

# **TSA Handbook**

## **403(b) And 403(b)(7) Tax Sheltered Accounts**

### **Tax Deferred Retirement Plans**

#### **Irving ISD**

## **Wants You To Know About The Advantages**

Administered By:  
National Plan Administrators  
PO Box 161630  
Austin, TX 78716  
800-880-2776  
[www.NatlPlan.com](http://www.NatlPlan.com)

# Basic Information

## 403(b) and 403(b)(7) Accounts

### “The TSA”

#### **Tax Sheltered Account**

A Tax Sheltered Account (TSA) is otherwise known as a 403(b) plan. 403(b) is a section of the Internal Revenue Code that provides for a Voluntary Tax Deferred Retirement Program. Participation is limited by law to employees of public educational organizations and certain nonprofit organizations [501(c)(3) companies]. The vast majority of participants are teachers in public schools, colleges, and universities.

The contributions to a TSA are made for the participating employee by his/her employer. The money that is contributed usually comes from employee contributions, called elective deferrals. The elective deferral is deducted from the participant’s gross pay and forwarded to the Provider (insurance company or mutual fund custodian) which is selected by the participating employee. The participating employee signs a salary reduction agreement, giving the employer the authority to make the paycheck reduction and remits the moneys to the Provider chosen by the participant.

#### **Why Consider Setting up a TSA**

Two main reasons for participating in a TSA are: 1) reducing your current tax expense, and 2) building a retirement pool with tax deferred compounding. Let’s demonstrate the advantages by exploring a couple of examples. Mary V. Smart and her spouse John N. Smart are teachers. Both Mary and John make \$24,000 per year in annual salary. Mary decides to invest \$100.00 per month into Hope TSA fund as a retirement plan. John does not start a TSA but decides to save \$100.00 per month in the Local Savings and Loan. Both Mary and John do this faithfully for twenty (20) years. Let’s look at their monthly paychecks.

	Mary V. Smart	John N. Smart
Gross	\$2000.00	\$2000.00
TRS	\$128.00	\$128.00
TSA	\$100.00	\$0.00
Taxable Income	\$1772.00	\$1872.00
Tax	\$221.66	\$236.66
Savings	\$0.00	\$100.00
Net Pay	\$1550.34	\$1535.34

At first glance you will notice that Mary has more disposable income than John does. She is taking home \$15.00 more a month than John. Remember, if they do this for twenty years, that’s  $(\$15 \times 12 \times 20)$  \$3,600.00.

Let’s assume that both accounts earn at a rate of six per cent (6%) per year and review the differences. The first major difference is that John receives an IRS form 1099 for his interest earnings. He must pay taxes annually on his interest.

The most significant difference is that Mary's account is compounding tax deferred.  
Account Values over time:

	Mary	John
1 <sup>st</sup> year	\$1,233.35	\$1,224.16
2 <sup>nd</sup> year	\$2,543.30	\$2,502.81
20 years	\$46,204.09	\$32,806.00

Which investor do you want to be? Should you participate in a TSA plan? Mary does have to pay taxes when she takes her money out; however, she has a lot more money to work with and will probably be at a lower tax rate.

The Texas Teacher Retirement System will provide generous benefits. However, chances are that your retirement plan will not provide enough income after retirement to enable you to maintain your standard of living. A TSA allows you to accumulate a retirement nest egg on a highly tax-favored basis.

Congress has provided you a powerful tax break with Section 403(b). Combine that tax break with tax free accumulation and compound interest, and it permits large sums of money to be accumulated over a period of years. An intelligently planned and funded TSA, together with teacher retirement, can afford you a comfortable retirement.

## Summary of Retirement Plan Issues in the Economic Growth and Tax Relief Reconciliation Act of 2001

Provision	Old Law	New Law																														
403(b) and 401(k) Elective Deferral Limits	Current deferral limit is \$10,500. Employees of qualified employers may contribute up to an additional \$3,000/year after 15 years of service.	\$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006 (indexed in \$500 increments thereafter)																														
“Catch-up” opportunities for individuals aged 50 or greater	None under current law.	Individuals aged 50 or more who participate in 403(b), 401(k), governmental 457(b) plans or SIMPLE plans have increased limits as follows: <table style="margin-left: auto; margin-right: auto; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Year</th> <th style="text-align: left;">403(b)</th> <th style="text-align: left;">401(k)</th> <th style="text-align: left;">457(b)</th> <th style="text-align: left;">SIMPLE</th> </tr> </thead> <tbody> <tr> <td>2002</td> <td></td> <td>\$1,000</td> <td></td> <td>\$ 500</td> </tr> <tr> <td>2003</td> <td></td> <td>\$2,000</td> <td></td> <td>\$1,000</td> </tr> <tr> <td>2004</td> <td></td> <td>\$3,000</td> <td></td> <td>\$1,500</td> </tr> <tr> <td>2005</td> <td></td> <td>\$4,000</td> <td></td> <td>\$2,000</td> </tr> <tr> <td>2006</td> <td></td> <td>\$5,000</td> <td></td> <td>\$2,500</td> </tr> </tbody> </table> <p>* In 401(k) plans, “catch up” contributions are not considered when applying the ADP test.</p>	Year	403(b)	401(k)	457(b)	SIMPLE	2002		\$1,000		\$ 500	2003		\$2,000		\$1,000	2004		\$3,000		\$1,500	2005		\$4,000		\$2,000	2006		\$5,000		\$2,500
Year	403(b)	401(k)	457(b)	SIMPLE																												
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Maximum Exclusion Allowance (MEA)	403(b) plans: cannot exceed the individual’s MEA.	Repealed in 2002. For 2000 and 2001, the MEA is amended to eliminate prior defined benefit contributions from the “prior contributions” portion of the MEA calculation.																														
415 (c ) Limit	Lesser of 25% of compensation or \$35,000. Employees of qualified employers offering 403 (b) plans are eligible to use special A, B, and C elections to increase normal limit.	Lesser of \$40,000 or 100% of compensation and indexed in \$1,000 increments thereafter.  Special A, B, and C elections are repealed.																														
Roth-Type 403(b) and 401(k) Plans	None under current law. Only Roth IRAs are permitted.	Employees could elect to treat all or any portion of their elective deferrals into 403(b) or 401(k) plans as Roth contributions with rules similar to Roth IRA. <ul style="list-style-type: none"> <li>• 401(k) plans: the Roth-type employee contributions are included as “pre-tax” contributions for purposes of the ADP test.</li> <li>• Separate accounts required for Roth and non-Roth contributions to the same plan.</li> <li>• This provision is not effective until 2006.</li> </ul>																														

Provision	Old Law	New Law												
Pension Portability	Amounts in qualified plans and 403(b) plans may only be rolled over into plans of the same type, or into IRAs. 457(b) plans may not be rolled over into any type of plan or IRA.	<p>Rollovers from 401, 403(b), governmental 457(b) plans and IRAs may be made into any other 401, 403(b), governmental 457(b) plan or IRA without regard to the type of plan distributing the rollover.</p> <ul style="list-style-type: none"> <li>• Amounts rolled into a governmental 457(b) plan from an IRA, 401(a) or 403(b) would be subject to the 10% early distribution penalty tax.</li> <li>• Amounts originally contributed into an IRA may be rolled over into qualified plans, 403(b) and governmental 457(b) plans.</li> <li>• Surviving spouses could rollover distributions into their own 401, 403(b), IRA or governmental 457(b) plan.</li> </ul>												
403(b) and 457 Buy Back of Past Service Credits	No provision.	Employees of governmental employers may transfer assets from 403(b) and/or 457(b) accounts to state defined benefit plans to purchase past service credits.												
Retiree Contributions to 403(b) Plans	No statutory provision, however there are two private letter rulings that permit post retirement 403(b) contributions under certain circumstances.	Employers are permitted to make contributions into 403(b) plans for terminated employees for a period of up to 5 years, using final 12-month salary as basis for post-employment 415(c) limitation calculations.												
Hardship Withdrawal Safe Harbor	Participants must not make elective deferrals into 403(b) or 401(k) plans for 12 months after taking hardship withdrawal from plan.	The suspension period for elective deferrals after making a hardship withdrawal is reduced from 12 months to 6 months.												
Tax Credit for Low Income Savers	No provision.	<p>Nonrefundable tax credit for low/moderate income savers who make salary reduction contributions into 401(k), 403(b), 457(b) or IRA plans. Credit is claimed on Form 1040 and applies to first \$2,000 of contributions. The credit is based on the following AGI schedule:</p> <table border="1" data-bbox="857 1507 1510 1640"> <thead> <tr> <th>Credit</th> <th>Individual</th> <th>Joint Return</th> </tr> </thead> <tbody> <tr> <td>50%</td> <td>\$0-\$15,000</td> <td>\$0-\$30,000</td> </tr> <tr> <td>20%</td> <td>\$15,001-\$16,250</td> <td>\$30,001-\$32,500</td> </tr> <tr> <td>10%</td> <td>\$16,251-\$25,000</td> <td>\$32,501-\$50,000</td> </tr> </tbody> </table> <p>If an eligible saver (or spouse) receives a pre-retirement distribution in any year, the credit will be reduced in that year and the next two years.</p>	Credit	Individual	Joint Return	50%	\$0-\$15,000	\$0-\$30,000	20%	\$15,001-\$16,250	\$30,001-\$32,500	10%	\$16,251-\$25,000	\$32,501-\$50,000
Credit	Individual	Joint Return												
50%	\$0-\$15,000	\$0-\$30,000												
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10%	\$16,251-\$25,000	\$32,501-\$50,000												

<b>Provision</b>	<b>Old Law</b>	<b>New Law</b>
403(b)/401(k) and 457(b) Deferral Offsets	457(b) limits are reduced by any amounts contributed into a 403(b) and/or 401(k) plan.	Elective deferrals to 403(b) or 401(k) plans would not count against 457(b) plan contributions. 457(b) plans have separate limits, which are not reduced by employee contributions into either a 401(k) plan or a 403(b) plan.
457 Salary Reduction Limits	Limit for 457(b) plans is the lesser of 33 1/3% of pay or \$8,5000 per year. Limit increases to \$15,000 in the final three full years before retirement.	Limit is the lesser of 100% of compensation or: \$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006 (indexed in \$500 increments thereafter)
IRA Contribution Limit	Maximum is the lesser of \$2,000 or 100% of compensation.	\$3,000 in 2002-2004 \$4,000 in 2005-2007 \$5,000 in 2008 and later years (indexed in \$500 increments thereafter)
New IRA "Catch up" for aged 50+	No "catch up" opportunities for missed contributions.	Individuals aged 50 or more, limit increased by \$500 from 2002-2005 and by \$1,000 thereafter.

## **Investment Options**

TSA contributions may be placed in a fixed dollar annuity, a variable annuity, or a 403(b)(7) custodial account. Fixed and variable annuities are offered by insurance companies, while 403(b)(7) custodial accounts are sponsored by mutual fund organizations.

### **Fixed Dollar Annuity**

The insurance company receives your contribution on your behalf, invests your funds in a pool with other investors, and credits your account with interest. What you receive is interest on your money. You will have a guaranteed rate (i.e. 4%) and current pay rate (i.e. 6%). You will be credited with the current pay rate; however, it may never go below the guaranteed rate. It is similar to a saving account at a bank—a highly tax favored savings account. The risk you take is “Interest Rate Risk.”

### **Variable Annuity**

A variable annuity is more complex than a fixed dollar annuity. Variable annuities offer a choice of investment alternatives. The insurance company offering a variable annuity will typically give you a choice of four funds: 1) Fixed Annuity Fund, 2) Income Fund, 3) Growth Fund, or 4) Growth and Income Fund. The fixed fund will have an investment objective of security with income and will typically invest in government securities or very high grade corporate bonds. The income fund will have an investment objective of security with income and will invest funds in corporate bonds and high grade corporate stocks which pay dividends. The growth fund will have growth of capital as its investment objective and will invest funds primarily in common stocks. The growth and income fund sometimes called “balanced fund” will invest in both bonds and stocks and attempt to achieve a balance of investment.

The participant has a choice of participating in any of the funds or splitting his/her investment among them. Most often the participant may exercise switching privileges between funds (i.e. call them on the telephone and tell them to switch your investment from the income fund to the growth and income fund).

### **403 (b)(7) Custodial Account**

A custodial account is a mutual fund. Mutual funds typically are offered within a “family” of funds. They operate very similarly to the variable annuity except there is not a fixed account option and you bypass the insurance company.

### **Risks**

There are two kinds of risks associated with investing in a TSA—Interest Rate Risk and Market Risk. Interest rate risk is associated with fixed dollar annuities. Your principal is guaranteed by the insurance company and your only risk is the fluctuation of interest rates. Market risk is associated with the fluctuation of the equity markets. Your risk is associated with the fluctuation of value of ownership (ups and downs of the stock market).

A panel of experts could debate the issue of which risk is greater, and the issue would never be resolved. It is up to each individual person to determine which type of investment is best suited to accomplish his/her special objectives. Each of us has a different financial position and perspective. Your real issue is to understand each form of investment and choose one that you feel will fill your needs.

## **Popularity**

The fixed dollar annuity is by far the most popular TSA investment. Many would lead you to believe it is the most popular because it is the least risky. The more logical reason is that fixed dollar annuities are offered by insurance sales people who are very active in your market place. In order for a sales person to solicit for a variable annuity or a mutual fund, he or she must hold a securities license. There are considerably more people who hold insurance licenses than who hold securities licenses. Most insurance sales people are very qualified in financial planning. The point is not the qualifications or integrity of insurance agents. Rather, it is that there is a much greater probability of your visiting with an agent who does not also hold a securities license.

Consumers will buy what they are presented, and there is a greater likelihood that you will be presented with a fixed dollar annuity than any other type of investment.

It is also much easier to explain the TSA concept with the fixed dollar annuity. The product is simple to explain and to understand. It is not our objective to convince you that one type of investment is better than another type. Our objective is for you to understand all concepts and encourage you to investigate the alternatives and determine which program fits your investment objectives. Do your homework!

You are setting up an additional retirement program. You have aspirations of a retirement nest egg of \$50,000 to \$100,000. Doesn't it make sense that you should make an educated and deliberate decision?

## **When You May Withdraw Your TSA**

Under the general rules, you may begin withdrawals at any time once you have attained age 59 ½, and you are required by law to begin making withdrawals once you are 70 ½. There are important exceptions to the general rules.

If you separate from service with your employer prior to age 59 ½, but after age 55, the law allows you to withdraw from your TSA plan with no tax penalties or restrictions. If you separate from service prior to age 55, you are permitted restricted access to your funds, but you must stretch out the distribution in a way that would systematically liquidate your account over your life expectancy. The amount you may withdraw each year is restricted. Once you have attained age 59 ½, and you have made systematic withdrawals for at least five years, you are permitted to revoke the previous withdrawal election and have full access to your money.

When you reach age 70 ½, if you have not already started withdrawing money from your TSA, you must generally begin doing so at that time. There are exceptions. If you are still working for an eligible employer, and the employer is a public educational organization or church related organization, you may defer making any withdrawals until you actually retire, if you so desire.

There are some special hardship provisions that would allow you access to your money prior to retirement. If you die before you have begun making any withdrawals from your TSA, your surviving spouse (if any) may become success/owner of your TSA, with the same rights as you had.

The distribution rules are complicated, and it is important to comply with them to avoid tax penalties. Your TSA company can provide you with the information you will need. There is a reason for the withdrawal restrictions on your TSA. When Congress enacted the law creating 403(b), it intended for you to use your TSA as a retirement plan vehicle, not as a short term tax sheltered savings account.

### **Withdrawal at Retirement**

It is just as important to know how you may receive your money at retirement as it is to decide which program or product to choose. You should consider the distribution options that are available to you both legally and those that are allowed by the provider that you select.

All TSA annuity contracts, whether fixed dollar or variable, contain annuity payout options. Payout options are often called “settlement options”. A typical set of payout options will include life only, life with period certain, joint and survivor, installment refund and period certain. All of these options basically require you to surrender your rights to the principal for an agreed payout (i.e. you give your \$100,000 account to the insurance company and they agree to pay you \$800.00 per month for as long as you live). All of the options are designed to liquidate the principal and interest in your account over a period of time that complies with IRS regulations for TSA distribution.

Nothing in the IRS Code or Regulations requires election of a contractual annuity payout option. The IRS does require you to systematically withdraw the money in your TSA, once you reach a certain age. This is referred to as the start date, and is usually age 70 ½, but there are exceptions as previously mentioned. Once you reach the required start date, each year you must withdraw a minimum amount in order to avoid a stiff 50% tax penalty imposed by the IRS.

Rather than have a lengthy discussion on minimum distribution calculations, let’s agree that it is very significant and important and that the liability of a correct calculation should be the responsibility of the annuity company that you have chosen. Make them responsible for any penalties.

**THIS IS IMPORTANT.** Some companies do not require you to formally annuitize your TSA. Instead, you can simply wait until you reach the required start date, then each year you make a required minimum withdrawal of an amount that will satisfy IRS distribution rules and avoid any penalty tax. The company will tell you what the minimum amount is, and you may choose the minimum amount or any amount above that. You may withdraw all or part of your remaining money at any time. You maintain control of your principal.

**THIS IS ALSO IMPORTANT.** Some companies have two different account values. The higher account value is the value of your account if you agree to annuitize; the lower account value is the value that you would receive if you wanted a lump sum settlement (i.e. your account is worth \$100,000 if you will agree to accept \$800.00 per month for life payout; if you want a lump sum, the company will only write you a check for \$80,000). See discussion on two-tier annuities.

### **Withdrawal Charge**

Most fixed dollar and variable annuity contracts contain a temporary withdrawal charge. The withdrawal charge is a penalty, which is assessed by the insurance company upon early withdrawal of the funds in the account. In most cases the withdrawal charge grades down to zero over a period of years, but watch out for annuities with permanent withdrawal charges (note discussion on two-tier annuities).

The withdrawal charge (if reasonable) is a justifiable charge. The insurance company must absorb their acquisition cost (agent commission, advertising, etc.). They must also absorb any investment losses. Having a withdrawal charge permits the insurance company to invest in longer maturity investments with higher yields. Higher yields are reflected in the current interest rate, which is credited to your account. The withdrawal charge allows the company a period of time to recover its initial costs and invest more prudently.

### **Loan Provision**

TEFRA, the Tax Equity and Fiscal Responsibility Act of 1982, made it possible for you to borrow from your TSA. Most TSA contracts have a loan feature. Your ability to borrow from your plan will vary from company to company. Make sure you understand the provisions outlined by your company.

The law permits you to borrow 100% of the withdrawal value of your TSA, as long as the loan does not exceed \$10,000. If the amount borrowed is to exceed \$10,000, the maximum loan is 50% of the withdrawal value of your TSA not to exceed \$50,000. The loan must be repaid in at least quarterly installments of principal and interest over a period of time not to exceed five years. If the purpose of the loan is to acquire a dwelling intended to be your principal residence, the term may be extended to a "reasonable time."

Prior to making a loan, understand the terms and the cost. Find out the interest rate the company will charge for the loan and the effect(s) on your TSA plan.

### **Switching Companies**

In a recent IRS Revenue Ruling (90-24), you were given the right to make partial or full transfers of TSA funds between fixed dollar annuities, variable annuities, and 403(b)(7) custodial accounts. There are restrictions and rules, so do not attempt this without the assistance of the company or agent. All transfers must be conducted directly between the companies at your direction. You do not want the check to come to you. That would result in a tax liability. It must be company to company.

In addition to tax free transfers, you may rollover your TSA for reasons such as death, disability, separation from service with your employer, or attainment of age 59 ½. You may rollover to another TSA or into an IRA. Any rollover or transfer is permitted under certain circumstances; however, you should solicit assistance from the company and/or agent to insure that you do not suffer penalties.

Other reasons for wanting to switch companies may include diversification or simply to achieve a higher return. Please refer to your existing contract. There may be withdrawal charges assessed by the company from which you are moving funds.

## **Two-tier Annuities, Modified Single Tier Annuities, and/or Modified Two-tier Annuities**

These plans have permanent withdrawal charges that increase the longer you keep the annuity. A conventional annuity will have a withdrawal charge that declines to zero over a period of several years. The withdrawal charge on a conventional annuity declines to zero, and you may at any time thereafter transfer or withdraw all of your money without any penalty from the company.

Two-tier annuities typically offer higher current interest rates initially than you will find on conventional annuities. Actually, two different current interest rates are in effect—a higher, more competitive rate on the accumulation value, and a much lower rate on the withdrawal value.

Accumulation value is 100% of the contributions you make to the annuity, plus interest. Withdrawal value is a fraction of your contributions (i.e. 80% of first year contributions and 100% of renewal contributions) earning a lower rate of interest. A typical accumulation value interest rate might be 8%, while the withdrawal value interest rate might be only 6% or less.

The salesman for the two-tier annuity will tell you that you can have the accumulation value, with its higher interest rate, by annuitizing the contract at retirement. Remember the previous discussion on withdrawal at retirement. Is annuitizing what you will really want to do?

Proponents of two-tier annuities will argue that more money can be accumulated in a two-tier annuity, since a higher rate of interest is credited. What most fail to mention is that you must annuitize your contract to get the accumulation value. The insurance company is in a position during the payout period to take back the higher interest by reducing the annuitization rate factors. (i.e. just because you have \$100,000 accumulated account value today and will receive an \$800 per month life annuity, it does not mean that twenty years from now you will receive an \$800 per month life annuity).

If you choose a two-tier annuity, you are trusting the insurance company to remain competitive for many years into the future (20 years). Should the company choose not to be competitive, and should it lower the credited interest rate in the future, you are stuck. You must annuitize the contract at whatever rate of interest the company chooses to pay or take the withdrawal value with its large permanent withdrawal penalty.

Two-tier annuity companies typically pay the salesmen significantly higher commissions than do companies that provide conventional annuities. The two-tier annuity companies' acquisition costs (sale commissions) are high, so they charge high withdrawal penalties.

## **Old Money Rates and New Money Rates**

The insurance sets the initial rate of interest, which is credited to new premiums as they are received. This is called the current interest rate. The new money is placed in an investment pool with other contributors. The investment pools are closely monitored by the insurance company.

Periodically the insurance company may be required to make adjustments to the investment pool's interest rate. For most reputable companies, these adjustments are small and are merely pricing adjustments required to maintain their spread. This new interest rate is often referred to as the old money rate.

Watch out for any company that has a sharp reduction in their old money rates. Some companies will lure you into choosing their TSA by offering you an above market rate on your money. Once they have you, the rate is lowered. Ask questions. Make sure that any agent or company explains to you what their interest rate history has been. You won't know if you don't ASK.

### **The Agent (Solicitor)**

Your TSA agent is paid by the insurance company for each annuity contract that he/she writes. Most often the agent is paid a higher commission the first year of the contract than in subsequent years. The money used to pay the agent comes from the company's interest spread. The money is not deducted from your account. The exception occurs when there is a sales charge or front-end load. Most TSA contracts sold today are so-called no-load contracts.

Mutual Funds (403(b)(7) custodial accounts) are typically sold with a front-end sales charge, and there is a sales charge for each contribution. However, most funds that have a front-end charge do not have withdrawal charges.

The amount of commissions will vary from one company to another. A typical first year commission a salesman might earn for a conventional annuity contract would be 6%. A typical first commission a salesman may receive on a two-tier annuity contract would be 15%. Mutual Funds with front-end sales charges are usually in the 6% to 8% range.

### **IMPORTANT NOTE:**

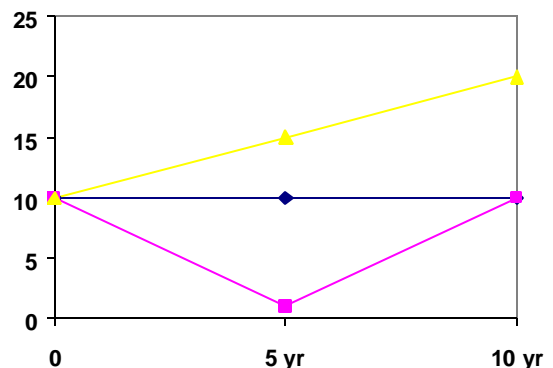
There are many fixed dollar annuities, variable annuities, and 403(b)(7) custodial accounts that may be purchased without the involvement of an agent (solicitor). Most often there are no loads (commissions) or withdrawal charges associated with these investments. The advantage is that the Provider (insurance company/mutual fund) does not need as much of spread. That usually translates to a higher return for the participants.

The disadvantage is that it requires more effort on your part to get your homework accomplished—harder to get information, more time required to make a decision, etc. (please not suggested reference material).

### **Dollar Cost Averaging**

This concept pertains only to variable annuities and to 403(b)(7) custodial accounts (mutual funds). The advantages of dollar cost averaging have been used for many years. Sales people use the illustration to demonstrate accumulation and as an argument against equity market risk.

The concept is valid. Let's review the concept with an illustration. There are two mutual funds:



Fund A and Fund B. At the start date both funds have a value of \$10.00 per share. For the next ten (10) years Fund A has a steady growth from \$10.00 per share to a value of \$20.00 per share. Fund B's value goes from \$10.00 per share to \$1.00 in the first five years. In the second five year period, the value goes from \$1.00 back to the original start value of \$10.00 per share. Our investor starts his TSA plan with Fund A and puts in \$100.00 per month for ten years. The second investor starts his TSA plan with Fund B and puts in \$100.00 per month for ten years. Which investor would you rather be?

The correct answer is the Second Investor with Fund B. Although the performance of his fund was terrible, he has a greater number of shares of the fund. When his fund has a value of \$1.00 his monthly investment of \$100.00 bought 100 shares of the fund. When the value was at \$10.00, his \$100.00 bought 10 shares of the fund. At the end of 10 years the value of his fund was only \$10 per share, but he has 3,269.75 shares ( $3,269.75 \times \$10 = \$32,697.50$ ). The First Investor who bought \$100.00 per month of Fund A has 834.25 shares at a value of \$20.00 per share ( $834.25 \times \$20 = \$16,685.00$ ).

Neither illustration is what will likely happen to you, but the theory is valid. If you elect a program (variable annuity or 407(b)(7) custodial mutual funds) and systematically purchase shares you will reduce or eliminate most if not all of the effects of market risk (ups and downs of the stock market).

### **Health of Life Insurance and Annuity Companies**

The life insurance industry is sound and secure. All indications are that the industry will enjoy continued strength and stability. Consumers do not expect their life insurance company to be exciting or enjoy a high profile. We do expect them to be there to pay our claims and honor their commitments. As a general rule we will not be disappointed.

As with any industry, there are a few companies that are not healthy. There are only a few, but what you want to know is: What about my company? How do I know? What should I look for?

Rating agencies keep investors and other market participants informed of a company's relative financial strength or claims-paying ability. You too can use the information provided by these rating agencies. You should consult these agencies to find out what the company's rating is and whether it has improved or declined in recent years. What is the trend?

The rating agencies are:

- A.M. Best
- Standard & Poor's
- Moody's Investors Service
- Duff & Phelps Credit Rating Co.
- National Association of Insurance Commissioners

You can acquire copies of the reports by simply asking the insurance company to price you with a copy. You must ASK. Many companies do not have ratings by all of the rating agencies. Companies must pay a fee to the rating agency to have a report made. The cost could be \$25,000 to \$50,000 for the company to get a Standard

and Poor's analysis or a Moody's analysis. Some companies refuse to pay the additional cost.

It is our advice that you get at least two reports from two different agencies on the company that you are going to use to build your retirement plan. You should look for companies with rating such as: A+, A, A-,AAA,AA+, Aaa, Aa1, Aa2, A1, etc. Look for the letter "A". If the rating service indicates a B+, C, D, Ca, Ba, etc., you should look for another company. Many will argue with that opinion; however, the security of your retirement funds is too important to take chances.

**Suggested Reference Material:**

Fixed Dollar Annuities:  
Fisher Publishing, Inc.  
13140 Coit Road, Suite 102  
Dallas, TX 75240-5755  
(800) 933-1450  
Single Issue Cost: \$20.00 (approx.)

Variable Annuities:

Variable Annuity Research & Data Service (VARDS)  
P. O. Box 1616998  
Miami, FL 33116  
(305) 252-4600  
Single Issue Cost: (\$50.00 approx)

403(b)(7) Custodial Accounts (Mutual Funds):

Kiplinger's Personal Finance Magazine  
1729 H St., N.W.  
Washington D.C.  
(800) 544-0155

**Closing Comments and Opinions**

As an employee of a Texas Independent School District, you are afforded an opportunity to participate in a Highly Tax Favored supplemental retirement program. Do not ignore your opportunity. It would be financially foolish. You are our educators. Do what you demand of your students—do your homework. Don't be lazy. It's your future. It has been asked, "Will you have any money when you retire?" the answer should be, "Sure I will because I am sending money now, and when I retire it will be there waiting for me." What about you? Is someone else sending money for you, or are you sending money ahead?

Choose a fixed dollar, variable, or mutual fund that fits your needs and get started. If it is a fixed dollar annuity, avoid the two-tier annuities. You are likely to be disappointed when you reach retirement. Accumulate a retirement fund that has no withdrawal penalty. When it is time to retire, do not annuitize. Make the withdrawals based on what you need or want. Your company should keep the plan in tax compliance. You should retain control of the principal.

Again, take advantage of the opportunity to participate in a TSA. It will be one of the most rewarding financial decisions you will ever make. It will have a major impact on your standard of living after you retire.

## **About National Plan Administrators, Inc.**

NPA is the third party administration company selected by your District. Our job is to assist the District with the administration of the TSA plans. NPA provides:

- One Slot Billing Service
- Exclusion Allowance Calculation
- Policing of Providers
- Policing of Agents
- Liaison contact for Employees(admin. Questions, etc.)
- Liaison contact for Providers and Agents
- Standardization of Paperwork
- Audit of all Paperwork

National Plan Administrators, Inc. does not sell or distribute 403(b) or 403(b)(7) plans. NPA views that as a conflict of interest. NPA is a fiduciary for the District and District Employees. NPA does not give investment advice nor advice on which solicitor (agent) you should use. NPA can and will assist you with information and sources of information. NPA will, to the best of our ability, assist you with explanation of plan(s) or concepts. Please feel free to contact us with your problems or questions.

National Plan Administrators, Inc.  
1101 Capital of Texas Highway South  
Building E, Suite 100  
(512) 327-6481  
(800) 880-2776

### **Closing Comment about Agents**

Most of the agents (solicitors) who offer TSA programs are very qualified and of high integrity. They solicit annuity contributions in order to make a living, but they are careful and concerned about you, the client.

There are, unfortunately, a few bad apples. These agents sell high commission products and constantly advise their clients to switch from one company to another. If an agent can convince you to switch your TSA from company A to company B, he will earn a fat commission. Many times the client is unaware of the withdrawal charge (may be 20%). There are just a few unscrupulous agents, but they are very active in the market place. If you are advised to switch your funds, be very careful. Check with your existing company regarding penalties.

Please remember that most agents are very reputable. Some are Certified Financial Planners (CFP). Agents provide a valuable service, but don't believe everything you hear. Do some of your own research.