Argus
Financial Management

Choosing between the Optional Retirement Plan and the Teachers' Retirement System

By Charlie Sawtelle, Owner, Argus Financial Management

Choosing between TRS and ORP is a decision that will have a lasting impact on your financial future. Professors at all Texas public universities are given a choice of retirement plans at the beginning of their employment. That choice is between TRS, the Teachers' Retirement System, and the ORP, or Optional Retirement Plan. TRS is the default choice for all employees at the beginning of their employment. They then have 90 days to decide whether to stay in TRS or enroll in the ORP. TRS is a pension funded by all teachers employed at public schools, including public universities, in which the participant receives a guaranteed monthly payment at retirement. The ORP works very much like a 401k. This means the ORP is invested in the stock market, using mutual funds or annuity funds, at the discretion of the participant or their advisor.

TRS is a guaranteed payment based on a formula which takes into account the teacher's age, salary history, and years of service. Based on the TRS website, the actual calculation is Years of Service x 2.3% x Avg Salary of your top Five Years. This number is then divided by twelve to give you a monthly benefit. For those that may want to calculate their anticipated retirement, you can visit the TRS Retirement Calculator by clicking here.

Just like TRS, the ORP is funded by both the participant and the employer. For those beginning at the University of Texas at Austin, your contribution each month to your ORP is 6.65% of your salary. The matching from the university can vary by tenure but it is guaranteed to be at least 6.0%.

Choosing between TRS and ORP can be difficult and requires a bit of research to decide which plan is more appropriate for each participant. It can also depend on the risk tolerance of each professor. Those that have no interest in watching market movement or begin to lose sleep on market corrections would most likely be more comfortable with TRS. However, that stability comes with a price. In the long run you will end up getting less with the guarantee than you would taking on more risk.

Risk means being in the stock market with the ORP. Risk also assumes your ORP account will rise and fall with the market and therefore you might lose money, sleep, sanity (or all three) when the inevitable correction hits. Many people think of risk as a negative but that is not the case. Risk in this context also means you can strive to get the 9% annual return the stock market has averaged since 1900. That 9%, of course, includes times like the Great Depression, the 1970s oil embargo, the stock market crash of 1987, the dot.com crash in 2000, and the Great Recession (a term for those who don't know their history) of 2008.

To put two comparisons in numerical value, let's start by using the TRS calculator located on the State of Texas website. If I take an average 5 year salary of $96,332 (the overall average UT salary according to the Faculty Salary Analysis 2009-2010), that faculty member will receive an average monthly payment from TRS of $7,385.45 based on 40 years of service and retiring at age 65.

40 Years of Service x 2.3% x $96,332 avg salary = $88,625.40/year or $7,385.45/month.

Assuming a 20 year retirement from age 65 to age 85, the total benefit paid will be 20 years x $88,625.40 per year or $1,772,508. As you can see, this program can be a very good option for those that do not want to invest in the market or tend to lose sleep during market corrections.

The math for the ORP is a bit trickier and requires more data because it assumes 12.65% of your annual salary from the time you begin work to the time you retire. In order to keep things as simple as possible, I am going to take the average salary today, $96,332.00, and project that over the next 25 years in order to be somewhat conservative in my estimate. This number will not take into account any raises nor will it take into account the use of the two other plans available to faculty, the Tax Deferred Account or TDA, or the UT Saver Account or DCP. Further, I am going to start with an average ORP balance of $150,000 because if I project ORP contributions for the next 25 years and use the same 40 years of service I did with the TRS calculation, this assumes you have been saving into your ORP account for 15 years at $10,000 per year with no growth (again, a conservative estimate). I have found that many professors with 15 years of service in the ORP typically have at least $150,000 and many usually have more. Using a future value calculation, the professor with an average salary of $96,332 contributes (at a minimum) 12.65% per year to her account or $12,186 per year. Over a 25 year period the total amount attained by age 65 would be $2,325,627.22 which would calculate to $9,690.11 per month, roughly $2,300 more per month than TRS.

But therein lies the rub. Can the amateur investor make 9% per year in the stock market? The short answer, according to studies of investor behavior, is no. The average investor tends to sell too quickly when the market falls and buys too late after the inevitable bounce back comes. During both good times and bad, the S&P 500 has averaged a return of about 9% per year since the 1900s and actually has averaged 9.14% per year over the past 20 years according to DALBAR, a market research company. Here we have the basic conundrum that pops up from using the ORP. You must take on the same risk level investing in the S&P 500 to achieve these returns. In order to remove the emotion of investing, an experienced investment advisor can help you attain the average return of the S&P. It is a disservice for any advisor to tell you that taking less risk at age 40 is ok. You will not end up with the full amount of retirement assets you deserve by being more invested in the stock market.

This is also just one half of the argument. Remember, at retirement, if you have $2,325,627, your ORP account will continue to grow using a mix of bonds and other conservative assets which will allow you to keep more of your principle to do with as you wish. With TRS, if your monthly payment is $7,385 per month, it is going to stay that way and you will not be able to pass anything on to your children or grandchildren. I believe it is very possible and likely you will not only have MORE money than you would

with TRS, but you will also be able to pass that money on to your heirs. The ORP is the option that allows this but it must be used prudently and thoughtfully as you work towards your financial goals.

A further argument for the ORP is its portability. With TRS, if you take a job in another state or with a private university, you can only take 2.3% of your account for each year of employment. However, with the ORP, as long as you are fully vested (generally 1 year) you can take the entire account with you, and roll it over into an IRA.

In the long run, it is preferable to enroll in the ORP if you can handle taking a bit of risk. It allows far more flexibility and the chance to make more money than you put in.

If you are interested in learning more about my ORP management philosophy and how Argus Financial Management can help you reach your retirement goals, please feel free to contact me at charlie@argusfm.com or call 512-436-9290.