SECrets to Investing

EPISODE 3: Mechanics of the 403(b) and 457(b) Plans

Guest: Ray

Vadim: Hi, and welcome to the third episode of the SEC's Teacher Outreach Podcast. I'm your host Vadim, and with me is Ray, an accountant with the SEC. Thanks for joining me, Ray.

Ray: Thanks for having me on.

Vadim: So, in the last podcast, we talked about why you should invest in your 403(b) or 457(b) plans even when you have a pension. In this podcast, we will talk about all the ins and outs of these plans. Ray, you've spent a lot of time researching these plans; can you give us an overview?

Ray: Sure. Depending on their school district, educators may be offered four types of retirement savings plans: 403(b) plans, 457(b) plans, and their Roth counterparts. The first two plans are tax deferred. That means teachers will reduce their taxable income and tax liability for the year they contribute to the plan.

Vadim: What do you mean by that, Ray? Can you give me an example?

Ray: Sure. For example, if a teacher makes $50,000 and contributes $2,000 to the 403(b) Plan, she pays taxes on only $48,000. No taxes are paid until she withdraws the money at retirement.

Vadim: Ah and what about Roth plans?

Ray: For the Roth plans, it's basically the opposite. You put in after-tax dollars, but your benefit comes when you withdraw the money from the Roth plan. You will not be taxed at withdrawal as long as you meet certain age and other requirements.

Vadim: So basically, for the 403(b) and 457(b) plans, you pay taxes later on withdrawal, and for the Roth plans, you're paying those taxes upfront.

Ray: That's right.

Vadim: I see. So, let's say that after listening to our podcast, you want to start contributing to one of these plans. How do you make that happen?

Ray: If you decide to participate in any of the retirement plans, once you fill out and submit the necessary forms to your district, a portion of your salary is automatically deducted and the funds moved directly into your investment account.

Vadim: Who decides the amount to invest?

Ray: You decide the amount. Filling out the paperwork to sign up for the plans may seem a little daunting at first, but it's much simpler once you are armed with the information to make good choices.

Vadim: Great, and once you contribute money into one of these accounts, what do the investment options look like for teachers?

Ray: The investment options for all four types of savings plans are mutual funds and annuities.

Vadim: What's a mutual fund?

Ray: Mutual funds are investments that pool together money from many people and invest in a portfolio of stocks, bonds, cash, or a combination.

Vadim: What about annuities? What are those?

Ray: Annuities are contracts with an insurance company, which pay a monthly amount at retirement, but which *can* carry higher fees.

Vadim: Just so you know. Just so our listeners know, in our future podcasts, we will cover mutual funds and annuities in much greater detail. I think each one really needs its own podcast to be easy to understand, but for now, let's get back to the logistics of how these plans work. So Ray, what's the maximum amount that an educator can put into these accounts. Are the amounts the same for these plans; are they different?

Ray: The maximum amount you can contribute to these retirement accounts is set by the IRS, so it's a good idea to check the amount each year. Let's take 2019 as an example. The maximum annual contribution limit is $19,000 for the 403(b) and Roth 403(b) combined. If you're 50 or over, you can increase your savings by $6,000, called a catch-up contribution. That means you can contribute $19,000 and an additional $6,000 for a total of $25,000.

Vadim: What about the 457(b) and Roth 457(b) Plans?

Ray: If your district also has a 457(b) plan or a Roth 457(b) plan, you can save an additional $19,000. For example, say in 2019, if you've contributed $19,000 in the 403(b) plan, you can allocate another $19,000 in your 457(b) plan, for your total retirement savings of $38,000.

Vadim: Whoa! That's a lot of money.

Ray: It is, but remember, you don't have to save that much, and every little bit of savings can help.

Vadim: That's true. We know from our last podcast that a little bit of savings can go a very long way.

Ray: By the way, I just wanted to mention that 457(b) plans also have catch-up contributions for those 50 or over, so look into that if it applies to you.

Vadim: Well Ray, it seems that for most people, the takeaway here is that you're looking at a limit of $19,000 unless you're 50 or over or you have access to a 457(b) plan.

Ray: That's absolutely correct.

Vadim: You know, we're just about out of time for this podcast, but I want to mention in our next podcast, we will talk about when educators can finally pull this money out of these retirement accounts, so they can start rewarding themselves for all those years of saving.

Ray: Good point, Vadim. In the next podcast, I'll explain how and when you can make withdrawals and not be subject to a 10% penalty.

Vadim: Great. Thank you, Ray. To our listeners, thanks so much for joining us, and be sure to tune in next time when we talk in a lot more detail about how and when, you can take out your money. 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.