

CLOSING THE GAP

SUPPLEMENT YOUR PENSION BENEFITS WITH A 403(b) OR 457 PLAN

INVESTING FOR YOUR FUTURE.

CTA Economic Benefits Trust

CTA Business Initiatives & Development Department
CTAinvest.org

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CALIFORNIA TEACHERS ASSOCIATION 403(b)/457 GUIDE FOR EDUCATORS

Investing for Your Future

A Message from Dean Vogel

Dear Colleague,

If there's one thing I've learned from nearly four decades in education and counseling, it's that things change. Presumptions we may have held 10 or more years ago – that our CalSTRS or CalPERS pension would be sufficient to support retirement and that our expenses would fall dramatically after we stopped working – don't hold up in the face of longer lives and higher health care costs.

Although CalSTRS and CalPERS offer valuable benefits – better than many other pension plans – they won't replace 100% of pre-retirement income. And many financial advisors are suggesting that is what we'll need to support a comfortable retirement lifestyle.

That's why you should consider taking advantage of voluntary saving in your district's 403(b) or 457 plan. These plans offer convenience, tax advantages and the opportunity to help fill any gaps in your retirement income.

CTA continues to be your advocate in protecting and strengthening your defined benefit pensions. But we also recognize that you may need to supplement your defined benefit pension with your own savings. This guide is designed to help you understand more about 403(b) and 457 plans and how they can help you work toward the retirement you want and deserve. Read it and use the resources we've developed at CTAinvest.org to learn more about these plans and how to invest wisely for your future.

Sincerely,

Dean E Vogel

Dean E. Vogel
President

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Closing the Gap

Supplement **YOUR** Pension Benefits with a 403(b) or 457 Plan

As a dedicated educator, you deserve a future that includes a financially comfortable retirement. Your defined benefit pension plan through CalSTRS or CalPERS is an excellent starting point, and CTA works hard on your behalf to protect and enhance your pension benefits.

Still, your CalSTRS or CalPERS pension may not provide enough retirement income to support the lifestyle you envision. Fortunately, you have another key advantage in your favor: the option to participate in a 403(b) or 457 defined contribution plan.

By choosing to contribute to a 403(b) or 457 plan through your district, you have a unique opportunity to supplement your defined benefit pension.

CTA has developed this guide to explain how 403(b) and 457 plans work, what they can do for you and how you can best take advantage of them. Don't delay. Read the guide, and if you haven't signed up for your 403(b) or 457 plan, consider doing so today. The sooner you start saving, the greater your potential to reap the rewards of a financially secure and dignified future.

Table of Contents

What Is a 403(b) Plan?

A 403(b) plan is a voluntary **defined contribution** retirement plan for employees of public schools, employees of eligible tax-exempt organizations and some ministers. It's sometimes referred to as a tax-sheltered annuity (TSA). A 403(b) plan is similar to a 401(k) plan in the private sector – a way to empower workers to save toward retirement.

403(b) plans are offered by your employer, who is the plan sponsor. The plan sponsor has specific reporting and compliance responsibilities for the administration of the plan. Plan documents spell out the overall offering of a 403(b) program, including approved vendors who offer an array of investments to plan participants. To find the approved vendors in your district's plan, visit *403bcompare.com*.

How 403(b) Plans Work

A defined contribution plan such as a 403(b) plan gives you the opportunity to supplement your **defined benefit** plan (CalSTRS or CalPERS) with your own savings.

- When you decide to participate in a 403(b), you (the plan participant) complete a salary reduction form and submit it to your district. Don't be alarmed by the terminology. Salary reduction doesn't mean you're lowering your salary. It simply means you will contribute a certain amount of your pay each pay period that will be used to purchase shares in the investments you choose through the vendors available within your plan.
- You make contributions to your 403(b) account with the vendor(s) of your choice, up to annual allowable limits, on a pre-tax basis from your paycheck. We'll cover pre-tax contributions and tax-deferral more starting on page 11.
- You choose the investments from among those offered by the approved vendors available in your plan, and you assume the investment risk.
- The amount you accumulate for retirement will depend on the amount you contribute, how long you participate in the plan, the performance of the investment choices you make and the fees charged by your plan and the investments within the plan.
- If you leave your job, you can roll over your balance to another employer-sponsored retirement plan, such as another district's 403(b) or 457 plan (as long as the new plan accepts rollovers), or roll it into an **individual retirement account** (IRA).

Tax Benefits

When you contribute to a 403(b) plan, your contributions are deducted from your pay on a pre-tax basis (unless you contribute to a Roth account). In addition, your earnings grow tax-deferred. We'll explain more about this on page 12.

Investment Options

Your district's 403(b) plan provides a convenient way for you to invest in any of the annuity or mutual fund investment options offered by the approved vendors in your plan. We will go into further detail about different types of investments offered by 403(b) vendors that may be available in your district's plan on page 18.

A Bit of **HISTORY**

403(b) plans were introduced in 1958 as a way for employees of public schools and other eligible institutions to put away money for retirement on a tax-deferred basis. Originally, annuities were the only allowable investment option. In 1974, Congress allowed participants to also invest directly in mutual funds through 403(b)(7) custodial accounts.

In 2008, new regulations were passed to make a 403(b) more like a 401(k) plan in the private sector, including the requirement that the plans be governed by a plan document maintained by your employer. The plan document includes a list of approved 403(b) vendors, and therefore you may now have more or different investment choices than you did before the regulations were put into place.

What Is a 457 Plan?

Your district may also offer a 457 plan. A 457 plan is similar to a 403(b) plan, but intended for state and government employees. Established by Congress in 1978, the basic features of a 457 plan are the same as a 403(b) plan:

- Pre-tax contributions
- Tax-deferred growth
- Portability if you leave your job
- The district is required to have a written document governing the program and its features, such as loans and hardship withdrawals.
- The district providing the plan must assume compliance responsibilities.
- Salary reduction agreements are the same.

There are some major differences:

- The assets in a 457 plan are held in a contract by the employer rather than the employee. It's important to note that the assets in your 457 plan account are protected from your employer's creditors by law.
- There is no penalty for early distributions from a 457 plan, as there is with a 403(b) plan (see page 5).
- Effective Jan. 1, 2011, 457 plans are allowed – but not required – to provide a Roth provision. Contact your district to find out if Roth 457 is being offered.
- There is no requirement that the 457 plan be offered to all employees, as there is with a 403(b) plan.
- There may be some different investment options available in a 457 plan.

Can I Contribute to **BOTH?**

Yes! If you are eligible for and have access to a 403(b) and a 457 plan and have enough includable compensation, you can contribute the maximum amount to each of the plans. In other words, up to $17,500 to your 403(b) and $17,500 to your 457, for a total of $35,000 – more if you are eligible for the age 50 or other catch-up provisions.*

* Contribution limit as of 2013. Indexed to inflation annually.

To learn more:
Visit www.CTAinvest.org.

Contribution Limits for 2013

	CONTRIBUTION LIMIT	AGE 50+ CATCH-UP	OTHER CATCH-UP PROVISIONS
403(b)	$17,500	$5,500	15-year rule*
Roth 403(b)	$17,500	$5,500	15-year rule*
457	$17,500	$5,500	3-year provision**
Roth 457	$17,500	$5,500	3-year provision**
Traditional IRA	$5,500	$1,000	N/A
Roth IRA* **	$5,500	$1,000	N/A

* 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.

*** See page 6 for more information about a Roth IRA.

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 (2013)	Up to $17,500	Up to $17,500	Up to $17,500	Up to $17,500	Up to $17,500
Age 50+ catch-up contributions	$5,500	$5,500	$5,500	$5,500	$5,500
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 • Rollovers	• Age 59½ and have held account at least five years • Death or disability • Other provisions same as 403(b)	• Termination of employment at any age*** • Unforeseeable emergency*** • 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
Loans	Yes, if plan permits	Yes, if plan permits	Yes, if plan permits	Yes, if plan permits	Yes, if plan permits
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 • Yes – to IRA	• Yes – to 401(k), 403(b) or 457 plan • Yes – to IRA	To another designated Roth account, but only by direct rollover	To another designated Roth account, but only by direct rollover

* 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.

** 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.

*** Ordinary income taxes may be due if not a qualified distribution, generally after age 59½ and have held account at least five years.

† Rollover may be subject to restrictions by vendor and the school district plan sponsor.

What Is a Roth 403(b) or Roth 457?

You may have heard about a Roth individual retirement account (IRA). In January 2006, the Roth 403(b) was introduced. In January 2011, the Roth 457 was introduced. Your district may offer a Roth 403(b) or Roth 457 option, but it is not required to.

If your district does offer a Roth feature with its 403(b) or 457 plan, you have a decision to make. Should you choose the traditional 403(b) or 457, which gives you upfront tax savings, or a Roth 403(b) or 457, which offers tax-free distributions when you retire? Your choice will depend on your goals and financial circumstances.

Comparing the Accounts

With a **traditional 403(b) or 457** retirement plan, your contributions are made before taxes, so you save on your current tax bill. Contributions and earnings grow tax-deferred, and withdrawals at retirement are taxed at ordinary income tax rates.*

With a **Roth 403(b) or 457,** your contributions are made on an after-tax basis; there is no current tax break. Contributions and earnings can be withdrawn tax-free at retirement if certain conditions are met.**

So Which Is Better?

There is no right answer for everyone. Whether a Roth rather than a traditional 403(b) or 457 makes sense for you will depend on your current and anticipated financial situations. If you expect your tax bracket to be lower in retirement than it is now, it may make sense to contribute to a traditional plan and take advantage of the tax break now. However, if you expect your tax bracket to be the same or higher in retirement, it may make sense to contribute to a Roth 403(b) or 457 and benefit from tax-free withdrawals later.

A financial or tax advisor can help you look at the options to see which makes more sense for you.

* Withdrawals made from a 403(b) prior to age 59½ (age 55 if leaving your job) may be subject to a 10% federal tax penalty (penalty doesn't apply to 457 plans).

** Withdrawals from a Roth 403(b) or 457 plan are tax-free if the account has been held at least five years and the account holder is at least age 59½. Nonqualified withdrawals are subject to ordinary income tax rates and a 10% federal tax penalty (penalty doesn't apply to Roth 457 plans).

What about a **ROTH IRA?**

A Roth IRA is different from a Roth 403(b) or Roth 457 in several important ways:

- It is a personal account. You do not participate through your employer. Instead, you set up a Roth IRA with a credit union, bank or broker and invest through them.
- You cannot establish a Roth IRA if your income is greater than $188,000 for married couples filing jointly or $127,000 if you are a single filer. (These amounts are for 2013 and may be indexed to inflation in future years.) There is no income restriction to participate in a Roth 403(b) or Roth 457.
- You can convert a traditional IRA to a Roth IRA, regardless of income. You must pay taxes on the conversion.
- A Roth IRA has the same contribution limits as a traditional IRA, which are much lower than the contribution limits for a 403(b) or 457plan. In 2013, you can contribute up to $5,500 to an IRA, or $6,500 if you are age 50 or older.

See page 54 for more information about IRAs.

What Optional Benefits May Be Available in Your Employer's 403(b) Plan?

Loans

Your district's 403(b) plan may offer loans. But keep in mind that the reason you are saving in a 403(b) plan is for your long-term financial health. Explore all other options for loans before taking money out of your 403(b) plan through a loan. If you borrow from your 403(b) plan, you will likely pay:

- A loan processing fee, which can be $100 or more.
- An interest rate determined by the 403(b) provider. This interest is generally paid back to your account.

Loan Pitfalls

- You lose out on any compounding earnings (see page 13) while the loan is outstanding.
- You pay back the loan with after-tax dollars. When you eventually withdraw the money from your plan in retirement, you will pay taxes again – essentially, double taxation.

Other optional features may include:

- Exchange and transfer of contracts.
- Hardship withdrawals.
- In-service withdrawals of rollover contributions.

You will need to review the features available in your district's 403(b) plan, as well as the options available through your chosen 403(b) vendor.

Thinking of taking a plan loan? Use the "What Will It Cost to Borrow from My 403(b) or 457 Plan?" calculator at **CTAinvest.org.**

Does Your Plan Offer Low-Cost Help Options?

One of the biggest expense factors in your plan is compensation for the marketing staff, such as the sales representatives who may come to your school to discuss the available investment options. If you do plan to work with one of these representatives or any other financial advisor or planner, be sure to read "Working with a Financial Professional" on page 39.

Another option for you would be to find out whether your vendor offers no- or low-cost advice. These might include:

Online asset allocation models and risk tolerance questionnaires. These are common in the 401(k) marketplace and help you create your investment strategy and select appropriate products. Generally, the vendor has these resources on its website. These tools may direct you to answer questions about your goals, timeline and risk tolerance, and then creates an unbiased recommendation on your asset allocation and/or products that you can apply to the vendor's offerings.

Toll-free or in-person access to registered investment advisors (RIAs). RIAs are registered with the Securities and Exchange Commission and may be fee-based or paid on commission, or in some cases the vendor may provide the service for free. Some vendors may offer the services of a salaried plan education specialist. These individuals may be able to help you explore the mutual funds available in your plan.

Managed accounts. In this case, the vendor may offer the option of having a professional investment manager manage your plan investments for you. They don't just offer advice; they monitor your investments and rebalance as necessary. There will be a fee for this service.

It may not be easy to determine whether there is a low-cost help option available from your vendor. If you need help, email CTA Business Initiatives at business_initiatives@cta.org.

Why Do You Need a 403(b) or 457 Plan?

Everyone has dreams for retirement. Perhaps you'd like to travel the world or indulge in a hobby. Maybe you dream of having a second home on a beach. Or maybe you'd like the financial wherewithal to help an adult child or grandchild purchase their first home or launch a business. The reality is that retirement is expensive, for a number of reasons:

Inflation – Even a very low rate of inflation can erode your savings over a long period (see chart on next page).

Health care expenses – The Employee Benefit Research Institute estimates that a married couple age 65 may need $271,000 in retirement savings just to cover health insurance premiums and out-of-pocket expenses during retirement.

Longevity – Living longer is usually a good thing, but it can also mean that you run out of money if your savings are insufficient to cover decades in retirement. The average age of retirement for CalPERS members is 60; for CalSTRS, 61.9. That means you could easily spend 20 years or more without a paycheck.

Your Pension Is Not Enough

If you are counting on your CalSTRS or CalPERS pension to see you through, consider this:

56% = Percentage of salary the California State Teachers Retirement System (CalSTRS) pension replaces, on average, for current and retired members, according to CalSTRS.*

$1,251 = In 2011, the average monthly check for retired school miscellaneous employees, according to CalPERS.

$0 = Amount CalSTRS participants can expect in the form of federal Social Security benefits. (Please note that educators participating in the California Public Employees' Retirement System (CalPERS) do pay Social Security taxes and are eligible to receive benefits. In addition, CalSTRS participants may be eligible for Social Security benefits from a spouse's earnings or earnings from other jobs, but those benefits may be reduced by the **Windfall Elimination Provision** or **Government Pension Offset**.)

90% = Percentage of salary financial experts recommend replacing in retirement to maintain same standard of living as your working years.

30%-40% = Percentage of CTA members who take advantage of a 403(b) retirement savings plan to supplement their pension plan.

The bottom line: The majority of educators are facing a retirement savings shortfall. That's why you need a 403(b) or 457 plan – to make up the difference.

Let's take a closer look at these sources of retirement income:

CalSTRS and **CalPERS** state pension funds. Your pension, or defined benefit plan, is an important part of your retirement savings. These retirement systems continue to provide a key benefit to educators. Your benefit is based on your age at retirement, years of service and final compensation level. You can run the numbers and estimate your benefit level by using the calculators on your pension's website (*www.calstrs.com* or *www.calpers.ca.gov*).

NOTE: Contributing to a 403(b) or 457 plan does not affect your CalSTRS or CalPERS benefit.

Watch "What Educators Need to Know about Social Security" at **CTAinvest.org**.

Social Security. Educators with a CalSTRS pension do not pay Social Security taxes on their income as educators. They contribute a greater percentage of pay into the pension fund instead, and therefore are generally not eligible for Social Security benefits. They may qualify for benefits earned through another job, although those benefits may be reduced due to the Windfall Elimination Provision. For more information, visit *www.ssa.gov/pubs/10045.html*. CalSTRS pensioners who are eligible to receive Social Security benefits based on a spouse's earnings may have their benefits reduced due to the Government Pension Offset (*www.ssa.gov/pubs/10007.html*).

Educators with a CalPERS pension pay 6.2%** of salary for Social Security and generally qualify for Social Security benefits. Educators are often confused or mistaken about what they will collect from Social Security in retirement. You can obtain an estimate of your projected benefit from the Social Security Administration, although the statement will not reflect adjustments due to the Windfall Elimination Provision or Government Pension Offset.

403(b) plan. The 403(b) is a voluntary tax-deferred retirement plan available for eligible employees of public schools and other tax-exempt organizations. It is called a defined contribution plan, because the participant makes contributions and investment decisions. It is different than your pension or defined benefit plan, where you and your employer make contributions to CalSTRS or CalPERS and they make all of the investment decisions. Ultimately, you are in control of your 403(b).

Prepare for a Financially Secure Retirement

The 403(b) or 457 plan is designed with features to help you make the most of your retirement savings. In 2013, you can contribute up to $17,500, or an additional $5,500 (total of $23,000) if you are age 50 or older. If you're a long-term employee who has not consistently contributed to your plan, you may also be eligible to make lifetime catch-up contributions.

Visit *www.CTAinvest.org* to find calculators that can help you estimate what you need to save for retirement based on your financial goals.

* Source: CalSTRS, *www.calstrs.com*.

** Temporarily 4.2% of salary for Social Security, thanks to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, signed into law Dec. 17, 2010, and extended through 2012 by the Middle Class Tax Relief and Job Creation Act of 2012.

Here's how three different average rates of inflation could affect the value of a $200,000 nest egg over time.

Inflation Rate	3%	4%	5%
After 1 year	$194,000	$192,000	$190,000
5 years	171,747	163,075	154,756
10 years	147,485	132,967	119,747
15 years	126,650	108,417	92,658
20 years	108,759	88,400	71,697

Chart does not take into account any potential earnings or taxes.

The Tax Benefits of 403(b) and 457 Plans

The federal government (and many state governments, including California's) want to encourage you to save for retirement. As a result, 403(b) and 457 plans offer two valuable tax advantages:

- Pre-tax contributions from your paycheck.
- Tax-deferred growth.

Pre-Tax Contributions – Current Tax Savings

With pre-tax contributions, you save on taxes now. That's because the money you contribute to a 403(b) or 457 plan is subtracted from your paycheck before federal and state income taxes are deducted.

Let's take this example: Suppose you are in the 25% federal tax bracket and 8% California income tax bracket. If you contribute $100 in a pay period, it doesn't reduce your take-home pay by $100. Instead, that $100 contributed to your account could reduce your take-home pay by just $67.

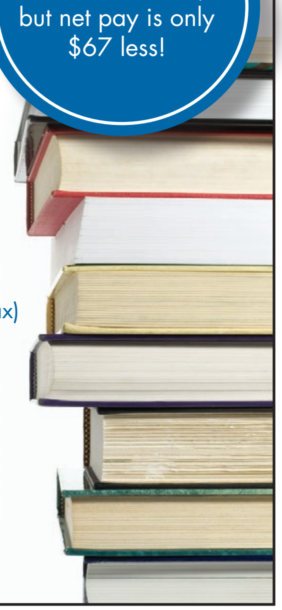
Put another way, let's say your gross paycheck is $2,100. After federal and state taxes are deducted, your net pay is $1,407. However, if you make a $100 pre-tax contribution to your 403(b) plan, your net pay would be calculated like this: $2,100 - $100 = $2,000 - 33% federal and state taxes = $1,340 net pay. Your paycheck is reduced by $67, but you've saved $100.

457 and 403(b) Plan Contributions Let You Save on Taxes Now

Regular semi-monthly paycheck with no plan contribution:		With a pre-tax contribution to a 403(b) plan:	
$2,100	(gross pay)	$2,100	(gross pay)
-33%	(federal and state income tax)	- $100	(contribution = $100)
$1,407.00	(net pay)	$2,000	
		- 33%	(federal and state income tax)
		$1,340	(net pay)

Contribution amount is $100, but net pay is only $67 less!

Note that no local or other taxes are considered in this simple calculation. Actual tax rates will vary depending on income, number of dependents claimed, amount of contribution, etc.



Use the "How Will My Pretax 403(b) or 457 Plan Contribution Affect My Take-home Pay?" calculator at **CTAinvest.org.**

Note that this is a simplified example that doesn't take into account the effect of other deductions from your paycheck. But it does illustrate how pre-tax contributions work in your favor.

Tax-Deferred Growth – Continued Tax Savings

The benefit of a tax-deferred account is that taxes are deferred until withdrawal. In a taxable account – like an interest-earning savings account at a bank or credit union, or an investment account that you have on your own – taxes are due each year on the earnings.

In a 403(b) or 457 account, any earnings in the account – such as interest, dividends and capital appreciation (increase in price of the investment) – remain in the account until you begin withdrawing money.*

You will have to pay taxes on the money once you start withdrawing it (Uncle Sam wants his due, after all). However, you may have already benefited from many years of compounding returns. In a taxable account, you would likely have to pay taxes on any earnings in the account each year. Instead, with a tax-deferred account, any positive investment returns remain in the account to potentially earn more returns. In addition, there is a possibility that you will be in a lower tax bracket after you retire, because you will no longer be drawing a steady paycheck.

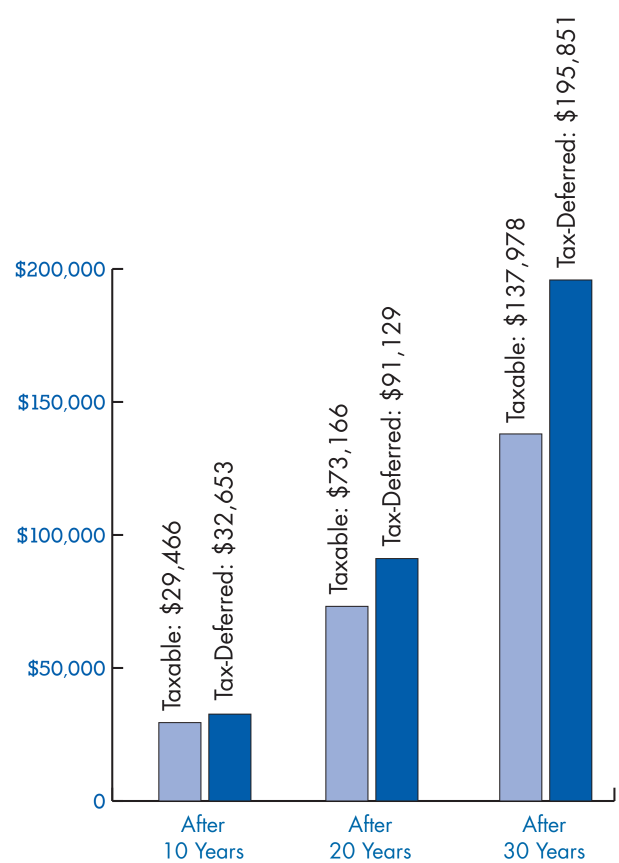
Finally, you can control the amount of money you withdraw from your 403(b) plan in retirement (subject to **required minimum distributions** – see page 42), which allows you to maintain some control over your tax bill in retirement.

* Taxes will be due upon withdrawal. Distributions before age 59½ (age 55 upon separation from service) may incur a 10% federal tax penalty. 10% penalty does not apply to 457 plans.

Tax-Deferred Savings

A tax-deferred retirement plan like a 403(b) or 457 plan can help grow your savings over time. For example, the chart compares a taxable account with a tax-deferred account. The amount invested is the same ($200 a month), and the annual rate of return is the same (6%). The only difference is that the taxable account figures in an annual 33% combined federal and state income tax rate, while the 403(b) account grows tax-deferred.*

* Return shown is for illustration only and does not represent the return of any actual investment. Your results will vary. Taxes will be due upon withdrawal. Distributions before age 59½ (age 55 upon separation from service) may incur a 10% tax penalty (does not apply to 457 plans). Note that the taxable account's tax burden may be overstated by this example because it assumes that all earnings within the account are taxable every year. That could be the case with interest earnings and short-term capital gains reported by a mutual fund, but not necessarily the case in an account that had little or no trading during the year.



Long-Term Compounding

If you've been an educator for many years, it's still not too late to start saving for retirement. But if you are young and just starting out in your career, you have an important advantage over your older colleagues: time.

If you have decades before you retire, you can truly benefit from the magic of long-term compounding. Albert Einstein called compound interest "the most powerful force in the universe." Although that may be arguable, it's certainly the most powerful force you have working for you when you save and invest over many years. Compounding interest simply means that, when the money you invest (your principal) earns interest and/or dividends, those dividends and interest are added to your principal and begin earning more interest, and so on. Over time, the money you earn in your account can actually outpace the principal amount you invest.

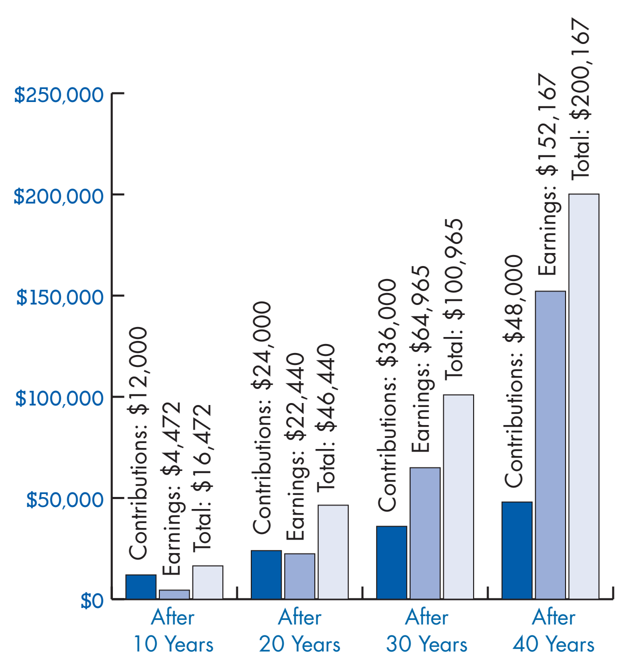
> Albert Einstein called compound interest "the most powerful force in the universe."

Use the "How Much Can I Save in My 403(b) or 457 Plan?" calculator at **CTAinvest.org.**

Over Time, Compounded Earnings Eclipse Contributions

As your money compounds for longer periods, the share of your balance from reinvested earnings grows. These charts show how your balance grows if you invest $100 a month in a tax-deferred 403(b) or 457 plan that earns a 6% annual return.*

* Assumes $100 a month invested in a tax-deferred 403(b) or 457 account at an annual average rate of return of 6%. Rate is for illustration only and does not represent the return of any actual investment. Your returns will vary. Taxes will be due upon withdrawal. Distributions from a 403(b) plan before age 59½ (age 55 upon separation from service) may incur a 10% tax penalty (does not apply to 457 plans).



Don’t Delay – Start Today

Here’s another reason why it makes sense to start saving earlier rather than later. When you start early, you can invest smaller amounts each month to reach your goals than if you start later, making your retirement plan contributions easier on your budget. For example, suppose two colleagues – let’s call them Sally Startup and Sam Slowdown – start working at the same time. They are both 25 years old, eligible to participate in a 403(b) or 457 plan, and want to retire in 35 years, at age 60.

Sally signs up for her 403(b) plan right away and starts investing $150 a month. Sam waits 10 years and starts investing $300 a month. They choose investments that provide the same 6% average annual rate of return.* Here’s how their accounts look:

Account Balance

	Sally Startup	**Sam Slowdown**
After 5 years	$10,465	$0
After 10 years	$24,582	$0
After 15 years	$43,623	$20,931
After 20 years	$69,306	$49,164
After 25 years	$103,949	$87,246
After 30 years	$150,677	$138,612
After 35 years	$213,707	$207,898
Total amount contributed:	*$63,000*	*$90,000*

To make up for the 10 years he lost, Sam had to contribute twice as much each month as Sally. He ended up contributing $27,000 more and still accumulated $5,809 less than she did.

* Rate of return is for illustration only and is not meant to represent the return of any specific investment. Your results will vary. No taxes or fees were included in the calculation. Investing in a 403(b) or 457 plan does not guarantee a profit or protect against loss in a declining market.

HOW CAN I START:

Use the handy document on page 46.

Before Investing, Know Your Investment Options

Your district's 403(b) plan should present you with multiple options for investing your money. That's a good thing, because with investment options comes the chance to allocate your assets among different asset classes, instead of putting all of your funds in a single type of investment – a potentially high-risk move best warned against in the age-old saying: "Don't put all your eggs in a single basket."

Instead, most investors use a strategy called asset allocation. The three main types of assets that will be found among the investment options in your 403(b) plan are:

- Stocks (also known as equities).
- Bonds (also often known as fixed-income investments).
- Cash equivalents (such as money market funds).

Because the investments you choose in your plan are typically mutual funds or annuities (see page 18), you are unlikely to invest in individual securities (stocks or bonds) unless you are investing outside of your plan. With your 403(b) or 457 plan, you will likely choose investments that may include a variety of stocks, bonds or both. Still, it's important to understand the basics of asset allocation.

Why Use Asset Allocation?

Asset allocation is very important for investors because each of the asset classes listed above may have different performance ups and downs and at different times. By spreading your funds among different asset classes, you may be better able to smooth out fluctuations in your 403(b) or 457 plan account's overall investment performance.

In fact, a landmark study suggests that asset allocation may account for more than 90% of the variability in a portfolio's return.* The remainder of return performance is based on specific investment choices and market timing.

Just as your investment goals likely differ from those of other people, so too should your asset allocation be unique to you. It will depend on multiple factors, including your:

- **Investment goals** – essentially, how much money do you wish to accumulate, for what purpose, and by when?
- **Risk tolerance** – are you a conservative investor seeking to preserve the money you have, or are you a more aggressive investor willing to pursue potentially higher-return, higher-risk investments?
- **Time horizon** – how many years do you have to achieve your financial goals? If you have many years until retirement, even if you consider yourself risk-averse, you may want to consider being more aggressive in your allocation, depending on your financial needs and goals.
- **Tax situation** – are you in a high-tax situation, low-tax situation, or somewhere in the middle?
- **Time and skill to manage your portfolio** – do you have the knowledge, access and time to manage your funds, or are you better served by employing professionals to handle your asset allocation for you?

Your answers to each of the questions above will help you determine the asset allocation specific to your needs. You should also know the advantages and disadvantages of each of the primary asset classes to help you determine your proper asset allocation.

Check out *www.CTAinvest.org* to learn more about determining your risk tolerance and different asset allocations that might be best for you.

* Source: "Determinants of Portfolio Performance II: An Update," Brinson, Singer and Beebower.

Asset Class Features

Stocks

Stocks are also called equities because they represent ownership (equity) in a particular company. In exchange for their ownership, stockholders receive the opportunity to participate in a company's gains, as well as its risks. Investors typically invest in stocks to provide a potentially higher investment return than other asset classes. These returns may also include income provided by companies that regularly pay dividends – a portion of earnings returned to shareholders, typically in the form of cash or company shares.

Advantages: Stocks have historically provided the greatest long-term investment returns of the three primary asset classes. From 1926 to 2011, large-company stocks (as measured by the Standard & Poor's 500 Index) posted an average annual return of 9.8%.* More recently, large-company stocks returned an average annual return of 11.0% (1982 through 2011).*

Since 1926, the stock market has posted positive annual returns in 62 years and has registered more than twice as many up years as down years. Additionally, investors have enjoyed double-digit returns in 48 out of these 62 years and returns higher than 20% in 32 years since 1926.* (Past performance is not an indication of future results.)

Disadvantages: Stocks are the most volatile of the three asset classes – that is, they are more prone to extreme ups and downs. It's important to remember that some years will have above-average returns and some years will have below-average returns. A classic example of volatility can be found in the early years of the Great Depression. Between 1926 and 2010, the stock market experienced its worst year in 1931, declining 43.3%; two years later, in 1933, it had its best year, increasing 54.0%.* Because stock returns are never guaranteed, shareholders have the potential to lose some or even all of their investment.

In 2008, a particularly volatile year, more than half the days between September and the end of the year resulted in a change of greater than 1% up or down. And there were several days in October 2008 when the market moved 10% or more in a single day. In addition, it is important to note that there are times when the stock market is depressed for an extended period. For example, in the 10 years ending Dec. 31, 2010 – which includes the worst-performing year (2008) since the Great Depression – the average annual return for the S&P 500 was 1.4%.* Still, that is just one 10-year snapshot. Since 1926, there have been 77 overlapping (rolling) 10-year periods, 73 of which had positive returns.* Out of 67 rolling 20-year periods, none posted a negative return.*

Investors who have only a few years until they need to tap their money, or those who have low risk tolerance, may need to consider allocating a small portion of their 403(b) or 457 plan contributions to stocks. Generally speaking, the closer you get to retirement, the less risk you want to take. Otherwise, like many retirees in 2008, you will be faced with having to take money out of your investments at a time when their prices are low.

Bonds

Bonds are known as "fixed-income" securities because the amount of income they generate each year is usually "fixed," or set, when the bond is issued, although that is not always the case. In general, bonds make payments to the bondholder on fixed contract terms that are stated in advance of issuance.

Bonds are essentially loans to issuers. They may be issued by governments, states, municipalities, agencies, institutions or corporations. Investors typically invest in bonds to provide interest income and help smooth the volatility of their total portfolio, because bonds usually move up and down at different times than stocks, and the price movement is generally (but not always) less extreme than with stocks. When investing in bonds, it is important to know that, all things being equal, bond prices and interest rates move in opposite directions. When interest rates rise, bond prices usually fall; when interest rates fall, bond prices rise (there are exceptions, such as with Treasury Inflation-Protected Securities (TIPS)). If you hold an individual bond, this usually doesn't matter unless you sell it before maturity. But if you hold bonds in a bond fund, as most retirement investors do, the bond manager will buy and sell bonds within the fund and that will have an impact on your return.

Advantages: Bonds typically deliver a higher return than cash investments and are generally less risky than stocks. From 1926 to 2011, long-term corporate bonds delivered an average annual return of 6.1%, and long-term government bonds returned an average of 5.7%.* During this same period, the best year for long-term government bonds occurred in 1982, when they returned 40.4%; the worst year came in 2009, when bonds fell 14.9%.*

Disadvantages: Bonds are issued with a fixed period of time to maturity, and selling bonds before they mature may result in a loss. Additionally, if the issuer of the bond declares bankruptcy, investors may lose money, since the bonds they hold may not be fully repaid. To help bond buyers assess the potential risk that a bond issuer is unable to make (defaults on) payments, ratings agencies such as Standard & Poor's (S&P) and Moody's assess the financial strength of bond issuers. S&P rates bonds from AAA (highest) to D (lowest). Moody's rates bonds from Aaa (highest) to C (lowest). The lower a bond's rating, the higher the likelihood that its issuer will default. To compensate for the risk that an investor takes when purchasing a lower-rated bond, the bond will pay a higher interest rate. The other disadvantage of bonds is that, if a company grows quickly and becomes very profitable, bondholders don't benefit, whereas stockholders may receive dividends or be able to sell their stocks at a gain.

Cash Equivalents

Cash equivalents include interest-bearing savings accounts, money market funds and U.S. Treasury bills. What these investments have in common is that they can be readily converted into cash – hence their name.

Advantages: Cash equivalents are good for meeting short-term financial goals (six months or less). They can also provide peace of mind to investors who are concerned about the potential volatility of their

stock and bond investments, since cash equivalents are designed to provide price stability and protect your principal while providing a modest return. Because of these attributes, cash equivalents may provide an appropriate short-term "parking place" for some of your assets until you decide what you wish to do with them longer-term.

Disadvantages: For long-term investment goals, such as retirement, the return of cash equivalents is likely too low to meet your needs. Between 1926 and 2011, a hypothetical portfolio of 100% U.S. Treasury bills would have significantly underperformed an alternative all-stock or all-bond portfolio, returning an annualized average of 3.6%.*

To Learn More

Visit *www.CTAinvest.org* to learn more about different hypothetical asset allocations. But remember, past performance cannot predict future returns.

* Source: 2012 Ibbotson® Stocks, Bonds, Bills, and Inflation® (SBBI®) Classic Yearbook. Past performance is not an indication of future results.

Visit **www.CTAinvest.org** to view helpful videos about your 403(b) or 457 plan.

403(b) and 457 Plan Investment Options

As a 403(b) and 457 plan investor, it's good for you to know about asset classes as the basis for your investment strategy. However, it is usually not possible for individuals in a 403(b) or 457 plan to invest directly in stocks or bonds. Instead, your 403(b) or 457 plan probably offers a range of mutual funds and annuities. Learning more about these investing options can help you make the most of your 403(b) or 457 plan.

About Mutual Funds

A mutual fund is a collection of stocks and/or bonds and/or money market instruments that have been purchased by a professional mutual fund manager with money pooled from individual investors. Mutual funds provide individual investors with enormous buying power – the chance to directly invest in a wide variety of investment types.

That sort of investment accessibility explains why mutual funds have become enormously popular with investors. According to the Investment Company Institute, in 2011 there was $13.1 trillion invested in mutual funds in the United States. Compared with individual stocks, mutual funds are easier to buy and typically require a much lower dollar threshold for purchase.

Mutual funds offer the advantage of:

- Diversification at lower asset levels (it would require a significant amount of money to develop a well-diversified portfolio with individual stocks and bonds).
- Professional investment management.
- Pooling of transaction costs to achieve lower average trading costs.

When purchasing a mutual fund, you're in essence buying the financial decision-making of the professional money manager (or managers) who run that particular mutual fund. If you're like most investors, you probably lack the time, knowledge or resources to sort through dozens if not hundreds of potential investment selections. Instead, with a mutual fund, you're ceding that decision-making authority to a professional who handles these tasks every day.

Diversification

Stock-holding mutual funds potentially provide enormous diversification, because a mutual fund includes stocks from several different companies. While this may limit the upside potential of a mutual fund (as opposed to owning a single high-performing stock), it also helps protect investors from the poor performance of any individual stocks.

For example, let's say you owned shares in the XYZ Stock Fund, which includes holdings in the fictional companies Acme Industries, Beta Beverages and Core Commodities. For the prior year, Acme delivers a return of 25%, Beta returns 0% and Core provides a return of negative 10%. Assuming that the XYZ Fund has had the same amount invested in each company, and no other investments, it would have returned 3.3% to investors for the year, based on the returns of these three companies.

Now, if you had invested all of your funds in Acme stock instead of the XYZ Fund, you would have earned 25% for that year. However, if instead you had invested all of your funds in Beta stock, you would have earned nothing; if you had selected Core stock, you would have suffered a 10% loss.

It's important to note, however, that diversification cannot guarantee a profit or protect against loss.

Trading Your Funds

When it comes time to sell or make investment changes, mutual funds are typically very liquid (easily sold), meaning you can quickly make changes. With just a phone call or online transfer, you can sell some or all of your mutual fund holdings in your 403(b) or 457, transfer assets from one fund to another, or change the way your contribution dollars are invested. (But be aware that your 403(b) or 457 plan has specific rules about transfers – see page 37.) Best of all, the 403(b) or 457 plan provider records all of these transactions on your behalf and provides you with periodic statements and reports, reducing the amount of recordkeeping and paperwork that you would need to perform yourself.

On the downside, mutual funds provide investors with no control over specific investment decisions – that is, buying or selling individual securities. Unlike picking your own individual stocks, having a mutual fund means letting someone else pick your investments for you.

Types of Mutual Funds

As discussed earlier, individual factors such as your age, investment goals, risk tolerance and tax situation will indicate your optimal investment choices. That's why mutual fund companies offer such a wide variety of choices to investors – to accommodate individual preferences and financial goals.

Once you've identified your financial goals, you'll want to determine which fund types may be best for you. There are literally dozens of types of funds available, but in general, the fund(s) you choose will likely come from one (or more) of the following types. Remember, however, that there are funds that combine some of these investments and/or investment styles. Read more about the funds you are choosing in the prospectus offered by the mutual fund.

Money Market Funds

Money market funds invest in high-quality, short-term debt instruments (typically issued by the federal government and corporations) that are generally considered to be conservative investments. They are typically considered to be the safest of all mutual fund investments because they provide a high stability of the principal amount invested. Money market funds typically keep a constant share price (usually $1, but this is not guaranteed) but offer a variable yield (return on investment) based on how they're invested. They are most appropriate for short-term financial goals (six months or less), as a haven for emergency funds (three to six months of living expenses) or as a "parking place" for assets you intend to invest elsewhere.

Bond Funds

Bond funds (also known as fixed income funds) invest in corporate and government bonds in order to provide shareholders with a fixed rate of income. They typically have more risk than a money market fund, but less risk than a stock fund. There are many different types of bond funds available; the most popular include:

- Municipal bond funds, which invest in bonds issued by state and local governments. "Munis," as these bonds are called, are typically exempt from federal taxes, and may also be exempt from state and local taxes. (Note that holding municipal bond funds within your tax-deferred 403(b) or 457 plan account does not result in any additional tax benefits.)

- Corporate bond funds include bonds issued by corporations. Funds that invest in riskier bonds (those at higher risk of default) generally have to pay a higher rate of return than other bonds in order to attract investors.

- U.S. government bond funds invest in debt instruments issued by the federal government. They are exempt from state and local income taxes. Again, you receive no additional tax advantages by holding a tax-exempt investment in your 403(b) or 457 plan.

- Core bond funds may hold a mix of long- and short-term government (Treasuries/agencies) and investment grade corporate securities. They may also hold highly rated residential mortgage-backed, commercial mortgage-backed and asset-backed (like credit cards and car loans) securities.

- International bond funds, which may invest in bonds issued by a single country or region, a number of different foreign countries or a mix of foreign and domestic (U.S.) bonds.

Stock Funds

Stock funds invest in the stock of companies. They are typically riskier than money market and bond funds, but also provide a potentially higher rate of return than other types of funds. There are many different types of stock funds available. They can be categorized as follows: strategic stock funds; size-based stock funds; and international-based stock funds.

Strategic Stock Funds

- **Aggressive growth** funds aim to maximize capital gains (appreciation) by investing in companies with potential for rapid growth. Aggressive growth funds are typically the most volatile of all fund types.

- **Asset allocation funds** typically invest in a mix of stocks, bonds and other investments, such as money market investments. The purpose of these types of funds is to provide you with the same type of diversification you would create by holding your own portfolio of different asset classes, but in an all-in-one investment.

- **Balanced funds** generally invest in a mix of stocks and bonds. Like asset allocation funds, they are designed to provide diversification among the asset classes in a single investment. Note that the definition of asset allocation and balanced funds will differ somewhat among different fund providers.

- **Blended funds** hold a combination of growth stocks (see growth funds, below) and value stocks (see value funds, below).

- **Growth funds** are similar to aggressive growth funds in their goal for capital appreciation, but in general, do not invest in stocks which are as small and/or as speculative as those held by aggressive growth funds.

- **Growth and income funds** typically hold "blue-chip" stocks – those issued by larger, well-established companies that pay dividends, thereby providing shareholders with the potential for income as well as limited growth. These funds often invest in larger companies that pay dividends, including utilities and companies that are found in the Dow Jones Industrial Average. Growth and income funds are generally less volatile than growth funds and more volatile than income funds.

- **Income funds** focus on providing shareholders with dividend income by investing exclusively in large, dividend-paying stocks. Any capital appreciation in these funds is an additional benefit. These funds are particularly favored by conservative investors seeking income.

- **Target-date funds** are a relatively new fund type. Like balanced funds, they invest in a mix of assets. Unlike balanced funds, however, they adjust their allocations based on the projected year of retirement. For example, a "2040 fund" may start out with an equity-oriented portfolio of large and small domestic stocks, international stocks and some bonds. It may gradually transition to a more conservative portfolio with fewer stocks and more bonds and cash equivalents as the target date nears. See page 34 for more information about target-date funds.

- **Lifecycle funds** are usually risk-based (aggressive, moderate, conservative), but some lifecycle funds combine a time horizon plus risk level.

- **Value funds** are invested in the stocks of companies believed to be undervalued in the current market compared to their peers, as well as those that are likely to pay dividends. Value fund managers seek to identify companies that they believe are underpriced in the hope that these stocks will gain once the market realizes the true value of these stocks. By purchasing stocks with lower prices, it is possible to have a higher dividend yield and greater potential for appreciation later on.

Size-Based Stock Funds

Although not strictly style-based, size-based stock funds typically also have a strategic and/or international component. For example, you might see a small-cap growth fund or a large-cap global fund.

- **Large-cap funds** generally invest exclusively in companies with a market capitalization (market value of outstanding stock) of $8 billion or greater. They are generally more conservative and less volatile than small-cap funds.

- **Mid-cap funds** typically invest exclusively in companies with a market capitalization (market value of outstanding stock) of $1 billion to $8 billion. They are usually more conservative and less volatile than small-cap funds.

- **Small-cap funds** invest exclusively in companies with a market capitalization (market value of outstanding stock) of $1 billion or less. Small-cap funds are generally less conservative and more volatile than large and mid-cap funds.

- **Micro-cap funds** usually invest exclusively in companies with a market capitalization (market value of outstanding stock) of $250 million or less. These are companies that are start-ups, takeover candidates and/or poised to exploit new markets. Micro-cap funds are generally more volatile than all other size-based fund types.

International Funds

International funds primarily hold securities from foreign countries. They may be an appropriate selection for investors interested in diversifying their portfolio internationally. The primary types of international funds are as follows:

- **Country-specific funds** invest only in companies located within a specific foreign country and are designated as such: for example, a Japan Fund or a Brazil Fund.

- **Emerging market funds** may invest within a single country or a larger region, but typically only invest in countries and/or regions considered to be emerging economically. For example, India may be considered to be an emerging market.

- **Foreign funds** invest exclusively in companies based in foreign countries. They may be invested in companies within a certain region of the world (an "Asia fund") or invested in any non-U.S.-based company.

- **Global funds** invest in companies around the entire world, including those which are based in the United States.

About Index Funds

Index funds are mutual funds that seek to duplicate the performance of a particular benchmark index (see page 25). The fund may hold all of the same securities that are in the index, in the same proportion, or it may include a statistical sampling of the securities in the index. These funds are passively managed – that is, securities are bought and sold only in response to changes in the index. With actively managed funds, the fund manager buys and sells securities in an attempt to outperform the market rather than match a particular index.

Most of the types of funds we've discussed are available in both actively and passively managed forms. For example, there are large-cap index funds that seek to track the performance of a corresponding large-cap index, and there are large-cap funds that are actively managed and thus seek to outperform the index by buying and selling large-cap companies based on research and analysis.

Other Investment Vehicles

These are investments which are not as readily categorized as the funds listed above and/or are intended for special investment situations.

- **Stable value investments.** These types of investments are considered lower risk than stocks, and are generally invested in a high-quality, fixed income portfolio that offers a steady investment value through the use of an insurance contract. Stable value funds typically stress preservation of capital and provide a steady stream of income. Before choosing a stable value investment, be sure to investigate the financial strength and stability of the issuing insurance company.

- **Real estate investment trust (REIT) funds** invest in commercial retail property, such as shopping malls, hotels, office buildings and apartment complexes. They enable shareholders to invest indirectly in real estate. Because they are invested in real property, and not stocks, REIT funds may move in a different direction than the stock market.

- **Precious metal funds,** as their name implies, invest in gold, silver, platinum, palladium and other precious metals. Precious metal prices often move in the opposite direction of the stock market, and thus these funds can provide a hedge against investments in common stocks and stock funds.

Check out the "A Look at Target-Date Funds" and "Choosing a 403(b) or 457 Product" videos at **www.CTAinvest.org**.

Mutual Funds – The ABCs of Fees and Share Classes

Mutual funds are generally categorized into those which assess a sales charge on the purchase or sale of shares, which are called "load" funds, and those which do not assess a sales charge, which are called "no-load" funds. Additionally, all mutual funds have expenses that they pass along to shareholders, including investment advisory fees, shareholder transaction expenses, and marketing and distribution costs. It's important to know about these fees before purchasing mutual fund shares. You will find information on mutual fund fees and expenses in a fund's prospectus, a legal document that prospective shareholders must receive before purchase.

The fees assessed on mutual fund shareholders will consist of at least some or potentially all of the following:

- **Management fee** – Paid out of the fund's assets (and thus indirectly paid by shareholders), these are fees paid to the fund's investment advisor for portfolio management (including security selection), miscellaneous management fees and administrative expenses. All funds assess a management fee, which can vary widely in amount between fund families and types of funds.
- **Account fee** – Some funds also assess an account fee, charged for the maintenance of the account. For example, some funds assess an account fee on accounts that are below a certain dollar amount.
- **Purchase fee** – Some funds assess a fee for the purchase of shares. Unlike a front-end sales load (described below), which is paid to a broker (a regulated professional who buys and sells shares), a purchase fee is assessed by the mutual fund company to defray up-front purchase costs.
- **Redemption fee** – Some funds assess a fee for the sale of shares. Unlike a back-end sales load (described below), which is paid to a broker, a redemption fee is assessed by the mutual fund company to cover the costs of share redemption. Some fund companies assess a redemption fee only on shares held less than a certain time period (for example, 90 days or less) to discourage shareholders from quickly selling their shares after purchase.
- **Exchange fee** – Some funds assess an exchange fee in order to cover their costs when shareholders exchange (shift) funds from one fund to another within the same fund family.
- **Distribution and/or service (12b-1) fees** – 12b-1 fees, which get their name from the SEC rule that authorizes a fund to charge them, cover distribution expenses and sometimes shareholder service expenses. Distribution fees include fees paid for marketing and selling fund shares, such as compensating brokers and others who sell fund shares, and paying for advertising, the printing and mailing of prospectuses to new investors, and the printing and mailing of sales literature. Some funds also authorize and include 12b-1 shareholder service fees, which are paid to cover the cost of responding to investor inquiries and providing investors with information about their investments.
- **Other expenses** – these include expenses not included under "management fees" or "distribution and/or service (12b-1) fees," such as shareholder service expenses not already included in 12b-1 fees, custodial expenses, legal and accounting expenses, transfer agent expenses and other administrative expenses.

About Mutual Fund Share Classes

Load mutual funds (those with a sales charge paid to a broker) are available in what are called share "classes." Each class of a single mutual fund will have the same portfolio manager, investment goals and portfolio. The difference between share classes is that the mutual fund company will charge you different fees and expenses depending on which type of share class you own.

A single mutual fund may have many (six or more) classes of mutual fund shares. There are many different share classes, but A, B and C are among the most common. Note that, when investing in your 403(b) or 457 plan, you do not generally get to choose which share class to buy. However, it is important to be aware of the share class that is being offered in the fund you are choosing, because it will have an impact on your fees.

Share classes do not have consistent definitions across providers, and some providers lack them or attach different terms to them. Following are typical definitions of A, B and C share classes. However, these definitions are provided for illustration only. You should carefully read the terms and conditions for each fund, and confirm with your plan what the relevant fees and restrictions are before making a purchase.

Class A Shares

Class A shares may or may not assess a sales charge when you buy the shares. Front-end loads are not common in 403(b) plans; however, if you buy Class A shares with a front-end sales charge, a portion of your investment goes to pay this sales fee, and is not invested. For example, suppose you decide to spend $1,000 on Class A shares with a front-end sales load of 5%. You will be charged $50 on your purchase, and the remaining $950 will be invested.

You may be eligible for what's called a breakpoint discount on a front-end sales charge if you make a large purchase of fund shares, already hold other mutual funds offered by the same fund family or commit to regularly purchasing the mutual fund's shares.

Class A shares typically have lower 12b-1 fees than other share classes, making them more attractive if you hold them for a longer time. In general, Class A shares are most attractive if you plan to invest a large sum and intend to hold these shares for a long time.

Class B Shares

If you buy Class B shares, you will not pay a sales charge up-front, but you will pay a back-end sales charge when you sell your shares. This back-end load, called a contingent deferred sales charge (CDSC), will usually decline over a certain time period (usually six to eight years). At the end of this time period, no charge applies, and your shares typically convert to Class A shares.

Unlike with Class A shares, Class B shares are not eligible for breakpoint discounts. In addition, the 12b-1 fees on Class B shares are typically much higher than with Class A shares. As a result, Class B shares may be most appropriate if you plan to invest a smaller amount of money for a long period of time.

Class C Shares

Class C shares do not impose a front-end sales charge on the purchase, so the full dollar amount that you pay is invested, and the CDSC is typically smaller than with Class B shares. As with Class B shares, the 12b-1 fees on Class C shares are higher than with Class A shares. Unlike with Class B shares, however, Class C shares do not convert to Class A shares after a certain period of time, meaning your expenses in Class C shares will not decrease while they are held.

As a result, Class C shares may be more appropriate for investors who have a large amount to invest for a short period of time (five years of less).

Mutual Fund Share Classes

Mutual funds may have many different share classes, but the most common are A, B and C. A fairly new category is R – share classes specifically for retirement investors. These share classes may add about 0.5% to the expense ratio over Class A funds – which typically have the lowest expense ratios – for shareholder fees.

	Class A	Class B	Class C	Class R
Front-end sales charge	Usually	No	No	No
Contingent deferred sales charge (CDSC or back-end load)	No	Usually, but declines over time (1%-5%)	Small, short duration (1%, may be eliminated after 1 year)	No
Annual expenses	Usually lower	Higher than A	Higher than A	Higher than A, but less than B

Class B shares may convert to Class A shares over time, at which point their annual expenses will drop to the same level as Class A shares.
Sources: *FINRA.org*; 2011 Investment Company Fact Book, *www.icifactbook.org*; Morningstar, *Morningstar.com*; *employeefiduciary.com*.

Deciding on Share Class

If you are investing in an account outside your 403(b) or 457 plan, you generally will need to determine which share class is most appropriate, based on how long you plan to hold the shares and the expense ratio (total expenses) of each of the share classes. That's important because the share class with the lowest expense ratio will have the highest return of all the share classes (since fund expenses are deducted as a percentage from share assets). Class A shares typically have the lowest annual expense ratio, and Class C shares have the highest. Class B shares, which usually convert to Class A shares after a period of time, will eventually have a lower expense ratio. Class C shares never reduce their expense ratio.

Inside your 403(b) or 457 plan, you may not have a choice, but it's important to understand what you are purchasing. In some cases, the vendor may offer the same fund with different share classes.

In general, if you are planning to hold your shares for 10 or more years, you may want to consider Class A shares. If you believe you will hold your shares for 5 years or less, Class C shares may be more appropriate; between 6 and 10 years, Class B shares may be appropriate. You should consult with your financial advisor before deciding.

Why the Share Class Is Important to You

- You may not have a choice of share class in your 403(b) or 457 plan.
- If you do, note the sales charges and expense ratios.
- Generally, Class A shares are cheaper over the long term than B or C.

Example: Brad has $10,000 to invest (minus 3.75% front-end load) in Hollywood XYZ Fund's Class A Shares with 0.90% annual expenses. Angelina invests $10,000 Class C Shares with no load and 1.65% annual expenses. Shares in both examples earn an average of 6% a year before expenses.

	Brad	Angelina
Initial investment	$9,625	$10,000
After two years	$10,636	$10,889
After five years	$12,348	$12,373
After 10 years	$15,835	$15,308
After 15 years	$20,306	$18,940

Fund returns are for example only and not meant to represent any specific investment. Your results will vary.

What Do Indexes Measure?

Market indexes (or benchmarks) are useful tools for comparing an investment's returns with overall market trends. It's important to know what the appropriate index for your investment is. Indexes can be used to benchmark actively managed funds as well as passively managed funds – called index funds – which are designed to track the performance of a particular index. There are hundreds of indexes, all of which use different methodologies for construction and calculation of returns. The following are a few popular indexes, each measuring a different segment of the market.

Dow Jones Industrial Average	This is the oldest and most well-known stock market index, made up of 30 actively traded blue-chip stocks. The Dow tends to be used as an indicator of market trends, rather than as an index against which to measure performance.
Standard & Poor's 500-Stock Index (S&P 500)	This index measures the performance of 500 widely held common stocks of large-cap U.S. companies. This may be a good index to use if you invest in a large-capitalization equity mutual fund.
Russell 2000 Index	This index tracks the smallest 2,000 companies out of the top 3,000 in domestic equity capitalization. It represents a cross-section of the U.S. small-cap equities market and may be a good index to use if you invest in a small-capitalization fund. *Note that this is a sub-index of the Russell 3000 Index, which measures a broader market. There is also a Russell 1000 Index, which is the large-cap sub-index of the Russell 3000.*
Standard & Poor's 400-Stock Index (S&P 400)	This index follows 400 common stocks of industry, transportation, financial and public utility companies in the mid-range of capitalization. This may be a useful index if you invest in "defensive" funds (funds that tend not to fluctuate as much with the economy) such as utility funds.
Nasdaq Composite	The Nasdaq Composite Index is the "tech stock" index. It tracks stocks traded over-the-counter. It is a broad-based index including more than 3,000 companies, many of which are in the high-tech industry. This may be a good index to use if you invest in growth or technology funds.
Barclays Capital Aggregate Bond Index	This index measures the performance of government and corporate bonds and mortgage-backed securities. Consider this index if you invest in a diversified bond fund.
Barclays Capital U.S. Corporate High-Yield Index	This index tracks domestic non-investment grade ("junk"), fixed-rate corporate bonds, and may be useful if you invest in riskier bond funds.
MSCI (formerly known as Morgan Stanley Capital International) EAFE	This index tracks stocks traded on the largest developed international markets (Europe, Australia and Far East). It may be suitable if you invest in established foreign market funds.
MSCI ACWI (All Country World) ex-US Index	This index provides a broad-based measure of stock performance in both developed and emerging markets throughout the world, with the exception of U.S. companies.

In your mutual fund prospectus, you may find information about a suitable index against which to measure your fund. But it is also important to note that your returns will not be exactly the same as the index. That's because indexes aren't managed, as a mutual fund is. They measure performance during a specified period, which may not match the period during which you hold the investment. And finally, there are no fees deducted from indexes, as there are from your mutual fund and annuity investments.

An individual investor cannot invest in an index. But you can invest in an index fund that is designed to track the performance of a specific index. **(See page 21.)**

About Annuities – Fixed and Variable

Annuities are another investment vehicle available in your 403(b) or 457 plan. Annuities are investment contracts with a life insurance company ultimately designed to provide a steady stream of income. Your investment grows tax-deferred until withdrawal. However, investing in a tax-deferred annuity within your tax-deferred 403(b) or 457 plan offers no additional tax advantages, so you will likely end up paying fees for a feature that doesn't benefit you (see page 28 for more on fees).

There are two basic types of annuities:

- **Fixed annuities** have a fixed rate of return and generally are available through your 403(b) or 457 plan as either a traditional fixed or equity-indexed annuity. A variant of a fixed annuity is an **equity-indexed annuity.**
- **Variable annuities** are similar to mutual funds paired with an insurance component. As the name implies, the return varies with the market.

Whether you hold a fixed or variable annuity, there are two basic phases to an annuity contract: the accumulation (pay-in) stage and the distribution (pay-out) stage. During the accumulation stage, you put money into the annuity, either all at once or gradually over time, where it grows tax-deferred. During the distribution stage, which can start as early as age 59½ (earlier in a 457 plan, if desired, or as early as age 55 with a 403(b), if leaving your job), you can begin taking income from your annuity or convert your annuity to a plan that provides a guaranteed income stream over a specified amount of time (for a set number of years, or for life).

About Fixed Annuities

With a traditional fixed annuity, the insurance company guarantees you will earn a minimum rate of return during its accumulation period – the time your account is growing.

The insurance company also guarantees that your periodic payments will be for a guaranteed amount for each dollar in your account. These periodic payments may last for a fixed period, such as 20 years, or for an indefinite period, such as your lifetime or for the lifetime of you and your spouse.

With a fixed annuity, if you die during the accumulation stage (while you are making contributions), your beneficiaries will receive the total of all the contributions you've made or the account value at the time of death, whichever is greater. The cost is generally figured into the rate of return rather than as a separate fee.

When shopping for a fixed annuity, compare the rate of return, the surrender charge (the fee imposed for terminating an annuity contract prior to maturity), the sales charge and annual maintenance fees and charges. Avoid fixed annuities that charge front-end contract fees and sales loads, or excessive annual maintenance fees or charges. They reduce the amount of money that goes to work for you. Also, consider the length of the surrender charge period (in addition to the surrender amount); a surrender charge period of five years or more may be overly long.

Equity-Indexed Annuities

Another type of fixed annuity, called an equity-indexed annuity, operates somewhat like a variable annuity. When you own an equity-indexed annuity, the issuer agrees to pay you a fixed rate of return based on a percentage (often 75%) of a stock market index (such as the S&P 500). The issuer also agrees to pay at least a minimum return, in case the stock market index falls short of the guaranteed minimum. Thus, you have potential to receive some (but not all) of the upside of return in a stock market index, and are protected on the downside. To provide these benefits, equity-indexed annuities typically charge higher fees than other types of fixed annuities. Equity-indexed annuities (EIAs) can be extremely complex, and the rates paid may be difficult to determine in some cases. In fact, FINRA has issued an alert about EIAs. You can read it at *www.finra.org* in the Investor Alerts section.

About Variable Annuities

A variable annuity is similar to a fixed annuity in the sense that it's a contract between you and an insurance company, in which the insurance company agrees to make payments to you (in exchange for your investment) either immediately or at some future date. You can purchase a variable annuity either by investing a lump sum or by making periodic payments over time.

With variable annuities, your contributions ("premiums") are allocated to subaccounts held by the insurance company. These subaccounts are invested in underlying portfolios that may be composed of stocks, bonds, money market funds or a combination. A variable annuity offers a death benefit (based on the amount that you've paid in, or a guaranteed minimum), and provides the opportunity to receive periodic payments for the rest of your life (or for the lifetime of any other beneficiary you designate).

The death benefit of a variable annuity may also sound appealing, but keep in mind it typically consists of simply returning money that you've already paid into the annuity. You will pay an additional fee, called a mortality and expense fee (typically a percentage of the assets you've invested) in order to receive this death benefit. In reality, these fees become more expensive as their benefit becomes more remote. If you are earning positive returns over time, you are less likely to have your account balance be close to or less than the amount you originally invested. Since the fee is asset-based, you end up paying more for the protection as the protection's value relative to your balance declines. You may wish to consider the cost and return potential of an annuity's death benefit versus the cost and return potential of investing directly in mutual funds and purchasing low-cost term life insurance.

You should also closely examine a variable annuity's overall sales charges and fees. Some variable annuities have fees that are up to eight times more expensive than comparable mutual funds. Additionally, surrender charges on a variable annuity may last for more than 10 years.

If you are considering an annuity for your 403(b) plan, be sure to check out the fees at *403bcompare.com*.

Final Analysis of Annuities

As noted, annuities are able to grow tax-deferred. Your 403(b) or 457 plan also grows tax-deferred. When weighing retirement plan options, does it make sense to pay for an annuity sales charge to receive a double-dose of tax deferral?

Generally speaking, annuities make the most sense only after you have contributed the maximum amount (in 2013, $17,500 a year), to your 403(b) and/or 457 plan, and to individual retirement accounts (IRAs). Annuities may also be appropriate for high-income investors in a high tax bracket who may benefit from their tax deferral. Consult with your tax advisor for details.

Watch the videos, "The Truth about Variable Annuities" and "A Look at Fixed Annuities" at **www.CTAinvest.org** to learn more.

What You Need to Know about Fees

There's no escaping fees, whether it's to register your car or spend a day at a state park. Investing in your 403(b) or 457 plan is no exception. Someone needs to be paid to manage the investments and administer the plan.

Fees are an important consideration when choosing investments for your plan. Although fees may seem small when expressed as a dollar amount or percentage of assets, the reality is that they can have a significant impact on the ultimate balance of your nest egg when they are paid year after year.

When reviewing fees, also consider the level of support you receive from your 403(b) vendor and your personal preference. For example, some 403(b) vendors use a toll-free number to support operations, while other 403(b) vendors rely on individual agents or employees. Those services are reflected in the overall expense of the program and hence the fees. If you believe your district has not spelled out fees adequately, ask your union representative to send the district a letter requesting disclosure from the TPA (see sample on page 30).

Typically, a 403(b) or 457 plan has two kinds of expenses: administrative costs and investment management fees. The latter is often expressed as an **expense ratio**, or the amount of the fees as a percentage of your net assets. For example, if you had $1,000 invested, a fee of 0.2% would cost you $2 a year, while a fee of 3% would cost you $30 a year. Review the chart on page 29 to see the impact of various expense ratios.

Investment Options

As you know, your 403(b) or 457 plan typically allows you to purchase two types of investment products: **mutual funds** and **annuities** (including fixed, variable and equity-indexed annuities).* The fees will vary depending on which of these options you choose and also – if you select a variable annuity or mutual funds – on which investment choices you make within those products. In general, annuities offer more features – many of which you don't need – and charge more fees than mutual funds do.

Each of these types of investments charges fees. It's important for you to understand the fees charged, because they will have a significant impact on the amount of money you can accumulate toward your nest egg.

Explicit fees are the ones that are spelled out for you (see the previous section). They may include things like an upfront sales fee, usually a percentage. Or there may be an annual fee for administering the account or a contingent sales fee, which is a sales fee that is imposed when you sell the investment, instead of when you buy it.

With variable annuities, the explicit fees can be all of the above, plus a mortality and expense (M&E) fee that covers the death benefit. Most annuities also charge a surrender fee if you decide to sell the annuity before a specified period.

You should be able to find out about the explicit fees pretty easily. They should be spelled out at *403bcompare.com*, or in the insurance contract or prospectus. You can ask your 403(b) or 457 plan representative to identify all explicit fees. But watch out for implicit fees!

Typical Fees

	Variable Annuity	**Mutual Fund in a 403(b)7**
Operating/administrative expenses	0.15% or flat fee	0.0-1.0%/year
Investment management	0.5-1.0%/year	0.5-1.0%/year
Mortality & expense fee	1.25%	0.0%
Trading costs	Vary	Vary
Surrender fees	6% to 0% after six years	0.0%

Note that the fees you will pay will vary based on the vendor and investment vehicle you choose within your 403(b) or 457 plan.

Implicit Fees

Implicit fees are the ones that aren't spelled out, but will still have an impact on the return on your investment. For example, most mutual funds have turnover (selling investment shares within a fund). If a mutual fund manager sells a stock within a mutual fund, there will be a commission or other sales charge (called the spread) on the transaction, which will be deducted from the balances of everyone who owns shares in the fund.

In general, funds that are not actively managed (such as index funds that seek to track the performance of a particular index of stocks) have lower implicit fees because there is lower turnover in the fund. However, it is important to realize that paying fees for an actively managed fund may be worth it if the fund manager is successful in beating the overall market. If the outperformance of the fund is greater than the transaction costs and management fees, an actively managed fund may be more desirable than an index fund, which will not beat the market by its nature.

It may be difficult to figure out implicit fees, but you can estimate the impact of fees by using the Financial Industry Regulatory Authority (FINRA) mutual fund analyzer at *http://apps.finra.org/fundanalyzer/1/fa.aspx*.

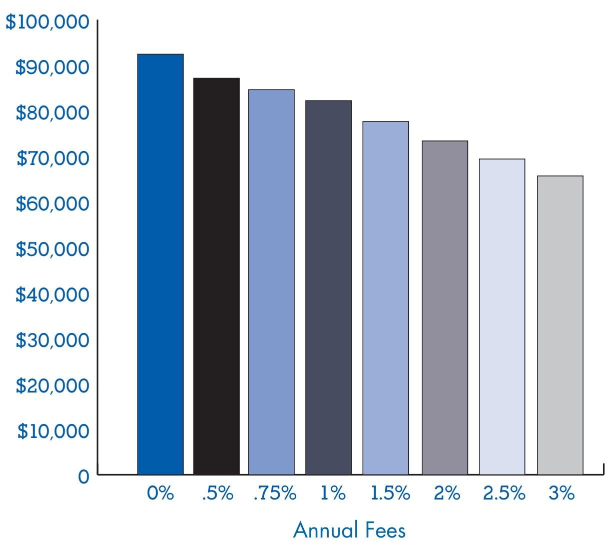
* A 457 plan may also allow you to purchase separate accounts and collective investments trusts. Each plan will offer different investments.

Use the calculator, "How Will Fees Affect My 403(b) or 457 Plan Savings" at **CTAinvest.org.**

How Fees Reduce Earnings

The chart below shows how various expense ratios reduce the ending balance of a portfolio. It assumes that you invest $200 a month for 20 years and earn an annual average return of 6%.*

Value of Investment Averaging 6% Annual Gross Return, Minus Fees



In general, actively managed investments and annuities charge higher fees than passively managed investments, such as index funds. Since fees have such a large impact on your return, it is important to compare both historical performance rates (but keep in mind that past performance is not an indication of future results) and the investment fees. Go to *403bcompare.com* to review the explicit fees charged by the investments available in your plan.

* Rate of return is for illustration only and is not meant to represent the return of any specific investment. Account value shows value after 20 years of a $200 monthly investment earning an average annual rate of 6%, minus the deduction of various annual fees.

Sample Disclosure Letter

Dear _________,

Disclosure requirements were recently added to the California Education Code to reveal all fees associated with the third-party administration of retirement investments by a third-party administrator (TPA). The district has hired ________ TPA, and we are requesting that you submit to us data that meets the following section of the education code:

SEC. 7. Section 44041.5 (d) is added to the Education Code, to read:

> *A third-party administrator shall disclose to any employer seeking his or her services any fees, commissions, cost offsets, reimbursements, or marketing or promotional items received by the administrator, a related entity, or a representative or agent of the administrator or related entity from any plan provider selected as a vendor of an annuity contract, custodial account, or deferred compensation plan by the employer. A third-party administrator that is affiliated with or has a contractual relationship with a provider of annuity contracts, custodial accounts, or deferred compensation plans shall disclose the existence of the relationship to each employer and each individual participant in the annuity contract, custodial account or deferred compensation plan.*

Additionally, please confirm in writing how the district has met compliance with California Education Code SEC. 7. Section 44041.5 (c)(1) in regards to safeguarding the contributions, changes, transfers and investment data of the assets, and maintaining timely transactions.

> *SEC. 7. Section 44041.5 (c)(1) of the Education Code reads:*
>
> *(c) (1) If an employer elects to contract with a third-party administrator for the administrative or compliance services to employers described in subdivision (b), the employer shall do all of the following:*
>
> *(A) Require the third-party administrator to provide proof of liability insurance and a fidelity bond in an amount determined by the employer to be sufficient to protect the assets of participants and beneficiaries in the annuity contract and custodial account or deferred compensation plan.*
>
> *(B) Require the third-party administrator to provide evidence of a safe chain-of-custody of assets process for ensuring fulfillment of fiduciary responsibilities and timely placement of participant investments.*
>
> *(C) Require evidence, if the third-party administrator is related to or affiliated with a provider of investment products pursuant to Section 403(b) or 457 of the Internal Revenue Code, that data generated from the services provided by the third-party administrator are maintained in a manner that prevents the provider of investment products from accessing that data unless access to the data is required to provide the services in accordance with the contract entered into with the employer pursuant to subdivision (b).*

Thank you,

What Is 403bcompare.com?

403bcompare.com is a Web site maintained by CalSTRS that lists the approved 403(b) vendors in your district, the products they offer and the fees charged. Here's how to use *403bcompare.com* to find fees:

Here's How to Find the Fees at *www.403bcompare.com*

1. Go to *www.403bcompare.com*.

2. Click on "Browse Vendors" on the left-hand-side menu. (Note: You can also search for vendors using the search tool, in which case you would skip steps 3 and 4.)

3. Click on the letter corresponding to the vendor's name.

4. A list of vendors will appear. Click on the vendor of your choice.

5. Choose the tab at top that says "Product List."

6. Select the product you are interested in.

7. Choose the tab at top that says "Fees and Charges." You can then review the fees and expenses charged by this investment product.

If you'd like to compare the fees and charges of this investment product to others:

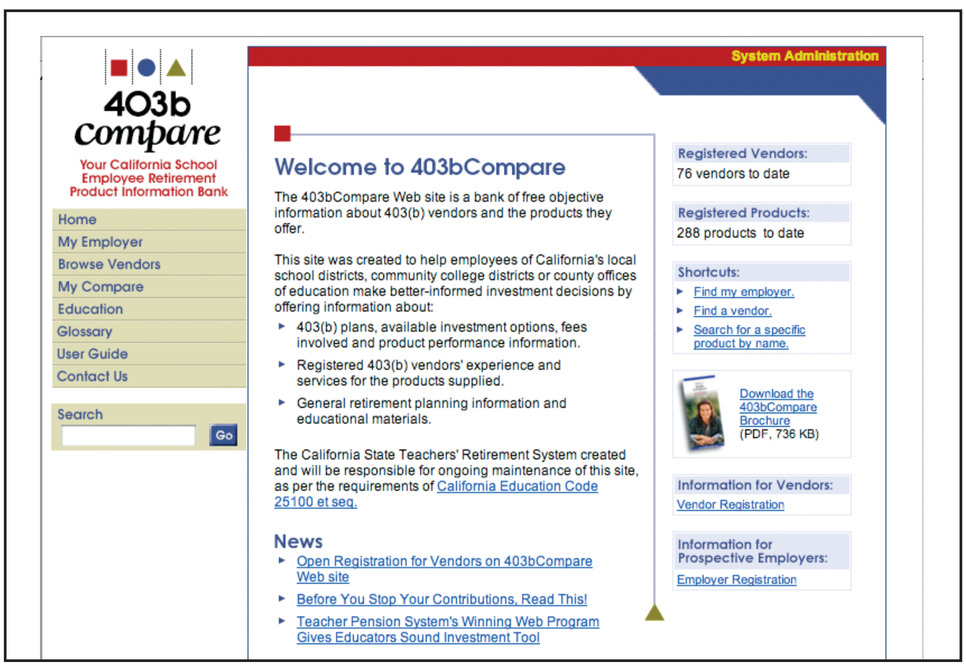
8. Select the "Add to My Compare" link. This will save the information to your "My Compare" box, similar to a shopping cart on a retail Web site.

9. Choose the next product, following steps 1-7 above, and select the "Add to My Compare" link.

10. When you are ready to compare the products, click on the "My Compare" link in the blue bar at the upper right-hand side of the Web page.

11. Your selections will be listed. Check the products that you would like to compare. You can compare only three at one time, and they must be in the same category (for example, you can compare different mutual funds, but you cannot compare a mutual fund with an annuity).

You may also choose to have your information emailed to you if you'd like to keep it for future reference. Otherwise, when you leave the site, your My Compare information will be deleted.



The Nitty Gritty:

Choosing the Investments in Your Plan

When it comes time to invest your assets in your 403(b) or 457 plan, you'll want to gain answers to several important questions, including: What is my risk tolerance? Where should I invest? Who can I turn to for help? In this section, we highlight the primary factors you'll wish to consider before you invest.

Risk Tolerance

It's important to determine your risk tolerance before you invest. Essentially, risk tolerance is the degree that volatility (changes up and down) in the value of your portfolio affects you. More simply put, if changes in your account value keep you up at night, your risk tolerance is probably low. If you shrug it off as the inevitable ups and downs of investing, your risk tolerance is probably high.

Your risk tolerance is unique to you, and will depend on factors such as your age, amount of assets, income goals and more. Generally speaking, a 30-year-old saving for retirement will have a greater tolerance for investment risk than a 70-year-old seeking retirement income.

It's important to also know that there are different types of risk to consider when investing. Among the many types of risk, these are the most important:

- **Market risk** (or volatility risk) is the chance that a broad investment market, such as the bond or stock market, will decline in value. You should know about this risk if you have assets invested in these markets.

- **Inflation risk** is the chance that the value of your money will decline as rising prices shrink the value of the dollar. This type of risk is relevant if you have funds invested in cash equivalent investments (savings accounts, money market accounts and mutual funds, etc.) that do not keep pace with inflation.

- **Principal risk** is the probability that your original investment will decline in value or be lost entirely. Similar to market risk, this type of risk pertains primarily to investments that stand a greater chance of losing principal, such as stock investments.

- **Credit risk** is the chance that a borrower will default on a debt obligation. This type of risk pertains specifically to fixed income (bond) investments.

- **Liquidity risk** is the chance that you won't be able to sell or convert a security into cash when you need the money. Technically, this risk applies to any type of investment, but is most applicable to thinly traded investments that lack a market. Both credit risk and liquidity risk apply less to mutual funds in a defined contribution plan such as your 403(b) or 457 plan than they do in general investing.

To help you determine your own tolerance for risk, we've prepared a brief risk assessment quiz on page 53. Please take a few minutes to complete and rate your answers. Note that this quiz is intended only to provide an idea of your tolerance for risk, based on emotional responses. For a more in-depth assessment of your risk tolerance, you should consult with a financial professional. You can also use the tools available at *www.CTAinvest.org*.

When determining your risk tolerance, you should also take into account anticipated income (such as your CalSTRS or CalPERS pension benefit) and the amount of income you will need to replace over and above your pension. Once you determine that amount, you should develop an investment strategy designed to help you reach that goal. If you fail to meet your investment goals, you may need to work additional years or accept a lower standard of living in retirement.

Selecting a 403(b) or 457 Plan Vendor

CTA helped secure a California state law that requires the California State Teachers' Retirement System (CalSTRS) to provide 403(b) plan participants with an online information bank of eligible 403(b) program vendors and products, *www.403bcompare.com*. This site's purpose is to provide eligible employees with "a bank of objective information about various 403(b) vendors and the products they offer." Only vendors that are approved to provide 403(b) plans in California may appear on this site. To learn more about using *www.403bcompare.com*, go to page 28.

The 403(b) vendors listed on *403bcompare.com* provide performance and cost information for the products they offer to retirement plan participants, including: (1) the investment's average annual total return for a period of not less than a year (as measured by a rating service selected by CalSTRS); and (2) a fee table showing the total cost in dollars that would be incurred by an investor based on an initial $10,000 investment (assuming a 5% return for time periods of 1, 5, 10, 15 and 20 years).

Given the dozens of vendors and hundreds of product choices available through *www.403bcompare.com*, you should know what to look for and what to ask before deciding where and how to invest your retirement plan assets. Specifically, you should research and/or ask about vendor fees and sales charges, product performance information and insurance company ratings (for insurance company vendors). Let's look more closely at each assessment category.

403(b) and 457 Plan Fees

After your asset allocation, fees may have the biggest impact on the return of your 403(b) or 457 plan. Fees cut directly into your rate of return. For a mutual fund held in a retirement plan, these fees can include sales charges and annual expenses which are passed along to shareholders. Mutual fund fees are explained in-depth on page 22.

For an annuity within a 403(b) or 457 plan, fees can include the following:

- **Mortality and expense risk fees:** These are fees that participants pay each year to the insurer to offset the risk of investment loss, plus fees involved to pay annuity provider expenses. "M&E" charges are set as a certain percentage of an account's value – generally an average of 1.25% annually, according to the Securities and Exchange Commission. That's $250 per year on a $20,000 account.
- **Administrative fees:** These can be flat fees of, say, $25 a year, or a percentage of someone's account. Typically that's 0.15% – or $30 for a $20,000 account.
- **Initiation fees:** These are one-time start-up fees that may be waived at the time of sale. Prices vary but can run approximately $60.
- **Sales loads:** These are sales commissions you typically pay up-front (front-end load) when you buy an annuity, and cut directly into the actual amount available to invest. For example, a 7% front-end load on a $10,000 investment will cost you $700, meaning you've effectively only invested $9,300. In 403(b) plans, back-end sales charges are more common.
- **Death benefit charges:** These are used to pay for an annuity's death benefit, a feature that guarantees your heirs will get a certain amount if you die prematurely. This amount is based on the total account value at a certain date in time or, alternatively, the value of the payments you've made minus any withdrawals.
- **Surrender charges:** These may apply if you sell an annuity within a certain period of time, known as the surrender period, which can last more than 10 years after purchase. This charge, also called a contingent deferred sales charge (CDSC), is a percentage of the asset balance at the time you withdraw or transfer and depends on how long you've had your money in place. For example, if you have a seven-year surrender period, and you withdraw money early – say, in the first year – you might pay a 7% surrender charge. The surrender charge typically decreases by 1 percentage point each year until the surrender period finally expires in the seventh year.

To give you an idea of the effect of fees on retirement plan assets, see page 29.

Ask for Fee Disclosure

To evaluate the fees of the investment products you're considering, ask about them. If you're working with an advisor, ask if he or she receives a commission based on the sale of the product, and the amount of this commission. Ask if the advisor will receive any additional compensation (such as a bonus or incentive gift) as a result of selling this particular product. Finally, ask if the advisor will receive a greater sales commission by recommending one particular product over another, and whether or not your needs would be equally served by the lower-priced product.

Performance Information

Fees can dramatically affect an investment's potential performance. When comparing investments, it is also useful to review, compare and contrast prior investment performance information. However, keep in mind that past performance is not an indicator of future returns.

A good way to assess past performance is to compare it versus a comparable benchmark index. This information can be found in a fund's investment prospectus. For example, if you're considering a large-cap growth fund, how does its performance compare with the Standard & Poor's 500 Index? If the fund has come close to matching the index performance, it may be worth considering. On the other hand, if the fund has significantly underperformed the index, you may wish to look elsewhere.

Financial Strength and Stability

If you're considering an insurance company as your 403(b) or 457 plan vendor, you'll want to review and compare its financial strength and stability before purchasing a product. Since these companies are selling insurance products that obligate the insurer to pay a return sometime in the near to distant future, you'll want to be sure that the insurer is in good financial health and able to pay on this obligation.

Various insurance rating companies, including Moody's, A.M. Best and Standard & Poor's, each rate insurers based on their financial health. Each ratings agency has its own particular alphanumeric ratings system, which you can learn more about by consulting the websites of each company. However, the ratings are fairly intuitive. For example, S&P insurer financial strength ratings go from AAA (extremely strong) to CC (extremely weak). Any rating below an "A" should be a source of concern.

Balancing (and Rebalancing) Your Assets: Do It Yourself vs. Target-Date Funds

If you're selecting mutual fund or variable annuity investments for your retirement plan, you will likely be presented with a choice of several different types of funds (large-cap growth, small-cap value, etc.) and the opportunity to assemble a portfolio from these funds that matches your age, risk tolerance and financial goals. You can select these funds yourself to create a balanced portfolio to meet your investment needs. Or, you can turn the reins of investment selection over, so to speak, to the manager charged with running a so-called target-date or lifecycle fund. Let's look more closely at the advantages of each approach – do-it-yourself versus a target-date fund.

When you select funds yourself from an array of options, you are able to exercise greater freedom of choice than is possible with a target-date fund. For example, let's say you're presented with multiple fund options, including an attractive stock fund, a top-performing bond fund and a target-date fund. If you believe that your financial goals would be better served owning the appealing stock and bond funds, these may be better options for your portfolio.

The key to selecting and owning individual funds is to understand the investment strategy and choose funds that suit your goals, timeline and risk tolerance. Be sure that the funds fit in with a fully diversified portfolio that takes into account all of your investments, in and outside the plan.

By contrast, target-date funds, which were also discussed on page 20 of this guide, automatically adjust each year to match your age and presumed investment needs for someone in your age group. Generally, the younger you are, the more aggressively your assets will be invested in a target-date fund. Over time, a target-date fund's manager will reallocate the fund's holdings – from higher-return, higher-volatility asset classes to those which are lower-return and have lower volatility – based on a predetermined "glide path" that reflects investors' presumably changing risk tolerance.

For investors, the primary advantage for target-date funds is that their owners no longer have to worry about when and how to adjust their portfolios to account for changes in their risk profile over time. The fund does the work for you. In addition, you don't need to put together a portfolio of multiple asset classes and monitor them each individually; target-date funds are designed to be an all-in-one solution. That can be a significant advantage to busy working educators when it comes to managing their retirement plans. Young adults, in particular, seem to be particularly interested in purchasing target-date funds.

Keep in mind, however, that target-date funds – like all mutual fund investments – do not insure your 403(b) or 457 plan assets, nor do they guarantee that you will have all the money you need to retire by the target date. For example, let's say you're 26 years old in 2012 and want to begin receiving benefit payments at the age of 60. You would likely invest in a 2045 target-date fund, which would be heavily invested in higher-risk and potentially higher-return investments – specifically aggressive stocks. Although, over the long term, stocks have historically returned an average of close to 10%, there is no guarantee that in 2045 your assets will have increased at a rate of 10% annually.

Between investing in mutual funds yourself versus investing in a target-date fund, there is no right or wrong answer as to which type of approach is best. You simply need to pick the approach that's best for your investment goals and personal approach toward money management. If you have neither the time, interest nor expertise to monitor your investments and rebalance as necessary, a target-date fund may be a good choice for you. This takes some of the emotion out of your investment choice. On the other hand, if you have a risk-return goal that is different from the available target-date funds and are capable of regularly monitoring and rebalancing your 403(b) or 457 plan investments, then a do-it-yourself approach may make more sense.

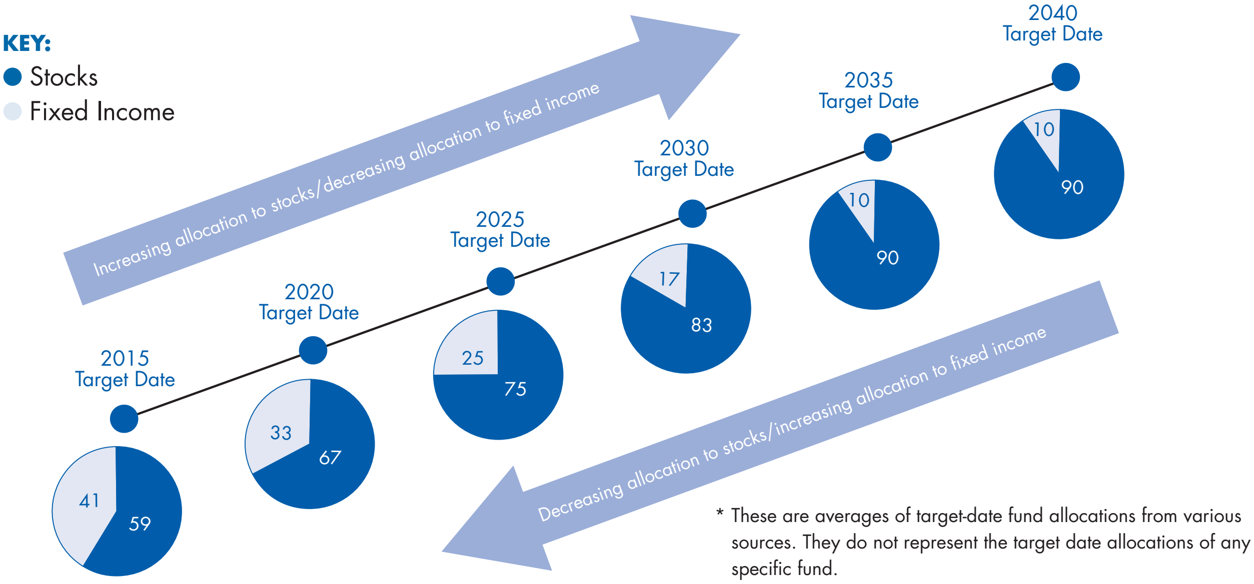
The Glide Path of Target-Date Funds

The glide path of a target-date fund is the strategy the fund uses to determine its asset allocation mix, based on the number of years to the target date. Typically, the asset allocation mix becomes more conservative (includes more bonds and cash investments and fewer stocks) as the target date nears.

It is important to note that target-date funds are designed to be an all-in-one investment that automatically rebalances. The idea is to choose the fund that has a target date closest to the date you plan to retire.

Watch "A Look at Target-Date Funds" at **CTAinvest.org.**

Typical Target-Date Fund Allocations*



* These are averages of target-date fund allocations from various sources. They do not represent the target date allocations of any specific fund.

Is Your Target-Date Fund "To" or "Through"?

Target-date funds can be designed to build up savings "to" an individual's target retirement date, with allocations becoming more conservative at retirement. This approach results in funds adopting higher allocations to fixed-income investments at/toward the retirement date, and a static portfolio thereafter.

Contrary to this approach is the principle of "through" retirement funds. Here the target-date fund is designed to help investors through retirement, with the goal of accumulating wealth long after the retirement (target) date. Funds adopting this approach may have higher allocations to stocks at the target date, followed by a declining allocation 10 to 30 years post-retirement. It is important to understand that these two approaches may differ vastly in risk and reward trade-off due to the way a fund invests in stocks and bonds over time.

Changing Your Investments

If you've invested in a variety of mutual funds yourself, you'll want to periodically review them when your account statements arrive in the mail each quarter (or do so more frequently, online) to determine if they still match your investment needs. If not, you'll want to make some investment changes, potentially to how your current assets are invested and/or how your future investments are allocated.

With a 403(b) or 457 plan invested in mutual funds or in funds invested in a variable annuity, changing your investments with your current vendor, if approved by your plan, is typically easy. You simply request (online or by phone) that your plan administrator shift assets from one fund to another and/or reallocate your future asset allocations to your newly selected funds. Because you are making these changes within a tax-deferred account, there is no current tax liability as there might be in a taxable account. (Taxes will be due at ordinary income tax rates upon withdrawal at retirement.)

If you wish to change your 403(b) vendor for your retirement plan you need to check the employer's plan document to see if you can exchange. You will need to complete a new account form for your new fund company, as well as a fund exchange form. You'll also need to specify which fund(s) at the new company should receive your transferred assets. Once you submit this paperwork, the two respective fund companies (old and new) ought to work together to ensure a smooth transition of your funds. However, be aware that there may be tax implications if you intend to transfer funds to a nonapproved vendor. See page 44 for more information.

If you seek to change your retirement plan assets from one insurance company to another, things potentially become more complicated – and costly. Bear in mind that an annuity is an insurance contract, and as such contains stipulations made by the insurer as to the length of time you're to remain in the contract, and the financial consequences of making changes (or withdrawals) from your account.

Whether or not you're assessed charges when making an investment change in an annuity will depend on the type of product you initially chose and when you purchased it for your account. For example, if you take money out of a variable annuity within a certain period after a purchase payment (typically within six to eight years, but sometimes for more than 10 years), the insurance company will generally

Exchange – movement of your money between vendors approved by the employer and noted in the plan document.

Transfer – an in-service transfer of your account balance from one employer-sponsored 403(b) plan to another district's plan.

assess a surrender charge, which is a type of sales charge that compensates the financial professional who initially sold the variable annuity to you.

Generally, the surrender charge is a percentage of the amount you sell or exchange, and it will decline gradually over a period of several years, known as the surrender period. For example, a 7% charge might apply in the first year after a purchase payment, 6% in the second year, 5% in the third year, and so on until the eighth year, when the surrender charge no longer applies. Some variable annuity contracts will allow you to withdraw part of your account value each year, such as 10% or 15% of your account value, without paying a surrender charge.

Bottom line, you'll want to be familiar with the rules and potential fees of making investment changes in your retirement account before doing so. In addition, exchanges and transfers have to be permitted as noted in the district's plan documents.

Impact of Surrender **FEES**

The following shows the impact of surrender fees in various years on a hypothetical annuity balance. The chart assumes the following: a variable annuity of $10,000 with a surrender charge of 6% the first year, declining by 1% per year until it reaches 0%; the annuity earns an average annual return of 5%;* you are allowed to take out 10% of the balance each year not subject to a surrender fee.

	Balance at End of Year	Surrender Fee	Amount Subject to Surrender Fee	Net Balance after Withdrawal	Total Fee
Year 1	$10,500	6%	$9,450	$9,933	$567
Year 2	$11,025	5%	$9,923	$10,530	$495
Year 3	$11,576	4%	$10,418	$11,159	$417
Year 4	$12,155	3%	$10,940	$11,827	$328
Year 5	$13,401	2%	$12,061	$13,160	$241
Year 6	$14,071	1%	$12,664	$13,944	$127
Year 7	$14,775	0%	$0	$14,775	$0

* Annual rate of return is for illustration only and does not represent the return of any specific investment.

To learn more about fees, watch "The Impact of Fees on Your 403(b) or 457 Plan" at **www.CTAinvest.org**.

Working with a Financial Professional

When considering where to invest your 403(b) or 457 plan assets, you should also consider the merits and attributes of the financial professionals representing the 403(b) or 457 plan vendor(s) you're considering. After all, these will be the individuals charged with helping you achieve your financial goals and entrusted with your assets. You'll want to make sure that the financial professional you ultimately select to help manage your assets is knowledgeable, trustworthy and familiar with your retirement plan goals.

What criteria should you use when evaluating a financial professional? Consider asking the following questions to learn about your candidate's attributes.

Q: What are your qualifications?

A: Financial professional should be prepared to discuss their professional training and qualifications, such as whether they've completed training to become a Certified Financial Planner (CFP) or a Chartered Financial Consultant (ChFC). You should look for a professional with proven experience in financial planning for retirement, including on such topics as investments, insurance, tax planning and estate planning. You should also seek someone with specific expertise in 403(b) plans. Also, inquire about how the professional stays current (courses, books, etc.) in his or her field of expertise and ask, "Are you acting as a fiduciary?" (A fiduciary is someone who is legally and ethically bound to put your interests first.)

Q: What experience do you have with 403(b) or 457 plans?

A: Find out how long the financial professional has been advising clients on the specific type of retirement plan you wish to purchase and have him or her describe this experience to you. You want someone with experience addressing retirement needs such as yours.

Q: How do you approach financial planning?

A: Learn how the financial planner handles clients and investment goals similar to you and your situation. Some financial professionals want to get an idea of your complete investment picture; others are more interested in addressing your specific financial planning needs. For example, ask how regularly this professional formally meets with clients. Does he or she do so each quarter, twice a year or annually? Is he/she open to regular calls from clients? Will he or she contact you on a regular basis to inquire about your financial needs? Be sure that the professional's investment philosophy and approach are similar to yours. You literally want to be "on the same page" as the person you ultimately hire to handle your finances.

Q: What type of products and services do you offer?

A: The type of products and services that a professional may offer depend on factors such as the company the individual represents, as well as his/her credentials, licenses and areas of expertise. In general, you want someone more interested in addressing your specific needs, as opposed to trying to sell you a certain product from a specific company.

Q: How much do you charge and how do you charge?

A: Financial professionals are entitled to receive a fee for the services they provide. However, these fees should be fair and comparable to what similar financial professionals charge. The financial professional you're considering should be able to provide you with a general estimate of costs, in writing, before doing any work on your behalf. Many financial professionals provide a complimentary initial visit with prospective clients, as a way to get to know you better, and vice-versa. Financial professionals can be paid in multiple ways:

- **A straight salary** – the professional is paid a salary by the company he/she represents, based on the commission (or fee) you pay on products you purchase from the company.
- **Fees** – based on an hourly rate or a percentage of your assets invested. The advantage of fee-based financial professionals is that they are paid based on a pre-determined rate, not based on the type or amount of product(s) sold, as with a commissions-based financial professional. Keep in mind that professionals who are paid based on a percent of your assets have a vested interest in increasing your assets, since the more your account increases in value, the more income they ultimately receive. It's important to note that they will be compensated more as your account balance grows due to your deferrals and returns, even if they don't provide more work or advice. Those paid a flat fee generally have no conflict of interest.

- **Commissions** – paid by a third-party provider of financial products, based on sales made of the provider's products.

- **A combination of fees and commissions** – for example, fees may be assessed to complete a financial plan, and commissions are paid based on products recommended and sold to you.

The type of fee arrangement that's best for you will depend on your individual circumstances and interests. For example, if you're a savvy investor who had already done considerable research on your available investment options and you know what you want (you simply need someone to execute the transaction for you), you may not want to pay extra for consulting services from a financial professional.

Make sure that the financial professional you're considering specifies his/her compensation arrangement with you in writing. You may also wish to ask if the professional's compensation structure is negotiable. For example, if you're trying to decide between two comparable financial professionals, you might ask the one you prefer if he or she is willing to reduce his/her fees in exchange for your business.

Q: Will I be working exclusively with you?

A: Some financial professionals work alone; others have assistants to help with their work. You should know up-front how your finances will be handled and by whom. If others will be assisting with the handling of your account, you should meet them also, get their names, and assess their qualifications independent of your assessment of the financial professional you're considering.

Q: Who else, besides me, may benefit from your recommendations?

A: If other parties, such as individuals or companies, stand to gain from the recommendations made by your financial professional, you deserve to know this information. Your financial professional should always place your financial interests first. If he/she recommends products and/or services from others, these recommendations should be made because they are in your best interests, not based on the interests of the financial professional and/or the other parties recommended.

In addition to asking these questions, you may also wish to check with federal and/or state agencies charged with licensing the financial professional you're considering. The Financial Industry Regulatory Authority (FINRA) maintains a free national database of firms and brokers licensed to sell securities, called FINRA BrokerCheck, and has information on any disciplinary action taken against specific firms and/or individuals. Go to *http://brokercheck.finra.org* to learn more.

To check on insurance licensing in California, go to the website of the California Department of Insurance at *www.insurance.ca.gov/license-status*. The site allows you to search by individual name and contains information on each individual's continuing education and certification status.

Once you have decided on a financial professional, be sure to keep copies of all documents and correspondence provided by this individual. You should start an online and/or paper-based file to keep track of these records. Not only will this help you keep better track of your financial professional's performance, but it will also serve as a "paper trail" in case any questions, concerns or issues arise during the course of your business with this professional.

Caution about Product Sales

The majority of financial professionals who sell products and provide services related to 403(b) or 457 plans are ethical, trustworthy and deserving of your business consideration. However, as with any profession, there are some individuals who do not reflect well on their profession. Typically, these are sales representatives more interested in making a "quick buck" than in serving your specific financial needs and interests.

How do you recognize such self-serving individuals? For starters, beware of any financial professionals who begin their conversation with you by trying to sell you specific products and/or bragging about the returns of the products they represent, before they have taken the time to get to know you and your financial needs. More than likely, these individuals are more interested in collecting a sales commission than in establishing a long-term relationship with you.

Be cautious also of any financial professional who does not fully disclose answers to any of the financial professional screening questions posed above. In particular, pay attention to the professional's answers to questions on compensation and potential conflicts of interest. You want someone who is working primarily on your behalf, not someone more interested in representing the interests of themselves or others.

Also be careful not to rely too heavily on a referral or recommendation from a friend or colleague. Referrals and recommendations are useful as a starting point when considering whom to hire to manage your money. But know also that less-than-scrupulous financial professionals often seek to ingratiate themselves with those in positions of power, stature or authority, like senior business leaders, government officials or even members of the clergy. They then seek referrals from these individuals as a means to maneuver their way into meetings with sales prospects.

On the positive side, by taking the necessary due diligence screening steps for financial professionals that have been outlined above, including asking the right questions and conducting necessary research, you can be better assured that the financial professional you hire will ultimately be the best choice for your financial needs.

To learn more, request a copy of "Selecting a 403(b)/457 Advisor & Understanding Plan Fees," available at CTAinvest.org

Watch "Finding a Trustworthy Financial Advisor" at **CTAinvest.org.**

Income Options When You Retire

If you're at or near retirement age, you'll want to begin thinking about how to begin tapping your retirement account for income. But don't act too rashly. There are specific guidelines as well as potential tax advantages associated with properly taking distributions from retirement plans such as 403(b) or 457 accounts.

403(b) Distribution Requirements

In general, qualified distributions (distributions without penalty) can be made from a 403(b) plan when one of the following triggering events occurs:

- The employee becomes disabled
- The employee dies
- The employee is under retirement age and leaves employment, but only if the distribution is rolled over into another qualified plan or an IRA
- The employee reaches age 59½
- The plan is terminated; but only if the distributions are rolled over into another qualified plan or an IRA

While most 403(b) plans allow participants to begin tapping their account without penalty at normal retirement age, some plans may allow you to annuitize payments earlier. You should check with your specific plan to see if it qualifies. Distributions made to individuals before they turn age 59½ may be subject to an additional 10% early-withdrawal penalty, but several exceptions to this rule apply. Consult with your tax advisor for details.

Withdraw from Taxable Accounts First

Because a 403(b) plan's earnings potentially grow tax-deferred until withdrawal, it may be in your best interest to postpone your plan distributions for as long as possible (until age 70½). Keep in mind that in general, distributions from a 403(b) account are taxable as ordinary income (at federal income tax rates as high as 35% and California state income tax as high as 9.3%, depending on your tax bracket), which is another reason not to immediately tap these assets.

Instead, it's usually best to withdraw assets from your taxable accounts first. Try to first withdraw taxable assets held for one year or longer, because of their preferential tax treatment. Long-term gains – profits from assets sold after being held for more than a year – are taxed at 15%*, which is lower than the tax for most people on ordinary income. If you sell assets held one year or less, they are taxed at short-term capital gains rates, which are the same as ordinary income tax rates.

At age 70½, the IRS requires that you begin taking required minimum distributions (RMDs) from your tax-deferred retirement accounts. In fact, if you fail to take an RMD by April 1 of the year after you turn 70½, not only will you be required to take an IRS-specified amount out of your retirement account, you may be hit with a 50% excess accumulation tax on the amount of the distribution that should have been taken, but wasn't. In a simplified example, suppose you have a balance in your 403(b) plan of $100,000 and you are subject to RMDs. According to the IRS Uniform Life Expectancy table, you are expected to live another 26.5 years. That means you would need to divide $100,000 by 26.5 and take a distribution of about $3,775. If you fail to take the distribution, you may have to pay a penalty of up to half that amount, or $1,887.50.

When it's time to take RMDs, consult IRS Publication 590: "Individual Retirement Arrangements" available at *www.irs.gov* and check with your tax advisor.

Annuity Distribution Options

If your 403(b) assets are held in an annuity, you will likely have multiple distribution options. You can choose to simply withdraw your earnings (or earnings and principal) in a lump sum, or over a period of time through regular or irregular withdrawals. Or you can choose to "annuitize" your assets, meaning that the current value of your annuity is converted to a stream of payments distributed over a specified period of time (such as for 20 years) or for the remainder of your life and the lifetime of another individual (called a joint and survivor annuity).

If you elect to simply withdraw assets from your annuity periodically, it's almost as if your annuity acts like a bank savings account. Keep in mind that if you're age 70½ or older you will need to take at least the annual RMD in order to avoid penalties. In addition, if you withdraw too much from your annuity, it may not last as long as you had hoped.

If you choose the annuitization option for your annuity, it's impossible to withdraw too much from your annuity, which is why this is also called the guaranteed income option. The amount you receive each month, quarter or year (whichever you choose) from your annuity will depend on the cash value of your annuity, how earnings are credited to your account, the age when you begin receiving payments and the length of the distribution period.

Thus, if you're age 65 and elect to receive monthly payments over the remainder of your lifetime, the amount you receive will be less than if you were to receive monthly payments over, say, a five-year time period.

If the annuity is a fixed annuity with a fixed rate of return, the payments you receive will remain the same over the entire time of the annuitization. If instead you have a variable annuity, your payout amount may vary depending on the market value of the assets in the account. The payment amount is determined by the investment performance of the annuity's investment portfolio. However, the variance in these distribution amounts may likely be minimal, since at retirement your variable annuity account will likely be primarily (or entirely) invested in low-risk and relatively stable-return investments.

Distributions from a 457 Plan

Generally, you can take distributions from your 457 plan only when the following occurs:

- The employee separates from the employer due to death, termination, voluntary departure, retirement, etc.
- The employee is still working, but has attained age 70½
- The employee has an unforeseeable emergency

Distribution options are similar to those for a 403(b) plan. However, there is no 10% tax penalty on distributions before age 59½ (or age 55 if separating from employment), as there is with a 403(b) plan.

*0% for those in the two lowest tax brackets. These rates are scheduled to increase at the end of 2012 unless new legislation is passed.

How 403(b) Regulations Affect You

In the past, finding the information you needed about the 403(b) plans available to you was difficult. Perhaps you found out about these options when you were hired by your district, but haven't received any formal communications since. Maybe you learned about them from co-workers, or the insurance agent selling annuities in the break room, or a friend or family member.

IRS regulations that became effective in January 2009 are intended to move 403(b) plans closer to 401(k) plans in the private sector. Districts will now have to have a written plan document that spells out eligibility for participation, the form and timing of distributions, contracts available under the plan, who is responsible for administration and compliance of the plan, and what optional provisions, such as plan loans or hardship withdrawals, are available. They must also include a list of approved 403(b) vendors. Districts were required to make a best-faith effort to comply with the new regulations on Jan. 1, 2009, but have been granted a grace period to fix errors in the plan's operation.

The regulations also spell out that your deferrals must be submitted within a reasonable period by your employer (generally no later than the fifteenth business day of the month following the month in which the amount was taken out).

Failure to comply with the new regulations is a serious issue and could result in disqualification of the district's 403(b) plan, triggering tax consequences for participants.

What the Changes Mean for You – Technically

Transfers and exchanges will be different under the new regulations. Moving assets between vendors and between 403(b) plans must be permitted by the Employer's Plan Document. An exchange is the movement of your money between vendors that are approved by the employer and noted in the Plan Document. The new regulations require that there be information sharing agreements or a protocol in place between the approved 403(b) vendors and your employer. A plan-to-plan transfer is an in-service transfer of your account balance from one employer-sponsored 403(b) plan to another unrelated employer-sponsored plan (used if you transfer to a new district). Any exchanges or transfers completed that conflict with the IRS regulations can be treated as a taxable event.

In addition:

- Your district is now responsible for and involved in the management of your 403(b) plan, including distributions such as loans and withdrawals.
- Your district's 403(b) plan provisions may differ from benefits you've had in the past.
- You may have a new list of approved 403(b) vendors. If your current vendor is deselected, you will need to find out if there is an opportunity to have them included or choose a new vendor from your list of approved vendors.
- Your district may have contracted with a third-party administrator (TPA) for some of their recordkeeping and compliance work. This cost may be passed on to you directly or deducted from your plan assets. Note that some third-party administrators are affiliated with 403(b) vendors, which can create a conflict of interest.

You can expect to receive an annual notice from your employer informing you of the right to participate in the district's 403(b) plan or change your election if you are a current participant. As noted above, some districts may outsource this communication requirement to a third-party administrator, which may be a potential conflict of interest if the TPA also sells products. CTA has partnered with CalSTRS and its endorsed TPA, 403(b)Comply. This is a TPA that can provide help to districts that need help with the new IRS compliance responsibilities without ties to any 403(b) product sales.

- Since 403(b)s must be universally available, they are, in most cases, open to part-time eligible workers.
- The district's new list of approved 403(b) plan vendors may result in new sales solicitations to you. It's important that you understand the investments available in your plan BEFORE signing up, which is one reason we've developed this booklet and the California Educators Investment and Retirement Guide website at *www.CTAinvest.org*.

Who Does What?

The change in 403(b) regulations may have you wondering who is responsible for what. Here's a quick review.

District

The district is the sponsor for the 403(b) plan and:

- Creates plan document and list of approved vendors
- Offers a 403(b) plan to employees
- Is ultimately responsible for the operation and compliance of the 403(b) plan
- Complies with IRS regulations

Third-Party Administrator (TPA)

May be hired by the district to provide IRS compliance responsibilities, including:

- Remitting employee salary reductions to 403(b) vendors
- Maintaining Information Sharing Agreements (ISA) with 403(b) vendors
- Recordkeeping and other compliance duties contracted by district

403(b) Vendors

403(b) vendors offer various types of products such as fixed annuities, variable annuities and mutual funds through 403(b)7 custodial accounts. They:

- Provide investment options from which 403(b) participants choose
- Employ sales agents to market their 403(b) products
- Examples are Pension2 (CalSTRS), Vanguard, Fidelity, MetLife and others

You

As the 403(b) plan participant, you:

- Elect to participate in a 403(b) plan
- Choose and contribute to one of the 403(b) vendors offered by the district plan sponsor
- Select investment or annuity options available with the vendor you have chosen
- Complete a salary reduction agreement

The District's Third Party Administrator

Many districts have hired a third party administrator (TPA) to help them with IRS regulations, including remitting contributions to various 403(b) vendors. Typically, TPAs charge annual fees ranging from $24 to $36 a year per participant.

Sometimes the TPA is affiliated with a 403(b) vendor. This can create a conflict of interest if the third party administrator is influencing the list of approved vendors available to you. Upon request, a 403(b) TPA must disclose to participants any affiliation or relationship to a 403(b) vendor and disclose to the employer any fees, commissions, markups or promotional items received by a 403(b) vendor.

Under Ed Code Section 44041.5, the TPA should, when requested:

- Disclose affiliations with vendors as well as direct and indirect compensation.
- Provide proof of liability and a fidelity bond.
- Provide proof of a safe chain of custody (fiduciary responsibilities and timely placement of investments).
- Demonstrate that there is a firewall to protect TPA data to be used by TPA affiliated vendors.

So Now What Do I Do?

It's time to put what you've learned in this guide to good use. Here are some steps and decision points to help you make the most of your 403(b) and 457 plan opportunities. When you see this icon ➡, it indicates a "planning pointer" – a resource for more information.

1. Save through a 403(b) or 457 plan

➡ CTAinvest.org video: "Why Participate in a 403(b) or 457 Plan?"

➡ CTAinvest.org consumer guide, "Closing the Gap: Supplement Your Pension Benefits with a 403(b) or 457 Plan" – read pages 2-10

2. Do you want to invest pre-tax (traditional 403(b) or 457 plan) or after-tax (Roth 403(b) or Roth 457 plan)?

➡ CTAinvest.org consumer guide, "Closing the Gap: Supplement Your Pension Benefits with a 403(b) or 457 Plan" – read pages 5, 6, 10 and 11

➡ CTAinvest.org > 403(b)/457 Plans > Roth or Traditional 403(b) or 457 Plan? (http://ctainvest.org/home/403b-457-Plans/403b-457-overview/Roth-or-Traditional-403b-or-457-Plan.aspx)

3. Do you want to invest in a 403(b) or 457 plan or both?

➡ CTAinvest.org video: "Comparing 403(b) and 457 Plans"

➡ CTAinvest.org consumer guide, "Closing the Gap: Supplement Your Pension Benefits with a 403(b) or 457 Plan" – read pages 2-5

4. If you want/need help with your investment choices, how will you get it? Working with a fee-based financial planner? Purchasing directly from a vendor via a call center/toll-free number? Or working with a commissioned agent/representative of a company? Important: Is the person you choose acting as a fiduciary on your behalf?

➡ CTAinvest.org consumer guide, "Selecting a 403(b)/457 Advisor & Understanding Plan Fees":

- Read pages 2-4
- Read pages 8-10
- Ask your advisor the questions on pages 15-18
- Have your advisor complete the information on investments he/she is recommending on pages 20-24

➡ CTAinvest.org video: "Finding a Trustworthy Financial Advisor"

STOP If the advisor will not act in a fiduciary capacity (in your best interests, regardless of his or her own), ask why not.

5. How much will you contribute to your plan?

- In 2013, you may contribute up to $17,500 each to your 403(b) and 457 plans.
- Find out if you are eligible for any catch-up provisions (age 50+ or special catch-up provisions for 403(b) and 457 plans – see chart on page 5).

➡ CTAinvest.org calculators:

- How much can I save in my 403(b) or 457 plan?
- How will my pretax 403(b) or 457 plan contributions affect my take-home pay?
- How much more do I need to save for retirement?

6. Do you want to invest in an annuity or directly in mutual funds?

STOP Equity-indexed annuities are complex investments that generally involve high fees and are difficult to compare due to their complicated indexing formulas. FINRA (the Financial Industry Regulatory Authority) has posted an investor alert on its website (*www.finra.org*).

Variable annuities include subaccounts – basically mutual funds within an insurance contract. Fees may be high because you not only are paying the fees to the insurer, but the fees of the underlying subaccounts. Variable annuities also generally have surrender fees.

Current annuity investors: If you are considering changing your investment(s), see the information about changing investments in the box on page 48.

CTAinvest.org > Investing > Annuities > Beware of Equity Indexed Annuities

- (http://ctainvest.org/home/investing/annuities/Beware-of-Equity-Indexed-Annuities.aspx)

CTAinvest.org video: "The Truth about Variable Annuities"

6a. If you want to consider a variable annuity, check into:

- Surrender fees (how long and how much?)
- Mortality & expense fee (averages 1.25% annually – would you be better off with mutual funds and term insurance?)
- Expense ratio and share class of underlying subaccounts (do they include front-end loads (sales charges) or back-end loads (contingent deferred sales charges))?

CTAinvest.org calculator: How will fees affect my 403(b) or 457 plan savings?

The CTAinvest.org consumer guide, "Selecting a 403(b)/457 Advisor & Understanding Plan Fees":

- Have your advisor complete the information on investments he/she is recommending on pages 20-24

6b. If you want to consider a fixed annuity, check into:

- Surrender fees (how long and how much?)
- Liquidity restrictions
- Insurance company ratings

CTAinvest.org video: "A Look at Fixed Annuities"

The CTAinvest.org consumer guide, "Selecting a 403(b)/457 Advisor & Understanding Plan Fees":

- Have your advisor complete the information on investments he/she is recommending on pages 20-24

7. If you are considering a mutual fund custodial account or 403(b)(7) plan check into the following:

- Target-date funds (built-in diversification and automatic rebalancing of asset allocation over time)
- Choosing your own asset allocation:
- Should you use computer-based models that determine an asset allocation for you (no conflict of interest)?
- Consider professional advice (see step 4)?
- Managed accounts?
- Do you want to invest in actively managed or passively managed funds?
- What is the share class of the fund?
- What is the past performance (consider three-, five-, ten-year and since-inception periods, not just the past year)? (Keep in mind that past performance is not a guarantee of future results.)
- Do you have a copy of the prospectus?

CTAinvest.org videos: "A Look at Target-Date Funds"

CTAinvest.org consumer guide, "Selecting a 403(b)/457 Advisor & Understanding Plan Fees":

- Have your advisor complete the information on investments he/she is recommending on pages 20-24

8. Now review the approved vendors or go to 403bcompare.com. What is the best option for you?

The CTAinvest.org consumer guide, "Closing the Gap: Supplement Your Pension Benefits with a 403(b) or 457 Plan" – read page 31

9. Implement your investment. Be sure you have all the following documents:

- Salary reduction form
- Written plan document
- Prospectus (for variable annuities or mutual funds)
- Contract (for fixed annuity)

10. Review your statements. Rebalance at least once a year if appropriate.

CTAinvest.org > Investing > Setting Your Goals > Position Yourself for Success: Rebalance (http://ctainvest.org/home/investing/Setting-your-goals/Position-Yourself-For-Success-Rebalance.aspx)

CTAinvest.org: Complete "Your Personalized Financial Checklist" to remind you when to review and rebalance your investments as well as other financial tasks.

Do You Want to Change Your Investments?

1. If you want to exchange your contract for a new contract, it is subject to the district's rules.

The CTAinvest.org consumer guide, "Closing the Gap: Supplement Your Pension Benefits with a 403(b) or 457 Plan" – read pages 37-38

2. If you are a current annuity investor and would like to get out of your annuity contract, make sure to find out if there are liquidity restrictions or surrender fees in effect. If there are liquidity restrictions, you may be able to:

- Stop contributing to the annuity and surrender only the allowable amount each year until the liquidity restriction is eliminated.
- Stop contributing to the annuity, leave the current balance in place and redirect future contributions to another investment.

If there are surrender fees, you may be able to:

- Stop contributing to the annuity and wait out the surrender period until it reaches 0% before surrendering the annuity. Redirect any new contributions to another investment.
- Cancel the contract and pay the surrender fees. Then you can transfer your balance to a new provider subject to the rules or provisions in your district's plan.
- Keep contributing to the annuity and cancel when the surrender period is up, provided the surrender period is based on the date of the contract and not on the premium payment dates.

Glossary

Annuity. This is a contract between an insurance company and an individual that generally guarantees a lifetime income option, usually at retirement, in return for either a lump sum or periodic payments. See fixed annuity and variable annuity.

Asset classes. These are the main categories of investments at the most basic level, generally stocks (also called equities), bonds and cash or cash equivalents. When participating in a 403(b) or 457 plan, you will generally invest in mutual funds (should you choose) that incorporate the risk/return profiles of one or more of these asset classes.

Asset allocation. This is the strategy of dividing your money among the three major asset classes. This helps manage risk while you pursue growth, because the three classes tend to react differently to economic conditions.

Beneficiary(ies). The beneficiary or beneficiaries you name when you enroll in your 403(b) or 457 plan are the person or persons who will receive the balance of your account, if any, upon your death.

Bonds. Bonds are loans to a government, state, municipality, agency, institution or corporation. Typically, in return for the loan, the bond issuers agree to pay interest to the bondholder and pay back the principal (the amount paid for the bond) at the end of the bond's term (maturity). With zero-coupon bonds, however, no interest is paid. Instead, the bond is purchased at a discount from its face value to be redeemed at full value at maturity.

Cash equivalents. These are liquid investments (easily sold and converted to cash) that have little or no change in underlying price. Examples are money market or stable value funds.

Compounding. With compounding, earnings on the account (which can be any combination of interest, dividends and capital gains) are added to the principal, increasing the base upon which subsequent returns are earned.

Contribution. This is the amount of money, or percentage of your pay, that you put toward your 403(b) or 457 plan through a salary reduction agreement. The contribution is also sometimes called a deferral.

Defined benefit plan. The traditional pension plan, where the employer and employee make contributions, but the benefit is guaranteed and based on a formula that is consistently applied to all participants in the plan.

Defined contribution plan. This is a plan, like your 403(b) or 457 plan, in which you (the participant) make contributions. The account balance is dependent on the amount contributed and the performance of the investments chosen by the participant.

Distribution. A distribution occurs when you start taking money from your 403(b) or 457, either as a lump sum or in a series of periodic payments. These distributions are generally taxed at ordinary income tax rates. Early nonqualified distributions from your 403(b) plan may be subject to a 10% tax penalty (does not apply to 457 plans).

Diversification. This investment strategy is a step beyond asset allocation. It means to spread your investments among not only the three asset classes, but also among different investments within those classes. In this way, you avoid letting any single investment have an outsized impact on your portfolio. Note, however, that diversification does not guarantee a profit or protect against loss in a declining market.

Dividend. A dividend is a share of the company's earnings that is paid out to stockholders. When you receive dividends within your 403(b) or 457 plan account, they are reinvested automatically for you.

Dollar-cost averaging (also called systematic investing). With this investment strategy, you invest the same amount of money on a regular basis, regardless of what the market is doing. In this way, you help remove emotional decisions from your investment strategy and decrease the impact that timing of the purchase has on your investments, which could be positive or negative. By contributing regularly to your 403(b) or 457 plan, you are taking advantage of dollar-cost averaging. Dollar-cost averaging cannot guarantee a profit or protect against loss in a declining market.

Fixed annuity. This is an annuity that guarantees a minimum return for a specific period, as specified in the contract with the insurance company.

Individual retirement account (IRA). This is a personal retirement account that you can get through a bank, credit union or brokerage account. You may open an IRA even if you have a defined benefit and/or defined contribution plan at work.

Mutual fund. A mutual fund pools money from many investors to purchase stocks, bonds, cash equivalents or some combination that is consistent with the fund's investment objective.

Portfolio. Your 403(b) or 457 plan portfolio is the collection of investments you have in your account. You may also have an investment portfolio outside your employer-sponsored retirement plan.

Principal. This is the amount of money you invest, before earning any interest or dividends.

Prospectus. The prospectus is the legal document that describes a mutual fund's objectives, types of investments and major holdings, risks and management style. It is important to read the prospectus before investing to see if the fund is appropriate for your goals, timeline and risk tolerance.

Re-allocation. Re-allocation occurs when you change your contribution strategy based on a change in your goals, timeline or risk tolerance. For example, you may decide that, as you near retirement, you want to re-allocate your contributions from 70% in a stock fund and 30% in a bond fund to 50% in a stock fund and 50% in a bond fund.

Rebalancing. This is the act of returning your investments to your original asset allocation if it has changed due to market performance.

Stable value investments. These types of investments are considered lower risk than stocks, and are generally high-quality, low-maturity bond funds that offer a steady investment value through the use of an insurance contract. Stable value funds typically stress preservation of capital and provide a steady stream of income.

Stocks. Shares in the ownership of a company are called stocks or equities. You can buy shares of stock in an individual company or through investment in a stock mutual fund.

Tax deferral. The major benefit of 403(b) and 457 plans, it allows funds within the plan to grow without being reduced each year by taxes. Taxes are paid at ordinary income tax rates when distributions begin at retirement.

Third-party administrator. An entity hired by the district to handle salary remittances to 403(b) vendors and other compliance and recordkeeping duties as assigned.

Variable annuity. This is an annuity (contract with an insurance company) in which the performance of investments in a subaccount determines the return.

Volatility. This is the fluctuation in prices of an investment over short periods of time.

Questions to Ask Agents Who Sell Investments

- Are you acting in a fiduciary capacity? If not, why not?
- Are you registered with a state securities regulator?
- Are you registered with the Securities and Exchange Commission?
- What is your disciplinary/arbitration history?
- What is your training and experience?
- How long have you been practicing?
- Are you limited to the types of products and services you can recommend to me? If so, why?
- Do you have any securities licenses? If so, which?
- Tell me about your investment philosophy and typical clients.
- May I see a list of references?
- How are you paid? Fee-based or commission-based? Are you in a sales contest?
- Do you have any conflicts of interest here?
- Are you an independent agent (who represents various companies), or are you an employee of an insurance company or 403(b)/457 provider?
- What are your credentials? Are you a ChFP (Chartered Financial Professional), CFP (Certified Financial Planner) or AIF (Accredited Investment Fiduciary)?

Additional Notes:

Be sure to get the information in writing, including the advisor's basis for recommending certain investments and disclosure of fees and penalties.

Questions to Ask Before Investing in a Product

- Is it registered with the SEC and my state securities agency?
- How will it make money? Specifically, what must happen for this investment to increase in value? How much will fees affect the amount of money it will make?
- What are the total fees to purchase, maintain and sell this investment? After all the fees are paid, how much does this investment have to increase in value before I break even?
- What are the specific risks associated with this investment? What is the maximum I can lose?
- What are my retirement income goals and needs?
- What is my risk tolerance?
- How long until I retire?
- Are all of the fees and risk associated with this investment disclosed in writing?
- What is the historical performance of this investment?
- Does this investment make sense for me in light of what I've learned about my goals, risk tolerance and timeline?

Additional Notes:

Risk Tolerance Quiz

1. I plan to use the money I am investing:

a) Within 1-2 years

b) Within 3-5 years

c) In 6-10 years

d) No sooner than 11 years from now

2. I expect that my future income from wages will:

a) Decrease

b) Remain about the same or go up a bit

c) Increase faster than inflation

d) Increase rapidly

3. In the event of a job loss or medical or other emergency, I have:

a) No emergency savings

b) Some savings, but less than three months' worth

c) At least three months' worth of savings

d) More than six months' worth of savings

4. My most important investment goal is to:

a) Preserve the money I have at the expense of growth potential

b) Receive some growth and some income

c) Grow my investments somewhat faster than the rate of inflation

d) Grow my investments much faster than the rate of inflation, even if it means greater risk to my principal

5. Of my current investments, I have this much invested in stocks or stock mutual funds:

a) Less than 15%

b) 15-39%

c) 40-70%

d) More than 70%

6. When I invest my assets in stocks or stock mutual funds, I feel mostly:

a) Anxious

b) Cautious

c) Comfortable

d) Confident

7. Which would you rather have:

a) 100% chance of receiving $1,000

b) 50% chance of receiving $5,000

c) 25% chance of receiving $20,000

d) 5% chance of receiving $100,000

Give yourself one point for each "a" answer, two points for each "b" answer, three points for each "c" answer and four points for each "d" answer.

Scoring

If you scored between 25 and 28 points, consider yourself an aggressive investor with a very high risk tolerance. An aggressive investor is someone who is willing to accept a high degree of investment risk in exchange for the chance to earn a dramatically higher rate of return.

If you scored 20-24 points, you have an above-average risk tolerance and could be considered a moderately aggressive investor, or one who is willing to accept a greater degree of risk for the chance to earn an above-average return.

If you scored 15-19 points, you are likely a moderate investor with an average tolerance for risk. This means you're willing to accept some risk in exchange for a potentially higher rate of return.

If you scored 10-14 points, consider yourself a conservative investor with a below-average tolerance for risk. This indicates that you're likely unwilling to accept a greater degree of risk in exchange for the chance to earn a higher rate of return.

If you scored less than 10 points, you may think of yourself as a very conservative investor. Chances are you cannot afford to lose any amount of your principal assets and/or you do not wish to take on much risk at all with your investments.

About Individual Retirement Accounts

Individual retirement accounts (IRAs) offer another tax-advantaged way to save for retirement outside of your 403(b) or 457 plan. IRAs are available through banks, credit unions, brokerage houses and mutual funds. Be sure to ask what investments are available (for example, if your credit union does not offer investment services, you may only be able to put your IRA money into an insured IRA certificate), what the minimum opening deposit is, what the minimum contributions are and what fees are charged.

You can choose – on your own or with the help of a financial advisor – from literally thousands of stocks, bonds and mutual funds, as well as cash, certificates of deposit and money markets. You can even keep investment real estate in your IRA. There are some prohibited investments, though. For example, you cannot put collectibles, such as art or antiques, in an IRA.

Two Types: Traditional and Roth

Both types of IRAs provide potential tax benefits. Which you choose will depend on a number of factors, including your current tax rate and the tax rate you anticipate in retirement. There is no crystal ball that will tell you which is better, because tax rates may go up or down before you retire. For some individuals, having some money in each type may help provide withdrawal and tax flexibility in retirement.

The following page explains the features, benefits and restrictions on traditional and Roth IRAs.

Traditional IRA vs. Roth IRA

	Traditional IRA	Roth IRA
Taxation of contributions	Tax-deductible (subject to certain conditions)	After-tax
Taxation of investment earnings	Tax-deferred	Tax-free (after age 59½ and 5 years)
Maximum contribution (2013)*	$5,500	$5,500
Maximum catch-up contribution**	$1,000	$1,000
Deductibility/eligibility	Deductibility dependent on whether covered by employer plan and, if so, MAGI***	Eligibility dependent on MAGI***
Required minimum distributions	Age 70½	No required minimum distribution during original account holder's lifetime
Early withdrawal penalties	10% before age 59½, with some exceptions	None on contributions; earnings withdrawn before age 59½ and 5 years subject to taxation and 10% penalty, with some exceptions
Exceptions for 10% penalty for withdrawals before age 59½	• Death • Disability • Certain distributions for higher education • First-time home purchase • Certain medical expenses • Annuitized payments	• Death • Disability • Certain distributions for higher education • First-time home purchase • Certain medical expenses • Annuitized payments

* Or adjusted gross income, whichever is less. Annual contribution limit for 2013; indexed to inflation in future years.
** For individuals age 50+.
*** MAGI - modified adjusted gross income.

Learn more about IRAs at www.CTAinvest.org.

Resources

- California Educators Investment and Retirement Guide at *www.CTAinvest.org*. An education and information resource developed by the California Teachers Association to help you make informed choices about your finances and retirement planning. Includes calculators, videos and other tools about financial topics, and more.

- CalSTRS at *www.calstrs.com*. For information about your CalSTRS defined benefit pension, workshops, calculators that can help you estimate your pension benefits and more.

- CalPERS at *www.calpers.ca.gov*. For information about your CalPERS defined benefit pension, benefit calculators and more.

- 403bCompare at *www.403bcompare.com*. To find the vendors available in your district and research the products they are selling, including fees.

- Financial advisor websites, including *www.cfp.net* and *www.napfa.org*.

- Financial Industry Regulatory Authority (FINRA) at *www.finra.org* for background information on financial professionals and information about mutual funds and variable annuities.

- Securities and Exchange Commission at *www.sec.gov* for investor protection information.

- A.M. Best at *www.ambest.com*, Moody's at *www.moodys.com* and Standard & Poor's at *www2.standardandpoors.com* for independent financial ratings of insurance companies.

Visit www.CTAinvest.org.

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