Let's Talk About 403(b) Plans - Transcript

Tom Mullooly: Welcome back to the Mullooly Asset Management Podcast. This is episode number 278. I am one of your co hosts, Tom Mullooly.

Tim Mullooly: This is Tim Mullooly here with Tom today.

Tom Mullooly: Hey, Tim.

Tim Mullooly: Hey. There's a couple things that we wanted to talk about today. I think it's time that we talk a little bit about 403(b)s.

Tom Mullooly: It's something that there's a lot of listeners who may be involved in a 403(b) at work or someone they know is involved in a 403(b). We have friends of the firm, the Isola's, who do a lot of work on this. I find myself often retweeting some of their excellent posts. All I'll say on Facebook and Twitter is if you know a teacher, share this with them.

Tim Mullooly: Right. Yeah. I interviewed Dina Isola, Dina and Tony. I saw our advisors at Ritholtz Wealth Management, but I interviewed Dina on living with money. You can go check out that episode as well, but we talked about all of their work with 403(b)s. Like Tom said, if you know a teacher, odds are they are participating in some capacity in a 403(b) plan. Some of the practices that are going on, which we'll get into, are less than ideal for the teachers. It's kind of disappointing.

Tom Mullooly: The greatest disinfectant in the world is sunlight. If you get a little sunlight on some areas like 403(b)s, you're going to find a lot of things that you don't like. Now, when you interviewed Dina, it was not long after she had a given a testimony to congress.

Tim Mullooly: Right? Yeah. They were interviewing her or she was testifying about this regulation best interest or Reg BI. She was talking about some of the practices that go on within 403(b) plans and how they're not required to act in the client's best interest. Unfortunately, Dina expressed that her testimony wasn't really welcomed with open arms by the members of congress, and she was kind of frustrated by the reception that she got from the people in congress, but she also said it motivated her to continue spreading or exposing what is going on in some of these plans.

Tom Mullooly: It's a long road, but it will be worthwhile because what they're doing by exposing some of the sales practices in this industry are really going to help individual investors, teachers, nurses, other people who were involved with 403(b) plans at work. I think it's worth it to just talk briefly about what a 403(b) plan is. Now, 403(b) is the section of the IRS tax code that permits these kind of plans.

Tim Mullooly: Right. It's a pretty much like a 401(k) for teachers.

Tom Mullooly: In fact, we've had people who say, "Yeah, a 401(k) or a 403(b), they're the same thing."

Tim Mullooly: Right. People kind of interchange them because in a sense, it's the workplace retirement vehicle for teachers and some other types of employees as well, but mainly teachers is what we see here.

Tom Mullooly: It's interesting that people call them, "I have a 403(b) annuity.

Tim Mullooly: Right, yeah, I was going to I was going to say that.

Tom Mullooly: Sorry I stole your line there.

Tim Mullooly: Some people just add annuity onto the end of it because that's how common these annuities within the 403(b) plans have become. It's unfortunate because you don't need to invest your money in a 403(b) plan into an annuity. I forget the exact number, but I think something like 70... Dina said like 70 or 75% of assets within 403(b)s are in some type of annuity.

Tom Mullooly: All right. I just want to hit the pause button on this and just remind people that a 403(b) plan is a tax shelter plan, so you're not paying taxes on it. Why in the world would you put a tax deferred investment, like an annuity, into a tax deferred account like a 403(b)?

Tim Mullooly: Right.

Tom Mullooly: That's it's like buying a tax-free bond in an IRA. Why would you ever do that? It shouldn't be allowed.

Tim Mullooly: That's what Dina said too. She was like it shouldn't be allowed.

Tom Mullooly: I'm tripping all over you in this podcast.

Tim Mullooly: No. No. I mean, you're hitting the nail on the head though. You're not getting any extra tax deferred... You're not getting like enhanced tax deferred coverage by having this annuity within a 403(b) plan. It's just really redundant. As we've talked about before on videos and podcasts, annuities are sold because they come along with some nice high fees for the people that sell them.

Tom Mullooly: Let's kind of break this down and bring it to a local level so folks can understand how this happens. 403(b) plans are basically permitted. I wouldn't even say set up by, but permitted by school districts. What happens is a school board will decide, "Our school district is going to have three different vendors in our 403(b) plan area, or we're going to have five different vendors." It's usually just a handful. It's not unlimited.

Tim Mullooly: Right.

Tom Mullooly: We'll see a couple of the same players over and over in school districts. If you are appointed as one of the vendors, say it's an insurance company, I don't know, rhymes with Alec or something like that, or something like that. Anyway, but these reps are essentially inviting themselves in to sit in the teacher conference room. They kind of grease the wheels with bringing a box of donuts, and they hang out in the teacher conference rooms talking to all of their targets.

Tim Mullooly: Yeah.

Tom Mullooly: That's what they are.

Tim Mullooly: Yeah, unfortunately.

Tom Mullooly: Talk to their targets about saving money for retirement. Now, these teachers...

Tim Mullooly: "Saving money for retirement."

Tom Mullooly: Yeah, saving money. These teachers will often have a pension. This is a supplemental way to save money.

Tim Mullooly: It makes me cringe a little bit like picturing something like that because I know a lot of teachers and I know how busy they are all the time with making lesson plans, grading papers. The school day doesn't just end and your day's done. Teachers, they're busy all the time. I know how important it is to save for retirement, and a lot of these teachers just don't have the time to do the research on their 403(b) plans. They just assume that the person coming in is there to help.

Tom Mullooly: Right.

Tim Mullooly: It's really unfortunate and it's slimy. Some of these vendors that come in, they're not there to help. They're there to sell on unsuspecting teachers.

Tom Mullooly: What makes it worse is that we've read stories where the agent will say, "Your school district sent me in here," so it implies that day we're endorsed by the district when there could be nothing further from the truth with that. That's just a springboard to let's see what else you got in terms of investment assets.

Tim Mullooly: Right. Yeah. I mean, these vendors coming in, it opens the door to the conversation of whether or not these people are fiduciaries, and they're not there. Most times they're not. I mean, the normal everyday person would think that naturally this person has my best interest in mind. They're not just trying to sell me some garbage.

Tom Mullooly: To be fair, the folks that work for these firms don't think that they're selling garbage. They think that they're selling something that is really going to help their clients, but they couldn't possibly be a fiduciary if they're recommending putting an annuity of a retirement account.

Tim Mullooly: Right. Oftentimes Dina and Tony have outlined how these annuities and products within the 403(b)s are not sold accurately or in a forthright manner. People will come back to them and say, "Well, I was told I'm not paying any fees," and then Tony and Dina have to break down the statements and find where the fees are located. Even sometimes for them it's hard to find in the 10 to 12 page packet that they give you like where the fees are outlined. Sometimes you even have to call a line to figure out how much you're paying. But at the end of the day, you are paying fees and oftentimes they're pretty steep.

Tom Mullooly: It's overwhelming all of the information that you get. It's a blizzard of paperwork that you get one once you get enrolled in a 403(b) plan. You're right in the sense that they're in many cases less than forthright, but you also have to stop and ask yourself, why would this person be hanging out with donuts in my conference room or in my teacher break room? No one works for free. They're getting paid somehow, and they're getting paid pretty well. Do you want to talk about like some of the horror stories we've heard where people are putting money in on a monthly basis attached with some of... A lot of annuities are surrender periods and surrender charges.

The surrender charge is basically if you want to get out of the product that you're entering the, the annuity, if you do it within five or seven years of buying it, there's a charge that you have to pay to get out. Once you get out of that period, the charge goes away, so you can get out of it for free. It's usually some kind of declining surrender charge so that in year one it's say 5%, then four, then three, then two, then one.

Tim Mullooly: Right. Yeah, to deter you from buying it and jumping out the next year. You get I guess you could say rewarded for holding onto it for a longer period of time.

Tom Mullooly: We can have another podcast about that.

Tim Mullooly: Yeah, that's not a great forward. The catch is for a lot of these annuities there, the surrender period gets restarted every time you make a contribution into the account, into the annuity. People have their contributions getting taken directly from their paycheck. Every time money comes out of their paycheck and goes into their 403(b) that goes into the annuity, the surrender period starts over again.

Tom Mullooly: Basically if you're getting paid twice a month, you're kicking the can further and further and further down the road where you'll basically never be able to walk away cleanly without any kind of surrender charge unless you wait an additional seven, eight, nine years after your last contribution.

Tim Mullooly: Right. Yeah. You stop teaching, you stop getting a paycheck, then the clock actually starts.

Tom Mullooly: You could be 90 at that point. That's a long way off in the future. Some of the folks that are getting into these programs are new teachers, so they're in their twenties, just out of school getting started. Oh boy.

Tim Mullooly: We're making it sound like 403(b)s are like the worst thing in the world, but they're not. I mean, there are just things that you need to learn about them there. It's pretty much just like a 401(k). You just need to know, you don't have to put your money into an annuity. There should be other options within the plan. Take the time to read up or at least ask someone else who might have a better idea before you enroll.

Tom Mullooly: I think one of the most eye-opening points that we can make when we're speaking with clients about a teacher retirement plan, whether it's theirs or someone they know, these are not ERISA plans.

Tim Mullooly: Right.

Tom Mullooly: If you have a 401(k), plan administrator has a fiduciary obligation, and it's serious. I mean, they have to post a big bond for the value of the account to make sure that they behave in the best interests of their plan participants. They have to act as a fiduciary. There is no fiduciary obligation with a 403(b) plan. It looks like a 401(k), looks like it walks like it talks like it, not a 401(k) plan. It's 403(b), not an ERISA plan. Most of them.

Tim Mullooly: Most of them.

Tom Mullooly: There are some ERISA 403(b) plans, but I've seen very few of them.

Tim Mullooly: Like I said before, unfortunately a lot of the participants are unsuspecting teachers who just don't have the time to look into this, but it really would save you a lot of headaches and probably a lot of money if you do take the time to look into it before you get going.

Tom Mullooly: The fees that are compounded every year will often outstrip the gains that you make right in some of these plans.

Tom Mullooly: Tim, in the rest of the time we have for episode 278, there was something else that you wanted to cover.

Tim Mullooly: Yeah. Kind of along the same lines of a 403(b). This article is talking about saving for retirement. It was an article in Forbes about like the formulas that you use to determine how much you need to save for retirement are broken. They started out by talking about the formula that they said general rule of thumb has been multiply your expected annual expenses by 25 and that's how much you're going to need in retirement. They also talked about the 4% withdrawal rate and got into how these aren't necessarily the case anymore, but we wanted to give our own take on it.

Tom Mullooly: Yeah, let's take these one at a time. The whole idea where you're multiplying your annual expenses by 25, I think we can poke a few holes in this.

Tim Mullooly: Yeah. I mean, that's assuming that your retirement is only going to last 25 years.

Tom Mullooly: What do you do when you're 91?

Tim Mullooly: Right. Let's say you work until you're 65 and then you retire, meaning you completely stop working, and then you just assume that your retirement is going to be 25 years and you're going to die when you're 90. Yeah, good question. What do you do if you live until you're 97.

Tom Mullooly: Right. The other thing is the amount of money you spent on food shopping last year, is it the same as what you spent this year?

Tim Mullooly: Right. Probably not. Are you going to be living the same lifestyle in retirement or maybe you're going to do things differently? How do you use...

Tom Mullooly: Don't know.

Tim Mullooly: It's tough to say that that's... Again, these are general rules of thumb. I don't even think they should be rules of thumb, but it's...

Tom Mullooly: A bad thumb.

Tim Mullooly: Yeah. Yeah. It's a broken thumb.

Tom Mullooly: It's a broken thumb. That's right.

Tim Mullooly: You need a cast.

Tom Mullooly: There's no room for inflation in a formula like that.

Tim Mullooly: Right.

Tom Mullooly: Right before we turned the microphone on, I was talking about how 25 years ago we bought a minivan when the family was growing. It was brand new. Sticker price was $21,000. I think if we were to try and buy the same car today, a brand new minivan, it would be something in the mid forties. You have to assume some kind of inflation. If you're just taking your expenses using that formula and multiplying it by 25, either you're going to run out of money or you can only buy half of what you used to buy. Half a loaf I guess is better than none, right?

Tim Mullooly: Right. Yeah. I guess it is, but wouldn't you rather have the whole loaf of bread?

Tom Mullooly: Shouldn't you buy two now and freeze one?

Tim Mullooly: I guess, yeah. I mean, if you're going to run out of money, yeah, that's probably the good idea.

Tom Mullooly: Then we won't have enough money to pay the electric bill, so we can't put it in the microwave and thaw it.

Tim Mullooly: I think when it comes to saving for retirement and personal finances in general, rules of thumb are not very helpful because they're meant to be applied to the masses and that just doesn't work.

Tom Mullooly: Tim, you've worked on so many plans here at Mullooly Asset Management. For our clients who are going through retirement, how many plans have looked identical? Identical.

Tim Mullooly: None. Absolutely zero.

Tom Mullooly: No two plans are the same.

Tim Mullooly: Because no two people are the same. It's that easy. I mean, just using these like basic rules that, oh, everyone does it this way, it's like, well, no, they don't. The same thing with the 4% withdrawal rate.

Tom Mullooly: Yeah, Let's talk about that.

Tim Mullooly: I mean, first off, everyone starts with a different balance in retirement. Everyone spends a different amount. 4% of what I have saved for retirement could be way different from 4% of what you have saved for retirement.

Tom Mullooly: That's true. The way that the 4% rule was originally written was the first year you're retired, take your retirement balances, take a 4% distribution, and that's the amount that you should be withdrawing each year. Because if you do 4% each year, you're going to get a different balance every year. But what they're saying is take 4% over...

Do the math. Four into a hundred is 25. It's really the same formula. It's 25 years and they're doing this. I'll also add that this 4% rule became really popular in the late 1980s. The market, the stock market, that we had through that period was very, very different than what we're sitting through now. We can't even guess what the returns are going to be like in the next five, 10, 15 years.

Tim Mullooly: I was just talking about how I think rules of thumb are stupid, but if it's using the 4% rule versus just flying by the seat of your pants and having absolutely no plan and just saying like, "I'm going to spend what I spend and that's how it's going to work," I would rather you use the 4% rule. It's a decent starting point I guess, but you really need to break it down and figure out what you want to do and especially because retirement now is changing for people. I mean, how many people are actually working until exactly 65, retiring, and then never working again? Some people might "retire" and take on a part time job and still have money coming in, or they might retire when they're 55 and never work again, or they'll take some time off and then start working again.

Tom Mullooly: We're seeing people getting aged out of their job at 58, 61, and they can't find work. They're really not ready yet. Then what do you do? You're still years away from being able to tap into social security. Now what? It's a real problem, and it's not something that you can basically just do on the back of an envelope. It doesn't work that way.

Tim Mullooly: No, it doesn't.

Tom Mullooly: We've seen variations on this where people use the 3% rule. It can't be a rule if people are just winging it, but they call it a 3% rule or you use a 3% distribution rate. Same premise. If at the time you start retiring, whatever age that is, if you retire at say 65 and take 3% in that first year and that's the number you take out, well, now you're preparing for 33 years of retirement. Now, that takes you to 98. That's going to cover a lot. The other thing I'll just throw in is that we know because we've seen a lot of folks, 67, 68, 69, 71 years old going on big trips and things that they never did while they were working, but you don't see too many 87 year olds going on month long cruises.

Tim Mullooly: Yeah. That's why I think taking just like a static number every year might not... Straight line all the way through retirement isn't necessarily practical because some people retire and then they want to cross so many things off their bucket list while they're still relatively young and they can travel and they can spend a lot of money. We see expenses go up a lot in the first handful of years in retirement, and then it significantly slows down once they have gotten it all out of their system and kind of want to slow down and just relax. It's hardly ever a straight line from year one in retirement to the end date.

Tom Mullooly: Right. I know that the article that we kind of used as a springboard to this discussion was geared at the 4% rule, and they started talking about some of these FIRE folks.

Tim Mullooly: FIRE, meaning financially independent, retire early. These are people that are saving a good amount of money while they're young in their thirties and forties, and then "retiring" in their forties like by the time they're 50. 45 to 50 just retiring.

Tom Mullooly: These are not the people who buy these little miniature houses that we see on HGTV.

Tim Mullooly: No, it could be. The media kind of polarizes the FIRE movement, and you see all of the articles that are written are about the extreme cases. No one's going to write an article about like someone who is trying to retire early, but they're just going about it like kind of conservatively like, oh, we cut down to one car as opposed to two.

Tom Mullooly: Makes sense.

Tim Mullooly: Or like we downsized a little bit in our house. We went from a two story place with two car garage to just like a smaller house. It's not sexy to write about someone doing something conservatively like that. You want to write about the extremes. It gets a bad rap, but majority of people that identify as FIRE or the early retirement people are not saving 95% of their money and eating cans of beans for 10 years.

Tom Mullooly: I think there's a bigger population of wannabe pyros. I mean, people who basically want to be retired early, but they're just being super practical about it and not splurging. Nothing wrong with that. Yeah, I think those are good habits yeah to have anyway.

Tim Mullooly: Right. I never really understood why those early retirement people get criticized for not spending a lot of money and saving money. Is that a bad thing?

Tom Mullooly: No, I actually that's what we...

Tim Mullooly: That's what more people should do.

Tom Mullooly: We encourage people to do that.

Tim Mullooly: Right.

Tom Mullooly: Well, this is episode 278, which is a horrible road in New Jersey.

Tim Mullooly: Right. We were confused before we started recording cause there is one 287 and 378, but I'm pretty sure both of them are bad.

Tom Mullooly: Which is equally horrible. Well, thanks for listening to the good episode 278, and we will catch up with you in episode 279. Thanks for listening.