Thrift Savings Plan post-retirement withdrawals



Ron Watson

he Federal Employees Retirement System has three components: the FERS annuity, Social Security and the Thrift Savings Plan (TSP). The FERS annuity and Social Security are defined benefit plans. They pay monthly benefits at retirement according to set formulas for the remaining life of the worker. The TSP is different. It is a defined contribution plan. It does not pay benefits according to a formula; instead, it constitutes an accumulation of wealth, the amount of which depends on the contribution rate that the employee allocated during his or her work-years, and the investment decisions he or she made. Upon regular retirement or age 59½, that accumulated wealth

becomes available to the retired worker, without penalty. TSP regulates withdrawal, but provides a host of options.

One option is to take the money out of the TSP and invest it with a private life insurance or securities company, usually upon the advice and urging of an insurance or securities salesman (sometimes known as a financial advisor). Retirees considering that option might consider some background information about the TSP and the private investment industry.

There are three major elements that make TSP an unparalleled attractive investment during an employee's work-years:

- Contributions shelter income from taxes. Contributions reduce the worker's tax liability in the year they are made. For example, if an employee contributes \$5,000 in a tax year, and has a marginal tax rate of 15 percent, the tax liability will be \$750 less than if no contribution had been made to the TSP. Instead of paying that \$750 to the IRS, the employee pays it into his or her own TSP account.
- The Postal Service matches up to 5 percent of basic pay. The first 1 percent is automatic; the Postal Service pays it into a worker's TSP account irrespective of whether he or she contributes. If the worker does contribute, the Postal Service will match up to an additional 4 percent (contributions by the employee are matched dollar for dollar up to 3 percent of basic pay, and matched 50 cents on the dollar for the next 2 percent of basic pay contributed). If an employee's basic pay is \$50,000, and he or she contributes \$2,500 (5 percent), the Postal Service will contribute an additional \$2,000.
- The low cost of administrating the TSP (in comparison with the private-sector investment industry) is **legendary.** In 2013, the cost of administering the TSP

funds was less than 0.03 percent. In comparison, typical administrative costs of private industry investment funds average around 1.5 percent or more. Administrative costs are ultimately paid by investors through reduced earnings on investment.

Once an employee retires, the first two elements no longer apply because there are no contributions being made in a tax year, and there are no agency-matching contributions. However, the third element continues in operation, and might be an important consideration for retirees thinking about what to do with their TSP.

The marked difference between the administrative costs of operating the TSP versus the cost of private investment companies is not hard to explain.

TSP expenses (i.e., the cost of administering the plan) include management fees for each investment fund and the costs of operating the TSP's record-keeping system, providing participant services, and printing and mailing notices, statements, and publications. The cost of operating the TSP, of course, includes the salaries of TSP employees. No TSP employee is paid tens of millions of dollars in annual salary and benefits.

Private investment company plan expenses include plan administration fees, investment fees, individual service fees, commissions to brokers and other salespersons, advertising and other promotion costs, front-end loads, back-end loads and more. Many bank and investment fund executives receive annual salaries and benefits measured in millions of dollars.

In addition to the difference in administrative costs, there is another major benefit to keeping money in the TSP after retirement. As a matter of law, the fiduciary responsibility of the TSP board and TSP director is to manage the plan solely in the interest of participants and beneficiaries (5 USC 8477b). Private investment companies may manage their plans in the interest of stockholders and owners.

Retirees who are contemplating moving their TSP savings to a private investment company might ask the salesman the following questions, as suggested on the TSP website:

- What is the average net expense I'll pay for every \$1,000 I invest?
- What additional annual fees, commissions, or charges will I pay for investments?
- What profit do you make if I invest with you?
- Do you have a responsibility (fiduciary obligation) to put my interests ahead of your own?
- Will your plan protect my retirement funds from creditors' claims?
- When I retire, can I receive a series of scheduled withdrawals without giving up control of my account?
- Can I change my investments or take withdrawals without being subject to surrender fees or backend charges?