

SECrets to Investing

EPISODE 2: Why Invest In a 403(b) or 457(b) Plan When I Already Have a Pension

Guest: Jennifer

Vadim: Hi, and welcome to the second episode of the SEC's teacher outreach podcast. Today, we're going to talk about a question that might be on your mind: Why on earth would I invest in a 403(b) plan if I already have a pension? I'm Vadim, and I'm your host. I'm here with Jen, who is also an attorney at the SEC, and we're going to try to help answer this question for you. Hi Jen!

Jen: Hey Vadim, thanks for having me on.

Vadim: So, Jen, I just want to get your thoughts on something. We've talked with many educators at SEC outreach events, and here's a common situation that we hear about: We have a young teacher—let's call him Rob—and Rob just got his credential and started teaching at a public school. Rob just isn't making a whole lot of money starting out, but he does have access to a great benefit that many people don't—and that's a pension. So that means, depending on the specifics of the plan and the state, if Rob spends his whole career as a teacher, he's going to have a pension that pays him a substantial amount of the salary he made teaching when he retires. So with that in mind, Rob just isn't sure why he'd want to invest part of that entry-level teacher salary into his 403(b) plan. So Jen, what benefit does it give him if he already has a pension?

Jen: That's a great question, Vadim. So first off, let's start with the basics. For those of you tuning in for the first time, a 403(b) plan or a 457(b) plan is a special retirement plan offered to certain employees of public school systems. A big benefit is that there are no vesting requirements for your contributions to a 403(b) plan or a 457(b) plan, so you can take all the profits from your contributions with you even if you decide not to be an educator after a few years.

Vadim: Yeah, that's really a great point. Most pensions have vesting requirements for at least five years. So, let's take the case of Rob, our brand new teacher. He's like many educators that we've talked to—he's not sure of what his life will look like fifteen to twenty years from now. Life happens to all of us. Maybe Rob will have to move back to take care of his parents, or his spouse's job might get relocated to another state.

Jen: So true. I think these are all things we've heard from teachers in the field.

Vadim: Yeah. And you know, regardless of the reason, say that Rob leaves teaching in his school district after four years. He'll discover that he's back to square one with his retirement planning at his new job. In many states, it takes five years just to become vested in the pension, so that means Rob won't see a penny from that pension when he retires. So even if he sticks it out for longer—say, ten years—his earnings from that pension are going to be pretty low, around 25% of the income he made as a teacher in one plan that we looked at. And when he begins to invest in his new employer's retirement plan, he's going to be starting from scratch.

Jen: That is a real concern and brings me to a huge advantage of the 403(b) plan or 457(b) plan, which is compound returns. And the concept is that you can earn returns on the money you put into a 403(b) plan or a 457(b) plan based on how the markets perform. But then, you can also earn returns on your returns—that's what's called compound returns.

Vadim: Right.

Jen: So the earlier you get started investing, the more money you can make over time.

Vadim: So, Jen, can you kind of put that into real life terms for us here?

Jen: Sure. So, let's say you invest \$1000 into your traditional 403(b) plan and don't touch it for forty years and let's also assume an annual return of 7%. So, in the first year, you earn seventy dollars, and don't have to pay taxes on those profits. And you now have \$1070 to invest within the next year.

Vadim: That's an extra \$70. What kind of impact is that going to have going forward?

Jen: Yeah, so, Vadim, every year you're making more money off your original investment without even lifting a finger. So, in the next year, you make almost \$75 in returns, bringing your total to almost \$1150. And if you keep doing this math, at the end of the day when you retire, let's say at the age of sixty-six, your \$1000 investment is now worth nearly \$15000.

Vadim: Wow.

Jen: Yeah, so the main idea is that compound returns can really add up over the years, and every dollar invested in your twenties and thirties is worth much more than a dollar invested in your fifties or sixties.

Vadim: Right, and that's all really important because even with a great pension, retirement can be really hard to pay for. Cost of living might increase sharply in your region. Health and long-term care expenses can really add up. You might still be paying educational expenses or helping out with living expenses for your kids. So, when you add all of that up, the cost can be just overwhelming if you're relying on just your pension. Investing in your retirement early through a 403(b) and benefitting from those compound and tax-advantaged returns can help you pay for the retirement that you actually want to live.

Jen: Oh, and Vadim, that totally reminds me that you just mentioned there are huge tax advantages to a 403(b) plan or a 457(b) plan.

Vadim: Yeah, absolutely, and we're going to cover all of those in the next episode of this podcast. So for our listeners, be sure to tune in. So with that, thanks so much for joining me, Jen.

Jen: Thanks for having me on!

Vadim: Yeah, and we really hope that our listeners tune in next time. Here's also a very important disclaimer: The views expressed in this podcast are not necessarily those of the SEC, the Commissioners, or other members of the Staff.