NEA Member Benefits

An Educator's Guide to Retirement Income Planning

What you need to know about state pension plans, Social Security and retirement savings accounts

Inside

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A comfortable retirement requires reliable income

Retirement planning for educators starts with understanding how to make all of your retirement income sources work together.

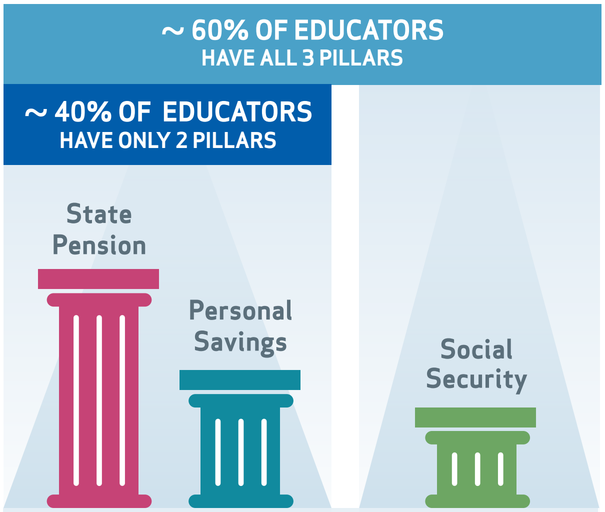
Planning is important even if your expected retirement is decades away. In fact, the earlier you start, the more options you'll have.

Public-school employees face unique circumstances when it comes to planning for retirement.

There's specific information you need to know, and distinct issues you'll have to consider, as you figure out how much retirement income you'll need and where that income will come from.

There are three basic retirement income pillars that people retiring from a career in education should understand: **a state pension, personal retirement savings** and **Social Security**.

Retirement Income Pillars



A majority of U.S. educators can rely on the first two pillars—a state pension and personal savings—and about 60% of educators also qualify for the third pillar—Social Security. But the roughly 40% of educators who don't qualify for Social Security have just two pillars to rely on.

This guide, which is written specifically for NEA members, provides an overview of these three income sources and explains various rules and regulations unique to education professionals and other public-pension employees.

The goal is to help you maximize your retirement income so you can live a fulfilling life in retirement.

- You'll learn how decisions you make around one pillar can affect the income from another pillar.
- You'll see how taxes figure into your retirement income calculations.
- You'll find links to resources for deeper dives and suggestions for putting your retirement income plan into motion.
- You'll get a handy checklist to help you keep track of the actions you need to take and the information you need to gather.

State Pension Plans

A pension is the foundation of an educator's retirement income security. Educator pensions are typically organized at the state level. Most are defined benefit plans that provide a guaranteed, fixed, lifetime benefit payment to eligible participants.

Who benefits from pension benefits?

State pensions are available to teachers, education support professionals (ESPs) and higher education support professionals (HESPs), among other state employees.

Currently, newly hired educators have access to a pension plan in 49 states and the District of Columbia. The lone exception is Alaska, where educators hired after June 30, 2006, cannot participate in the state's defined benefit plan.

Like salary and health benefits, a pension is an earned benefit that encourages people to enter and remain in public education for the long haul. However, economic realities, public opinion and legislative efforts often present challenges to maintaining educator pensions. The NEA is dedicated to protecting pension plans for public-school employees because these plans provide more retirement security with a defined, guaranteed benefit for life. Pension plans are also comprehensive, providing disability benefits, death benefits, and often cost-of-living adjustments.

Defined differences

States offer different types of primary retirement plans for educators.

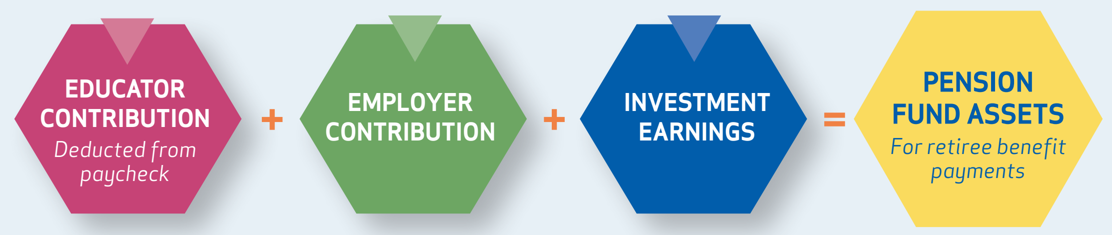
Defined benefit (DB) plans are the most common. DB plans are professionally managed and provide a guaranteed lifetime benefit based on a years-of-service and average-salary formula. Thanks to their fixed payouts, DB plans give you a clear view of your retirement pension income, which makes it easier to plan.

Defined contribution (DC) plans (403(b) and 457(b) plans) are offered as a supplemental savings plan in some states to give educators more retirement saving flexibility. DC plan benefits are not guaranteed because they depend on employee and employer contributions and accumulation of investment earnings, making it harder to know how much retirement income you can expect. DC participants must manage their investments and income streams themselves. See page 14 for more on DC plans.

How are public employee pensions funded?

Most public employee pensions require a contribution from both the employee and the employer. Contribution percentages vary by plan, but the median educator contribution is 6.8% of salary.[1] All contributions are pooled into a fund or trust and invested. Earnings on investments provide most of the funds that are used to make benefit payments to retirees.

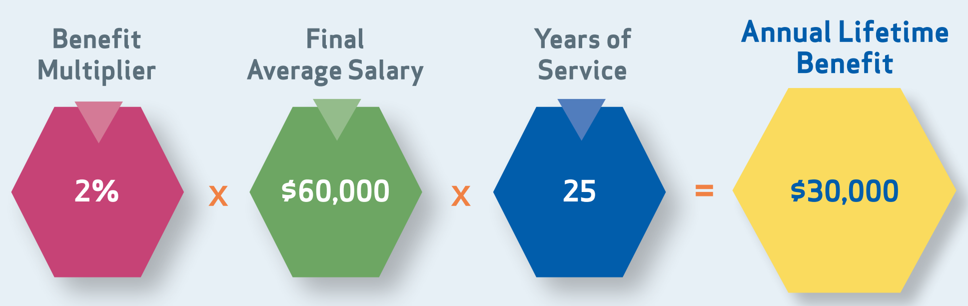
Public employee pension plan funding



How are pension benefits determined?

Benefit payments typically are calculated using a formula based on years of service (service credits), age at retirement and salary. The salary portion could be an average of the three highest earning years, or the final year or some other metric. Each part of the formula varies by state plan.

Sample pension benefit calculation
(actual formulas vary by state and pension plan)



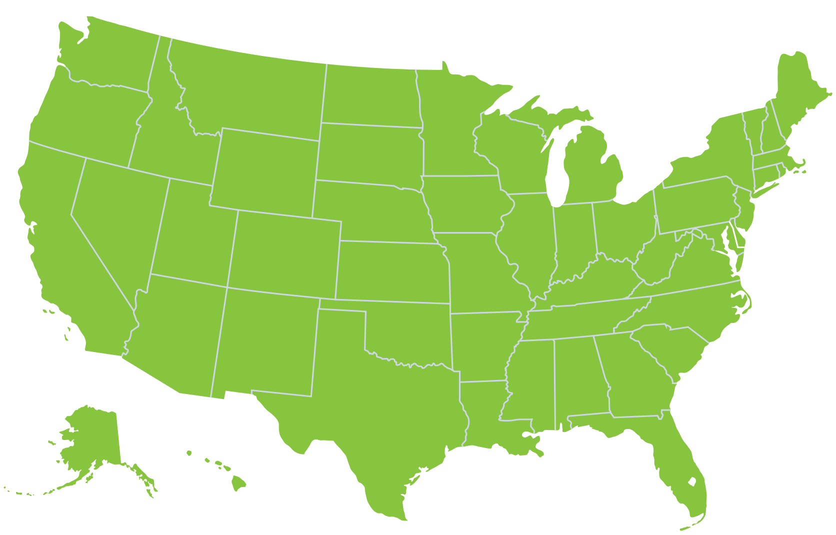
Generally, an educator must work a certain number of years to become vested in the plan—meaning, to qualify for pension benefits at retirement. In a 2016 NEA report, a little over half of the plans surveyed require just five years of service to become fully vested. Roughly another quarter of the plans require 10 years for full vesting.[1]

Vesting in DC plans is a little different. You're always 100% vested in your own contributions. You vest in employer contributions according to a schedule set by the employer. It can range from 100% immediate vesting to gradual vesting over three to five years.

It's important to understand the vesting rules of your state's plan so you can estimate how much you can expect to receive in retirement. This will help you determine if you'll need to supplement your pension with personal savings and how much you'll need to save.

What will my retirement look like?

The **NEA Retirement Income calculator** is designed especially for public-school employees. It includes your state pension data and has options to add other income sources.



Get the details

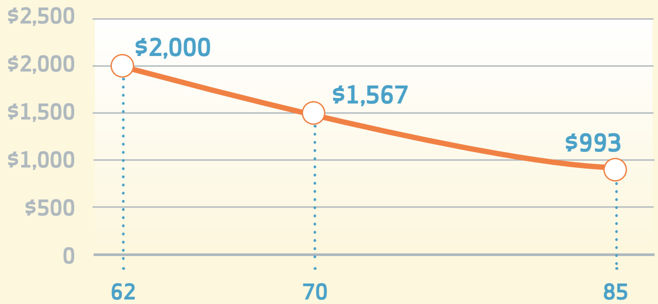
Contact your **NEA state affiliate** directly to learn more about your state's pension plan.

How do pension benefits keep up with inflation?

A pension benefit is calculated and then fixed for life. But the cost of living is certainly not fixed. It tends to go up every year, which means a fixed pension benefit will lose purchasing power over time.

To help offset the effects of inflation, the majority of public-employee pension plans include a cost of living adjustment (COLA) that increases the monthly benefit by a certain amount each year.

The Effect of 3% Inflation on a $2,000 Benefit[2]



The purchasing power of a $2,000 monthly pension payment for a retiree at age 62 could fall to about $1,570—a 22% drop—by age 70 if inflation averaged 3% a year and the pension had no COLA. By age 85, that purchasing power would be less than half the value of the initial benefit.

COLA calculations vary considerably among plans. Some are automatic, while others are discretionary. Some may track the inflation rate, while others consider investment performance. A 2016 NEA survey[1] found that 57% of plans offer an automatic COLA (typically 3% a year). The rest of the plans have either a discretionary COLA or none at all.

A COLA extends the life of your pension and becomes more important the longer you live in retirement. And because educators tend to retire earlier than workers in the private sector, they can expect to spend more years in retirement.

Check to see if your pension plan includes a COLA provision. Knowing whether or not you can expect cost-of-living adjustments to your pension income can help you determine if you'll need to bridge any gaps with supplemental personal savings.

"I find that the closer I am to retirement, the more I want to know. [The NEA] is extremely helpful in quelling my fears about having enough income when I retire."

– Lisa B.

Will pension benefits move with me?

Pensions are designed to encourage and reward educators for many years of service. But pay can vary widely across school districts and states, and educators may be motivated at times to change jobs.

Before you decide to move to a new district or state, check the "portability" of your current pension, as well as the options you may have to make up for any lost service credits in the prospective system's pension program.

- Determine if your years of service will transfer, particularly if you're already vested in your plan. It might be possible to purchase service credits to partially offset any service losses.
- See if your seniority will be impacted.

- Contact the **NEA Affiliate** in your current state and in the state you're considering moving to for the information you'll need to calculate and balance all potential impacts.

Generally, an educator who spends her entire career in one state can expect to retire with higher benefits than an educator who splits her career between two or more states. When you remain in one state or district, the service credits you earn and your average pay over the final few years of your career add up to boost your benefit allocation.

Are pension benefits taxable?

As you plan for the portion of your retirement income that will come from your pension, consider that taxes may reduce the amount you actually put in your pocket.

Generally, some or all of your monthly pension benefit is subject to federal income taxes. States have their own tax laws, so how—or if—your benefits get taxed will vary depending on which state is paying your benefit and which state you decide to spend your retirement in.

Typically, taxes are withheld by your pension administrator, so you don't have to worry about calculating or paying them directly. As with everything that's tax-related, it's best to consult with your tax adviser as part of your retirement income planning.

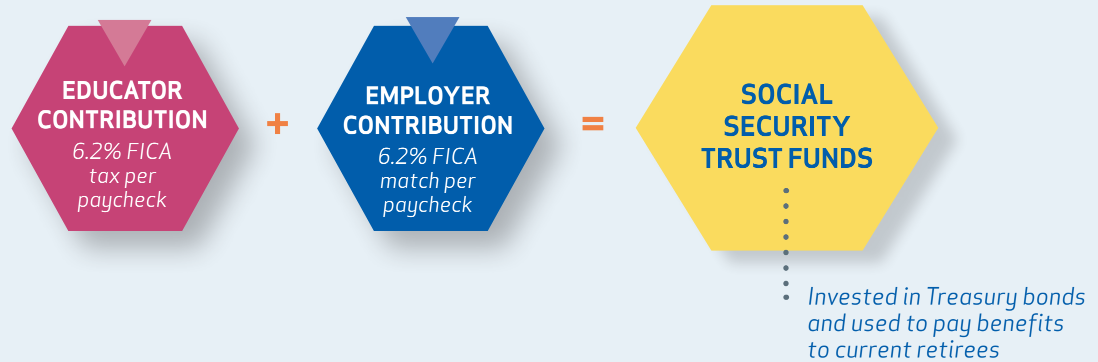
Social Security

Social Security provides a basic monthly income for millions of retirees, disabled people and their families. It's a major source of income for nine out of 10 people age 65 and older. Only about 60% of public-school employees are eligible for Social Security in addition to a state pension.

How does Social Security work?

Social Security is a social insurance program that works much like a pension plan, in that employees and employers both contribute to the program. An employee pays a 6.2% payroll tax on their salary, up to an annual limit (for 2020, the taxable salary limit is $137,700), and the employer matches that contribution dollar-for-dollar.

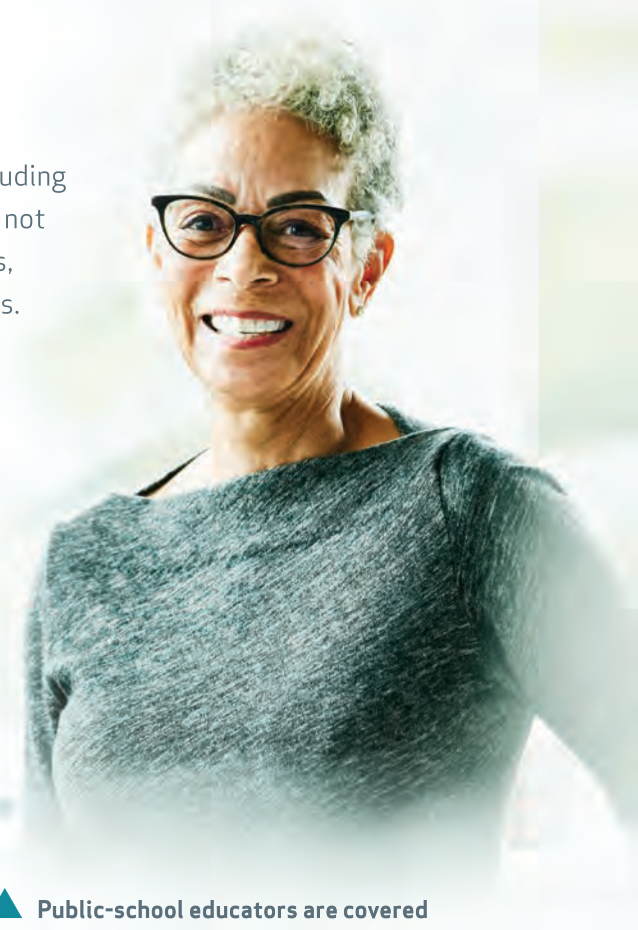
How Social Security is funded



Similar to a state pension, Social Security benefits are calculated based on the number of years you worked and paid into the system, your average earnings over 35 years and the age you first apply for retirement benefits.

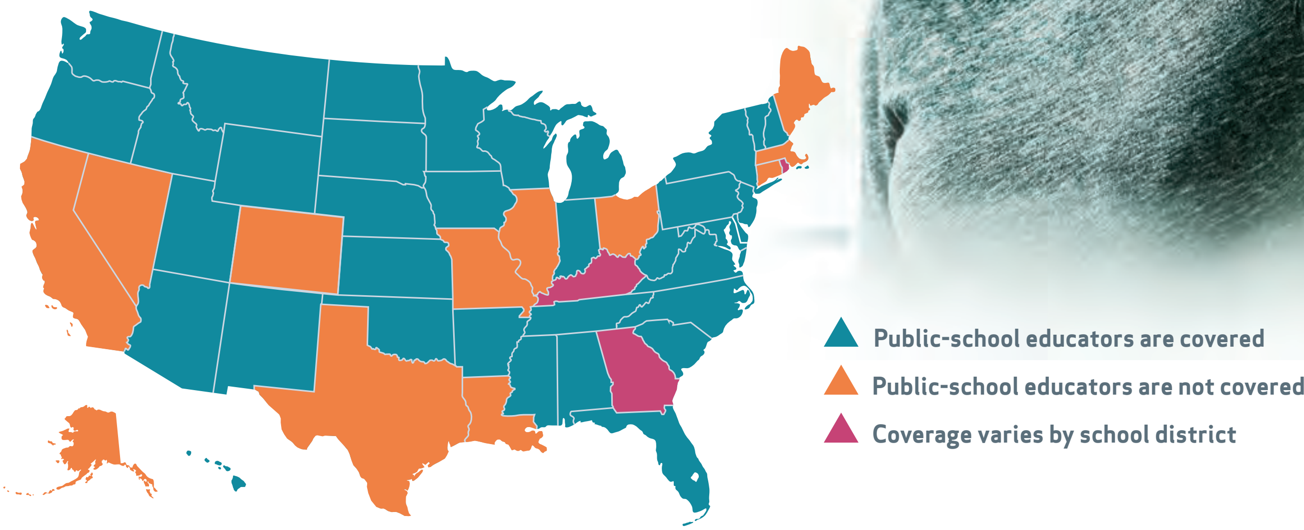
Who receives Social Security benefits?

When Social Security was formed in 1935, it only covered employees in the private sector. Public-sector workers were left out because there were questions about the constitutional authority of the federal government to impose taxes on states. Nearly 20 years later, in 1951, the Social Security Act was amended to give states the opportunity to participate in the program.



All but 12 states elected to enroll their public-sector workers—including public-school educators—in Social Security. The states that opted not to participate are Alaska, California, Colorado, Connecticut, Illinois, Louisiana, Maine, Massachusetts, Missouri, Nevada, Ohio and Texas. Three states—Georgia, Kentucky and Rhode Island—have partial participation depending on individual school districts.

Social Security Coverage for Public-Sector Employees *(by States)*



Nationwide, about 40% of public K-12 educators are *not* part of the Social Security system, which means they are significantly more reliant on their pension plans for retirement income.[3] In states and school districts where public-sector workers don't have access to Social Security benefits, pension plans typically provide higher pension benefit formulas to help compensate.

How much will Social Security provide in retirement?

The Social Security Administration has a **calculator** that can help you project the Social Security portion of your retirement income.

Does getting a state pension affect Social Security benefits?

It's complicated.

In the 1970s and '80s, two rules were enacted that could affect an educator's ability to receive full Social Security benefits: the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). These related provisions reduce Social Security benefits for people who have worked in a job that offers a public pension.

The NEA believes the WEP and the GPO unfairly reduce or eliminate benefits that public employees or their spouses have earned and is actively working to repeal those regulations by supporting the Social Security Fairness Act (S. 521/H.R. 141) and the Public Servants Protection and Fairness Act (H.R. 4540) that proposes adjustments to the WEP.

Windfall Elimination Provision (WEP)

The WEP applies to pension-eligible public-sector workers who are also eligible for Social Security based on their private-sector work history. This provision can reduce a worker's Social Security benefit by up to half of their public pension benefit, depending on the number of years they worked in the private sector. Even educators who work part-time or summer jobs to supplement their regular income can be affected.

There are a lot of moving parts to the WEP calculation. For instance, if you've accumulated more than 20 years of Social Security covered earnings, the WEP impact starts to diminish. Once you have 30 years of covered earnings, it no longer applies at all.

The Social Security Administration has more information, including a **chart** that allows you to estimate how the WEP may affect your benefits.

It's important to do some research on how your retirement benefits might be affected if you have ever worked in, or are considering working in, the private sector.

Government Pension Offset (GPO)

The GPO applies to workers who are entitled to Social Security benefits as a spouse or survivor ***and*** who are eligible for state pension benefits from a job in which they ***did not*** pay Social Security taxes. If you meet both of these requirements, your Social Security survivor or spousal benefit may be reduced by two-thirds of your pension benefit (a "partial GPO offset") or even completely eliminated (a "total GPO offset").

For example, let's say Arlene worked for 25 years as a teacher in California, a state that does not participate in Social Security for its public-sector employees. Arlene's spouse worked in the private sector and paid Social Security taxes for 35 years. When Arlene retired, she began receiving a state pension of $2,500 a month. Her spouse also retired and applied for Social Security benefits, receiving $2,300 a month.

When Arlene's spouse passed on, instead of getting the full $2,300 spousal benefit, the GPO reduced her monthly Social Security benefit to just $633. Here's the math:

Sample GPO Spousal Benefit Reduction Calculation	
Arlene's Monthly Pension	$2,500
GPO Reduction Factor	x 2/3
Social Security Benefit Reduction	**$1,667**
Social Security Spousal Survivor Benefit	$2,300
Benefit Reduction	-$1,667
Arlene's GPO-Reduced Monthly Spousal Benefit	**$633**

Arlene's sample benefit reduction is bad enough. But if the Social Security benefit reduction amount (pension benefit x 2/3) is equal to or more than the Social Security spousal survivor benefit, then the surviving spouse doesn't get any Social Security money.

The Social Security Administration has more **GPO information** including a calculator to help you estimate how your retirement income may be affected by the GPO.

WEP and GPO reductions are not reflected on your annual Social Security statement. You have to either use an online calculator to get an estimate or apply for benefits to see precisely how these provisions will affect you.

Personal Savings and Investments

Educators often can't rely solely on income from pensions and, if eligible, Social Security. Personal retirement savings can supplement those benefits to boost your monthly retirement income, broaden your retirement lifestyle options and provide additional financial security.

How can personal savings fit into my retirement planning?

Unlike the guaranteed, lifetime monthly payments from a pension and Social Security, retirement income from money you save on your own is dependent on how much you save over your career and accumulated investment earnings on your savings.

Considering the average educator retirement age is 59½, personal savings can serve as a cash cushion to help close any income gaps before Social Security is available (earliest eligibility age is 62 for reduced benefits) and before you qualify for Medicare at age 65. Your personal savings can also help to protect your purchasing power from the effects of rising inflation if your pension plan does not include a COLA provision.

What's the difference between saving and investing?

Your savings—the money you're not immediately spending on everyday expenses—is probably in a federally insured bank account so you can access it when needed. It's safe, but it's not growing much, if at all—especially when interest rates are very low.

When you invest your retirement savings in bonds, stocks and mutual funds, your money has the potential to grow more than it would in an insured bank savings account. In return for putting your money to work without any guarantees or insurance, you run the risk of investment losses, but a lot of that risk can be managed.

How do I manage investment risk?

As a long-term retirement investor, you're primarily concerned with two kinds of risk.

- **Market risk.** This is the risk that your investments will drop in value, causing them to be worth less than what you originally paid. Generally, stocks have a higher level of market risk because they offer more growth potential.
- **Retirement risk.** This is the risk that your investments won't grow enough to meet your retirement income needs or even keep up with inflation. If you make very conservative investment choices in an effort to decrease market risk, you'll likely increase your retirement risk.

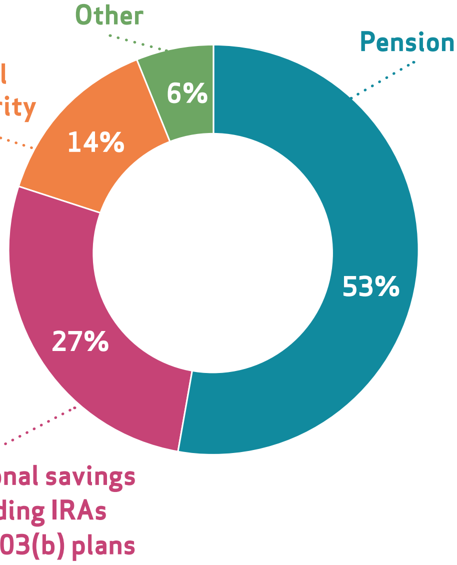
You can manage these contrary risks in two ways.

- **Appropriate asset allocation.** Asset classes are the types of investments you choose for your portfolio, such as U.S. stocks, foreign stocks, bonds, real estate and others. The percentage of your money you invest in each asset class is your asset allocation. It should be appropriate for your investment time horizon, which is the number of years you'll remain invested before you need to take withdrawals.

  The longer your time horizon, the more market risk you may want to take on—meaning more stocks—to help maximize growth potential and minimize retirement risk. As your time horizon shortens, you can reallocate your investment mix to favor more conservative options, such as bonds and stable value investments, to help manage market risk.

- **Broad diversification.** Spreading your money across many different investments within each asset class can lower the risk of loss if a specific investment performs poorly at any given time. Think of diversification as helping to protect your nest eggs by putting them in different types of investment baskets.

Where do you expect the majority of your retirement funds to come from?[4]



"[The NEA] has helped me realize the importance of preparing for that day. Investing in my new life is just as important as beginning teaching 34 years ago."

Julia A.

Where can I invest for supplemental retirement income?

A defined contribution (DC) plan is a personal savings plan offered to many education professionals through the workplace, as a supplement to their pension.

DC plans, including 403(b) and 457(b) plans, are a convenient place to save and invest. You contribute through automatic payroll deductions, which provides built-in discipline to save before you spend. Pre-tax contributions reduce your current income taxes, and your savings has the potential to grow tax-deferred until withdrawal.

Workplace DC plans will likely provide access to a pre-selected menu of investment options, including mutual funds and annuities.

Outside of a workplace DC plan, you can also invest in a traditional IRA, a Roth IRA or both. The tax advantages are similar to those in a DC plan.

Am I saving enough for retirement?

The general rule of thumb to give yourself the most flexibility in retirement is to save as much as you can. To get a bit more specific, NEA Member Benefits offers a **calculator** that lets you run "what-if" scenarios to help you estimate how the amount you're saving in your workplace retirement plan will affect your lifetime retirement income. Play with the numbers to find a savings amount that works for your present and future needs.

NEA Member Benefits helps you plan for the future

The **NEA Retirement Program** offers a customized suite of retirement solutions. Members can:

- Invest in a 403(b) plan, 457(b) plan, plus traditional and Roth IRAs
- Work with a local NEA Retirement Specialist with knowledge of the unique retirement planning needs of educators
- Manage their supplemental retirement investing themselves through a self-managed investment account

Retirement Planning Research Checklist

Public-school employees have unique needs and must consider a number of factors when planning for retirement. The checklist below can help you research the three retirement income pillars discussed in this guide so you can gauge how they apply to your specific situation. The more you know, the more control you'll have over your retirement security.

State Pension Plan

- ❑ Contact your **NEA State Affiliate** to learn the details of your pension plan, including vesting rules, COLA provisions and benefit formulas.
- ❑ If applicable, find out how moving to a different district or state may affect your pension.
- ❑ If applicable, find out how work you've done, or are planning to do, in the private sector—including part-time or summer jobs—may affect your pension.
- ❑ Consult with your tax adviser to understand how your pension benefits will be taxed so you can estimate what your actual "take-home pay" will be.
- ❑ As you get closer to retirement age, keep tabs on your estimated pension benefits (your plan administrator can provide this information). Knowing how your years of service factor into your benefit can help you determine when to retire.

Notes: ____

Social Security

- ❑ Create a free **"my Social Security" account** to get personalized retirement benefit estimates. You can also review your Social Security statement to make sure your earnings are being accurately reported.
- ❑ Use the Windfall Elimination Provision (WEP) **calculator** to see how your Social Security benefits may be affected by your public-employee pension.
- ❑ Use the Government Pension Offset (GPO) **calculator** to see if your Social Security spousal or survivor income will be affected by your public-employee pension.

Notes: ____

Personal Savings and Investments

- ❑ Tally up the balances in your existing retirement plans, including those offered through your workplace, and any traditional IRAs, Roth IRAs, money market accounts or CDs that you've earmarked for your retirement.
- ❑ Check the maximums you're allowed to invest in each of your retirement accounts. Determine if you have the cash-flow flexibility to increase the amount you're saving in one or more of the accounts.
- ❑ Check the asset allocation and diversification of your investment portfolios to see if you're investing appropriately for your risk tolerance and retirement time horizon.
- ❑ Enter all of your information into the NEA Member Benefits retirement income **calculator** to figure out whether you need to increase your personal retirement savings to help offset any shortfalls in your pension benefits or any payments that will be reduced by the WEP or the GPO.
- ❑ Consult with your tax adviser to understand how withdrawals from your different retirement accounts will be taxed so you can devise a strategy to minimize taxes throughout retirement.

Notes: ____

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Additional Retirement Planning Resources

- If you want to learn more about investing in the financial markets, NEA Member Benefits offers a **beginner's guide** to stocks, bonds and investing. In a 10-minute read, you'll get a basic understanding of the stock market, asset classes, mutual funds, index funds, and how to get started with an investment plan.
- Check out our retirement planning resources at **neamb.com/retireguide** for a wealth of information to help you plan for the retirement you deserve.
- NEA members have complimentary access to the monthly **Kiplinger's Retirement Report**, which offers practical information and advice to help you plan for and enjoy your retirement.
- Explore the **NEA Retirement Accounts** available to NEA members to see how those can help you supplement your pension.

[1] Source: NEA Collective Bargaining and Member Advocacy, Characteristics of Large Public Education Pension Plans, January 2016; **https://www.nea.org/professional-excellence/student-engagement/tools-tips/public-education-pension-plans**

[2] Source: **https://www.nirsonline.org/wp-content/uploads/2017/11/2014_pension_education_toolkit_full.pdf**

[3] Source: **https://www.nasra.org/socialsecurity**

[4] Source: NEA Member Benefits Member Advisory Panel (MAP) Retirement Readiness Study, August 2019

The information in this guide was accurate as of October 2020.