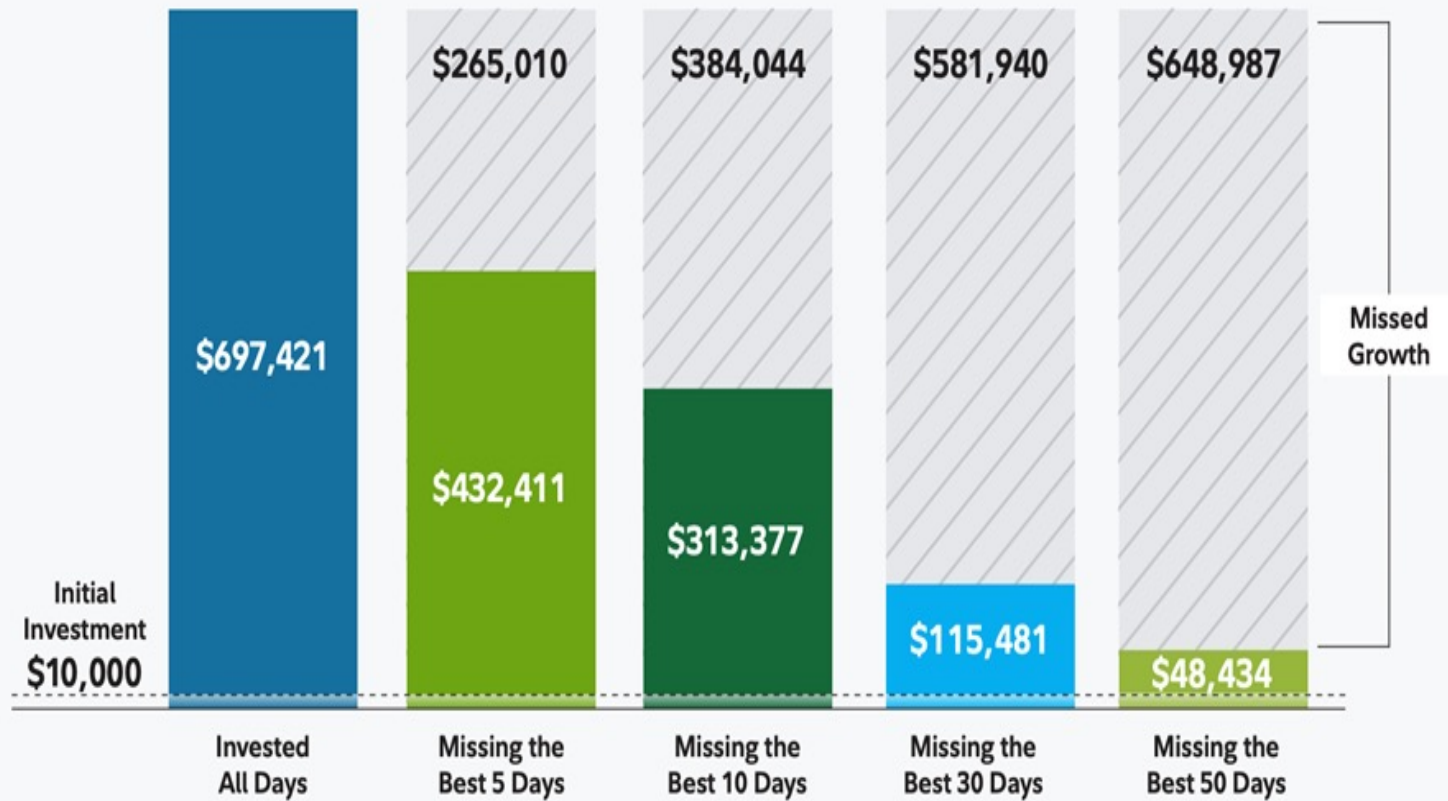
1995-2014



Source: Quantitative Analysis of Investor Behaviour by Dalbar, Inc. (Mar-15) & Lipper, Dalbar



## Hypothetical growth of \$10,000 invested in the S&P 500® Index January 1, 1980–March 31, 2020



# TYPES OF RETIREMENT ACCOUNTS

# COMMON RETIREMENT ACCOUNTS

- **Employee Sponsored Plans**
  - **Defined Contribution Plan**
    - Contributions paid into it (e.g., 401k and 403b)
  - **Defined Benefit Plan**
    - Pensions, generally based on years of service, average pay in last few years, and a percentage
  - **Deferred Compensation Plan**
    - Employee defers receiving income until a later date (i.e., 457)
    - Works much like a 401k or 403b
- **Individual Retirement Accounts**
  - Traditional IRA
  - Roth IRA

## DEFINED BENEFIT PLAN

- Pension
- May be available with public schools
- May have different types of pensions based on when you were hired
- Rules and risks for payment at retirement
- Survivor options

# TAX BENEFITS TRADITIONAL VERSUS ROTH

## TAX COATS NOT INVESTMENTS

- 403b's, 401k's, 457's, and IRA's are NOT investments
- They are tax coats that provide tax protection:
  - On the front end or back end depending on whether the account is a Roth or traditional (pre-tax) version; and
  - Protection from capital gains/losses on investment moves within the accounts
- The underlying investments that you select are where the money is and determines the growth of the funds

## TAX ADVANTAGED

- Pre-Tax
  - 401k
  - 403b
  - 457
  - Your contributions come out before federal and state taxes (Social Security and Medicare are still taken out)
- After Tax
  - Roth IRA
  - Roth 401k, 403b, and 457 (May see some, but not as common)
- Investment changes with no tax consequence
- Let's look at an example at how this impacts your taxes if you contributed \$200 of your \$1,000 gross income to a pre-tax 401k/403b or Roth IRA

## Traditional Accounts

- \$1,000 gross pay
- - \$200 401k/403b contribution
- = \$800 net pay
  
- \$800 net pay
- x 12% tax rate
- = \$96 in taxes
  
- \$1000 gross pay
- - \$200 401k/403b contribution
- - \$ 96 taxes
- =\$704 net pay (final)

## Roth Accounts

- \$1,000 gross pay
- - \$200 Roth contribution
- = \$800 net pay
  
- \$1000 gross pay
- x 12% tax rate
- =\$120 in taxes
  
- \$1000 gross pay
- - \$200 Roth contribution
- - \$120 taxes
- =\$680 net pay (final)

In both cases, you contribute \$200 to a retirement account. The Traditional account increases your current pay by \$24 since it's pre-tax, but you pay taxes on all of the growth of the \$200 when you withdraw the money in retirement. With the Roth, your current pay is decreased by \$24, but you don't pay any taxes on the growth of the \$200.



## EXAMPLE - RETIREMENT WITHDRAWALS

- Traditional (pre-tax) accounts
  - \$60,000 annual withdrawal from retirement funds (4%) = \$1,500,000
  - \$8,948 paid in taxes (assuming 22% tax bracket)
  - Net \$51,052 to spend
- Roth accounts
  - \$60,000 annual withdrawal from retirement funds (4%) = \$1,500,000
  - \$0 paid in taxes
  - Net \$60,000 to spend

# EMPLOYER SPONSORED PLANS

## 401K/403B/457

- Pay with income via your employer (paycheck deduction)
- Reduces the taxes you pay today if you opt for a traditional versus Roth version
- You select the investment portfolio
- Limited investment options
- May get a match from your employer

## TAKING THE EMPLOYER MATCH

- It's free money!
- Generally a percentage of your contribution is matched by the employer...up to a set limit
- For example, your employer might match the first 3% of what you contribute to your 403b
  - If you contribute 3%, so do they, so you have a total of 6% invested
  - If you contribute 8%, your employer still caps at 3%, so you have a total of 11% invested
- No guarantee on investment return
- Not related to a pension

## INVESTMENT OPTIONS

- Your employer has an arrangement with an investment company that allows you to invest in a limited number of products with (generally) a reduced fee
- You select how you want your contributions invested
- Create a portfolio you are comfortable with based on your risk tolerance and years until retirement
- Target Date Funds are becoming more popular
- Watch Expense Ratios

## INVESTMENT EXAMPLE

Your employer may have an arrangement with Fidelity to make the following available to you:

- 10 different Target Date Funds
- 5 different stock funds
- 5 different bond funds
- Total of 20 fund choices

## RETIREMENT ACCOUNT CONTRIBUTION RULES

- In 2024, regular per person contribution limit is:
  - 401k/403b/457 annual limit is \$23,000
- In 2024, catch up (50 years older) per person contribution limit is:
  - 401k/403b/457 annual limit is \$7,500
- Various rules for each program on withdrawals and mandatory distributions
- Generally, cannot start taking withdrawals before 59 ½ without paying penalties (some exclusions apply depending the account)
- No income limits set on ability to contribute to these accounts

# VESTING

- With employer matches, you will likely have to be “vested” before you can take that money with you when you leave
- Vesting means you’ve stayed with the company long enough to have earned the right to keep their match
- Vesting periods vary by company



## WHEN LEAVING AN EMPLOYER

- Anything you contributed to your account is yours
- If you are vested, the employer contribution is also yours
- Cannot contribute to the account once you no longer work for that employer
- Options:
  - Leave the investments there
  - Roll them into the account you have with your new employer
  - Roll them into an IRA (rules about moving pre-tax money into a Roth account)
  - Cash it out (worst options)

# THE MAGIC OF THE ROTH IRA

## ROTH IRA

- Must have earned income
- Pay with taxable income - not tied to your employer, so it's portable
- Not taxable when you withdraw at retirement (some penalty free withdrawal options prior to retirement)
- Can withdraw the amount you invested (not earnings) without penalty
- More investment options than you have with a 401k/403b/457
- Non-working spousal accounts are allowed

## INVESTMENT OPTIONS EXAMPLE

- Sticking with our Fidelity example from the employer sponsored plan (e.g., 403b, etc.)
- You can open a Roth IRA with Fidelity and have access to all of their funds versus the limited number that may be available in the employer sponsored plan

## IRA ACCOUNT CONTRIBUTION RULES

- In 2024, regular per person contribution limit is:
  - Traditional and Roth IRA annual limit is \$7,000
- In 2024, catch up (50 years older) per person contribution limit is:
  - Traditional and Roth IRA annual limit is \$1,000
- Generally, cannot start taking withdrawals before 59 ½ without paying penalties (some exclusions apply)
- You must not exceed the maximum income limits to contribute to this account

## 2024 MODIFIED ADJUSTED GROSS INCOME LIMITS FOR ROTH IRA

Tax Filing	Maximum Income	Phases Out
Individual =	\$146,000	\$161,000
Married Filing Jointly) =	\$230,000	\$240,000

Maximum Income = Income limit to make the full \$7,000 contribution. Above this, contribution limit decreases from \$7,000 until it completely phases out to \$0 at the "Phase Out" income limit.

## FUTURE TAXES AND IMPORTANCE OF ROTH'S

- Funding the government
- [US Debt Clock](#) and budget deficits (US Debt is growing at an alarmingly fast rate)
  - Think about all of the trillions added to it during COVID with the various pieces of legislation that gave us things like CARES, HEERF, ARP, etc.
- Revenue (tax) versus expenditures
- Roth accounts protect retirement income from potential future increases to the individual tax brackets

## WHEN LEAVING AN EMPLOYER

- It doesn't matter
- Roth IRA's are with an organization (e.g., investment, etc.) firm that is not tied to your employer
- You can continue contributing to the same account once you get a new job



# INVESTING PRIORITIES

## MULTIPLE ACCOUNTS

- Multiple accounts are allowed
- You need to stay with the maximum contribution limits for each one
- For example, you could annually invest (if you're under 50):
  - Up to \$7,000 in a Roth IRA (if you meet the income parameters)
  - Up to \$23,000 in a 403b
  - Up to \$23,000 in a 457
  - Total of \$53,000 invested annually
- Yes, I realize that's a lot of money and not the norm....just showing this for example purposes

## COMMON STRATEGY

1. Invest 15% of your gross income into retirement accounts (percentage may vary based on age)
2. Invest the minimum to get your employer match (free money)
3. Invest in a Roth IRA to the maximum amount
  - If your income exceeds the maximum account and your employer offers Roth 401k, 403b, or 457 option, you may consider that versus a Roth IRA
  - If your employer has great investment options and low fees in Roth versions, you may consider that instead of a Roth IRA
4. If still have money left to invest, go back and fund more of your employer account (i.e., 401k., 403b, 457)

## EXAMPLES

(SEE PRIOR SLIDE FOR ORDER OF OPERATIONS)

Individual	Annual Salary	Company Match	403b	Roth IRA	Employer Contribution	Your Contribution (15%)	Total Investment
Melissa	\$55,000	6%	\$3,300	\$4,950	\$3,300	\$8,250	\$11,550
Adrian	\$160,000	3%	\$23,000	\$0	\$4,800	\$24,000	\$27,800
Chelsea	\$28,000	No Match	\$0	\$4,200	\$0	\$4,200	\$4,200

### **Explanations:**

- Melissa will fund the 401(k) up to the match and put the remainder in her Roth.
- Adrian is not eligible to open a Roth IRA because he makes too much money. He will put his entire 15% (up to the limit) into his 401(k). While his 15% is \$24,000, he can only contribute \$23,000 because of the 403b limit. If he has a 457 option, he could invest the remaining \$1,000 (\$24,000 - \$23,000) there.
- Chelsea will fund her Roth IRA.

## 15% OR AUTO INCREASE

- If 15% isn't doable now, invest what you can
- With each raise, increase your retirement contributions with a portion of it
- Each year, set your investments to increase by 1% on an auto escalation scale
  - You likely won't miss a 1% deduction to your monthly income, but the value of that 1% growing in your retirement account for the next couple/few decades could be significant

**CLOSING**

## RESEARCH

- If you don't know what options are available through your employer...find out asap
- Vanguard, Fidelity, and Charles Schwab are three good resources to learn more about Roth IRA options
  - These three generally have good fund options and low fees
- Never invest in something you don't understand just because someone told you to do it....learn enough that you feel comfortable with what you're doing
- It's your money and your future...take control!

THANK YOU