

## Montgomery County Public Schools §403(b) Question and Answers

*This Q&A is only a description of the plan and, while the description is intended to be accurate, the rules are complex and subject to change. The MCPS §403(b) Tax Sheltered Savings Plan document governs all questions and interpretations.*

### What are the advantages of a 403(b) over other investments?

The 403(b) is a pre-tax savings plan funded through the convenience of payroll deductions. In addition to reducing taxable income, all earnings grow tax deferred. This tax-deferred compounding permits an account to grow faster than an account without these features.

### How much can be contributed to a 403(b)?

For 2010, participants are permitted to contribute up to \$16,500. Additionally there is a ["catch-up" provision available](#) for participants that will be age 50 or older by December 31, 2010.

### Is there a catch up for those ages 50 and over?

Yes. Participants age 50 or older at any time during calendar year are eligible to contribute an additional \$5,500 to their 403(b), raising their combined contribution amount to \$22,000 for 2010. This is known as the Age 50 Catch-up provision.

### Should I contribute a dollar amount or percentage of salary?

Employees have the option of choosing either a specific dollar amount or a percentage of pay. However, employees categorized as "temporary part-time" may only contribute a percentage of pay. The benefits of choosing a percentage of pay versus a specific dollar amount are very important over an extended period of time.

For example, if an employee chooses to save 5 percent of his/her salary this year, the contributions to the employee's account will increase each year as the employee's salary increases. However, if an employee starts his/her contributions with a specific dollar contribution he/she would have to update the amount every year as his/her salary changes. Setting up the account with a percentage of pay designated eliminates having to fill out paperwork every year, and helps employees' increase savings each time their salary increases. Participants always have the option of reducing the contribution amount.

**PLEASE NOTE: if you are contributing to more than one 403(b) vendor and/or a 457(b) account, all contribution types must be the consistent. For example, if you are contributing a percentage of salary to a 403(b) account, you must contribute a percentage of salary to your 457(b) account and vice versa.**

MCPS recommends that participants limit salary deferrals to no more than 75 percent of income to ensure other pre-tax deductions are taken prior to the 403(b) contribution.

The MCPS payroll system follows a sequence for pre-tax deductions. Since other pre-tax deductions (such as medical and dental plan costs) precede the 403(b) deductions, (provided the employee is making other deductions) a more practical limit on contributions to the 403(b) plan is approximately 75 percent of salary. If an employee does not have enough money remaining in his/her paycheck after the earlier pre-tax deductions are taken, the 403(b) plan contributions will not be withheld. It is also important to reserve money for after-tax deductions, such as mandatory union dues (if applicable).

## What investment products are available in a 403(b) plan?

There are two categories of investment options available: annuity products and a 403(b)(7) custodial account made up of mutual funds.

### Annuity Products

An annuity is a contract with an insurance company. There are two kinds of annuities: fixed and variable.

#### FIXED ANNUITIES

Fixed annuities operate much like certificates of deposit but are not insured by the [Federal Deposit Insurance Company \(FDIC\)](#). Generally, investors are given two interest rates: the current rate and the guaranteed rate. The current rate is the return that the insurance company promises to pay for a set period of time, typically between one and five years. The guaranteed rate, usually lower, is the minimum rate that investors will receive after the current rate expires, regardless of market conditions.

#### VARIABLE ANNUITIES

A variable annuity offers a range of investment options — typically mutual funds that invest in stocks, bonds, short-term money-market instruments, or some combination of the three. These investment options are referred to as the sub account. The value of the investment will vary depending on the performance of the investments in the sub account. There is usually a death benefit that will pay a beneficiary the greater of the account value or a guaranteed minimum amount, such as total purchase payments. Variable annuities are securities regulated by the [Securities and Exchange Commission \(SEC\)](#).

### Mutual Funds

A mutual fund is an investment that pools money from many participants and invests in stocks, bonds, short-term money-market instruments, or some combination of the three. The combined holdings of stocks, bonds, or other assets that the fund owns are known as its portfolio. Each investor in the fund owns shares, which represent a part of these holdings. There are two kinds of mutual funds: loaded mutual funds and no-load mutual funds. NOTE: MCPS does not permit contributions to load mutual funds. A load is a commission the investor must pay in order to purchase/sell that fund. All mutual funds have operating costs. Mutual funds are securities regulated by the [SEC](#) but are not guaranteed or insured by the [FDIC](#) or any other government agency.

## What companies/vendors can I invest with?

A list of vendors that MCPS employees may invest with is found in the [Vendors section](#) of this web site.

## What should I know before opening a 403(b)?

Fees, operating rules, and investment objectives can vary greatly among vendors and across investments. Therefore, it is important to understand all of these before you begin contributing to any investment. Additionally, some investments impose surrender charges or restrictions on withdrawals. Find out if there are surrender charges or restrictions on withdrawals before investing.

All mutual funds and variable annuities are required to produce a document called a prospectus, which details specific information about investment cost, objective, risk, performance, and operating rules. Ask to see the prospectus before contributing to a variable annuity or a mutual fund. Fixed-annuity products do not have a prospectus. Instead, they have a contract that details operation of the annuity. Ask to see the contract before investing in a fixed annuity.

For more information on general investing principles and terms, see the [Investment Reference section](#). For more information on the impact of investment fees on return, estimation of future savings growth, impact on paycheck of a 403(b) and/or 457(b) contribution, and exploration of various distribution scenarios see the [Calculators section](#).

## **What does it cost to invest in a 403(b)?**

Fees vary greatly among vendors and across investments; what follows are general guidelines.

### **Fixed Annuities**

There is no separate fee for a fixed annuity. Similar to the way in which a bank makes money on a certificate of deposit, annuity fees are built into the product. For example, an annuity company may believe it can earn X percent on an investment, so it will pay an investor Y percent. The company makes its money on the difference, or spread. Generally this spread is between 1 and 2 percent annually. For specific information on fees, consult the contract provided by the company offering the fixed-annuity before you begin making contributions.

### **Variable Annuities**

Variable annuities charge on average 2.25 percent a year, according to fund tracker Morningstar Inc. For specific information on fees, consult the prospectus for the variable annuity before you begin making contributions.

### **Mutual Funds**

Mutual funds charge on average 1.4 percent a year according to fund tracker Morningstar Inc. For specific information on fees, consult the prospectus of the mutual fund before you begin making contributions.

## **Do I need an agent or advisor to start a 403(b)?**

No. You are free to invest on your own. You may also use the services of a vendor representative or independent financial advisor. Financial representatives can provide valuable services to their clients. These services can include retirement planning, information about state retirement plans, and analysis of other financial needs. Annuity and variable-annuity products are often sold by vendor representatives who are also referred to as agents. All financial professionals charge a fee for their services. In order to determine the value of the service, it is important to know exactly what services are being provided and exactly what fees are being charged.

## **Can I change companies/vendors?**

Yes, the IRS and MCPS allow participants to change vendors, however it is important for employees to work with both their existing and prospective vendor, in addition to informing MCPS of any changes to your account. MCPS permits exchanges of existing account balances between vendors approved to receive payroll contributions and only to available investment products.

Contact your existing provider to find out if any fees may apply. Investments may charge surrender fees, lasting up to ten years. Be aware of all surrender charges before initiating a transfer. If charges do exist you have two choices; pay the fees and transfer the assets or only transfer any assets that are not subject to the fees. Employees do have the option to keep the investments with the current provider while directing future investments to a new provider. As the surrender charges decline or expire, employees may move assets that will not be charged a surrender fee.

MCPS employees wishing to move account assets from one approved vendor to another will be required to complete an In-Service Exchange Request Certificate, available from the [third party administrator website](#). You must include this certificate when submitting your exchange paperwork to the vendor receiving assets from your former vendor.

Please remember to submit a new [403\(b\) Salary Reduction Agreement \(PDF\)](#) or [457\(b\) Salary Deferral Agreement \(PDF\)](#) to MCPS directing MCPS to begin remitting your contributions to the new company and stopping contributions to the old company.

### **Can I change the amount I am contributing?**

Yes, changes can include change of dollar amount or percentages contributed, and change of vendor. Complete another [Salary Reduction Agreement](#) indicating desired change and send through the PONY or mail to the Employee and Retiree Service, Attn.: Transaction Unit, 7361 Calhoun Place, Suite 190, Rockville, Maryland 20855.

### **Can I stop contributing?**

Yes. You retain the right to stop contributing at any time. Complete another [Salary Reduction Agreement](#) indicating this change and send through the PONY or mail to the Employee and Retiree Service, Attn.: Transaction Unit, 7361 Calhoun Place, Suite 190, Rockville, Maryland 20855.

### **When am I eligible for a distribution from my 403(b)?**

If you withdraw assets prior to age 59-1/2, the IRS will impose a 10 percent penalty tax, in addition to the normal tax consequences, unless you meet one of the following criteria:

- Attain age 59 ½
- Hardship
- Disability
- Death
- Made due to an IRS levy upon your participant account
- Paid to an alternative payee under a qualified domestic relations order
- Is a qualified reservist distribution as defined under the Pension Protection Act of 2006

Vendor contracts may provide for additional distribution criteria.

Note that withdrawals will be taxed as ordinary income. See information on [Loans](#), [Hardship Withdrawal](#), [Changing Employers](#), [Becoming Disabled](#), [Divorce](#), [Death](#), and [Retirement](#) for more information on accessing 403(b) money.

### **When must I withdraw money from my 403(b)?**

Generally, you must begin to take withdrawals from your 403(b) no later than April 1 of the year following the year in which you turn age 70-1/2. If you are still working, you can delay withdrawal from your 403(b) until April 1 following the year in which you retire.

### **Can I borrow money from my 403(b)?**

Yes, but not all providers permit loans from 403(b) accounts. Contact your provider for availability. Plan loans are convenient, but they are not always the right solution. Consider both the positive and negative repercussions to determine if a plan loan is right for you. And, always compare the overall cost of a plan loan with other sources of funds. The true cost of the loan is more than just interest paid; it also includes the lost interest earned and/or growth from market returns.

If you are an active MCPS employee wishing to take a loan, you must obtain a Distribution Eligibility Certificate from the MCPS [third party administrator](#). The third party administrator will review all requests and determine if they meet the Plan or IRS requirements. The IRS and Plan limit loans to the lesser of \$50,000 or ½ of the account value. You are not eligible to receive a new loan if you have a defaulted loan outstanding.

The third party administrator will review the request, and if pre-approved will issue a Distribution Eligibility Certificate that must be printed and included with your loan application when submitted to your vendor. Loan requests for the purchase of a primary residence that will be repaid over a period of more than five years require documentation from your title company (typically the HUD1 document).

### May hardship withdrawals be made from a 403(b)?

Hardship withdrawals are permitted from a 403(b) account if the employee is under severe financial distress. The employee must have no other resources available to alleviate the stress, such as selling assets or obtaining a loan from a financial institution. Hardship withdrawals may be made for:

- Un-reimbursed medical expenses of the employee or his/her spouse and dependents
- Down payment on primary residence
- Tuition and fees for higher education needs, only for the next 12 months
- Eviction or foreclosure on your primary residence

You may only withdraw the amount that you need to meet your hardship, plus an amount to cover any taxes that apply. Hardship withdrawals can only be taken from salary reduction contributions, not earnings.

If you are an active MCPS employee wishing to take a hardship or unforeseen emergency withdrawal you must obtain a Distribution Eligibility Certificate from the MCPS [third party administrator](#). The third party administrator will review all requests and determine if they meet the Plan or IRS requirements. If the request is pre-approved the account holder must print the certificate and include it with any vendor required paperwork, including supporting documentation. Vendors will not process any withdrawal request unless the certificate is included with the request.

**SPECIAL NOTICE:** If you are requesting a 403(b) hardship request you are REQUIRED to submit documentation supporting the amount requested to your vendor.

MCPS will automatically suspend contributions, per IRS guidelines, to your 403(b) and, if applicable, your 457(b) account for six months.

### What happens to my 403(b) if I leave MCPS?

Assets can be transferred to your new employer's defined contribution plan, if permitted by that plan. Check with your new employer for details.

- Assets can be transferred to your new employer's defined contribution plan, if permitted by that plan. Check with your new employer for details.
- Assets may be moved to a Rollover Individual Retirement Account (IRA). This will permit the money to continue to grow tax deferred. Check with the institution currently holding the assets and the institution you wish to transfer to for more details.
- You can leave the money in the plan and continue to enjoy the tax-deferred growth.
- You can take a lump sum distribution. If you are not age 59-1/2, early withdrawal penalties and significant tax consequences may occur

**Former employees wishing to withdraw money must obtain a Distribution Eligibility Certificate confirming your separation from MCPS.**

### What happens to my 403(b) if I become disabled?

Withdrawal of 403(b) money is permitted in cases of disability, as defined by the IRS. Consult your vendor or a tax professional for more details.

### What happens to my 403(b) in the event of a divorce?

Some or all of the balance in your 403(b) account may be transferred. Distribution to an alternate payee will be permitted if it is made pursuant to a qualified domestic relations order (QDRO). This is a decree, judgment, or order that meets the qualification requirements of the Internal Revenue Code. Those requirements include the following:

- The order must have been issued under a state's community property or other domestic relations law
- It must relate to the provision of alimony, child support, or the property rights of a spouse, former spouse, child, or other dependent (alternate payee).
- It must assign to the alternate payee the right to receive all or a portion of the participant's plan benefits.
- It must clearly specify (1) the names and addresses of each alternate payee, (2) the amount or percentage of the participant's benefit to be paid to each alternate payee, (3) the period of time over which the order applies, and (4) each plan to which the order applies.

If a distribution is made to a spouse or former spouse under a QDRO, the distribution may be rolled into a qualified plan or IRA that the spouse or former spouse has. Distribution to any other alternate payee is not eligible for rollover. It is highly recommended that individuals seek the counsel of a qualified attorney in the event of divorce. It may also be necessary to speak with a tax or financial professional. Your vendor should also be able to provide information. Participants should review beneficiary designations annually and update as necessary through the 403(b) provider.

### **What happens to my 403(b) in the event of death?**

Death benefits are paid to beneficiaries on file with your vendor. How the proceeds are distributed depends upon the age of the participant upon death. Participants should review beneficiary designations annually and update as necessary through the 403(b) provider.

### **What happens to my 403(b) at retirement?**

You are free to begin penalty-free withdrawals upon retirement. Investment contracts may permit you to take withdrawals without the imposition of contractual surrender charges at retirement. Please refer to earlier question "[When am I eligible for a distribution from my 403\(b\)?](#)" for information regarding IRS penalties.

Note that withdrawals will be taxed as ordinary income.

### **Upon retirement can I defer unused sick leave (to a 403(b) plan)?**

Yes. Thirty days prior to your retirement date you must submit the required paperwork to MCPS [[Salary Reduction Agreement – Leave Payout Request \(PDF\)](#)]. You may rollover the value of the earned sick pay into your 403(b) account, up to the annual IRS contribution limit. If you are opening a new 403(b) account to receive this payout, you must follow the standard new account procedures detailed below and start the process early enough to accommodate paperwork processing both by MCPS and your 403(b) provider.

### **Can I purchase pension-service credit with 403(b) dollars?**

Yes. Contact the [Maryland State Retirement System](#) (800-492-5909) or MCPS (301-517-8100) for details.

### **Can I contribute to a 403(b) and a 457(b)?**

Yes. You are eligible to contribute the maximum allowable to each plan. See [457\(b\) FAQs](#) for information on the 457(b) plan.

### **Can I transfer 403(b) money to a 457(b)?**

No.

### **How is a 403(b) different from a 457(b)?**

The plans are similar in that pre-tax contributions are made on behalf of participants and the account grows tax-deferred until withdrawn. Differences between the plans include different distribution rules and withdrawal requests while under financial distress.

403(b) assets may be withdrawn beginning at age 59-1/2 while 457(b) assets may be withdrawn upon separation of service with MCPS.

Withdrawals requested under financial distress are subject to different rules for eligibility. The 457(b) plan typically has stricter requirements than the 403(b) plan.

### **How is a 403(b) different from the Maryland State Teachers Pension plan or the MCPS Employees Pension system?**

The Maryland State Teachers Pension plan and the MCPS Employees Pension system are defined benefit plans (also known as DB plans) for MCPS school personnel. Employees are automatically enrolled upon employment in one of these two plans based on job classification. Generally, employees who work directly with students are enrolled in the state plan, while employees who do not are enrolled in the school's plan. The Office of Human Resources will determine your status upon employment. Both plans have the same features and provide the same benefits. Employees automatically contribute a percentage of their salary pre-tax to the plan they are enrolled in. Currently employees contribute 5.5 percent of their salary. The school system also makes a contribution on behalf of the employee. In general, pension plans provide an income in retirement based on years of service, a retirement factor determined by the plan administrators, and average final salary. A 403(b) plan is a defined contribution (also known as a DC plan). Enrollment in a 403(b) plan is voluntary. Benefits are determined by the amount accumulated by the individual.

### **How is a 403(b) different from a 401(k)?**

A 401(k) is a tax-deferred retirement savings plan offered by private employers. A 403(b) is a tax-deferred retirement savings plan offered by educational institutions and certain nonprofit organizations.

### **Can I contribute to a 403(b) and to a Roth IRA?**

Yes, subject to adjusted gross income (AGI) limits. The Roth IRA presents another way to save for retirement. Contributions to a Roth IRA do not reduce taxable income, but withdrawals, subject to certain rules, are never taxed. Single workers earning up to \$95,000 AGI are eligible to contribute to a Roth IRA. Eligibility for singles phases out at \$110,000 AGI. Those married (filing jointly) and earning up to \$150,000 AGI are also eligible to contribute. Eligibility for the married phases out at \$160,000 AGI. Further details on the Roth IRA can be found in IRS Publication 590, [Individual Retirement Arrangements \(PDF\)](#). This publication may be downloaded from the [Internal Revenue Service \(IRS\)](#). It may also be obtained by calling 1-800-TAX-FORMS.

### **Does MCPS contribute to my 403(b)?**

No. MCPS provides retirement benefits through a [pension plan](#).

### **How are contributions made?**

The IRS requires contributions be made via salary reduction in accordance with a written [Salary Reduction Agreement](#) on file with MCPS. Lump sum contributions and retroactive contributions are not allowed. Twelve-month employees contribute equal amounts over 26 pay periods; ten-month employees contribute over 20 pay periods. Contributions can be set up as a percentage of salary or dollar per pay period. The IRS requires employee contributions to be remitted in a timely manner, typically within 15 business days of pay day.

*Notice: MCPS does not review, approve or endorse any of the investment options that may be offered by any vendor in connection with the plan. As a plan participant, you are solely responsible for the review and selection of any and all plan investment options. Not all investment options that may be offered by vendors may be appropriate or suitable for plan investments. You must review them carefully before making any investment decisions. Neither MCPS nor any of its employees have any liability or responsibility for investment options that you select.*