Is It Time to Retire Your Thrift Savings Plan?

Being a fiduciary wealth manager means two things in practice. First, I'm obligated to serve my clients' best financial interests. Second, I give big picture advice. This could be a recommended action (where to invest, for example), or a simple word of caution: Don't.

I recently offered that word of caution to a federal employee who's nearing retirement. His plan was to leave his $1 million Thrift Savings Plan (TSP) account with the government to maintain the ease and convenience that had helped him accumulate the $1 million in the first place. He isn't the first client to tell me this, and I'm willing to bet many federal employees in and around Montgomery County are planning to leave their TSP money where it is after they retire. If you're considering doing the same, I urge you to reconsider.

Strict Limitations Can Impose Hardships

TSPs have rigid distribution rules. If you want to spend some of your money, you have one chance to take a lump sum. After that, you'll either have to agree on some monthly dollar amount or annuitize your TSP over your lifetime which will prevent your account from growing. If you don't need your money, you can let it grow until you are 70 ½ and they will calculate your Required Minimum Distribution (RMD) to send to you. However, they'll also include your Roth account balances as well which normally don't count towards RMDs. In fact, they include the Roth balance in any distribution made which means you lose out on future tax-free growth of those contributions.

Many people don't mind these rules because they like the security of a monthly payment. That's fine, assuming you have additional savings for that new car purchase or once-in-a-lifetime travel opportunities. But if the bulk of your retirement savings resides in a TSP, lump-sum withdrawals even for health emergencies won't be available to you.

In addition, your TSP could be a burden to those you love. Surviving spouses who inherit TSP accounts are free to keep the accounts intact. But for subsequent beneficiaries, there is no "stretch" option to roll over shares to inherited IRAs; the entire TSP balance must be distributed and taxable in that year.

I recently spoke with adult children facing this scenario – their other parent, the TSP beneficiary, having passed away – and they were frustrated knowing they were about to get hit with $300,000 in taxable income putting them in the highest tax bracket. They would have preferred an inherited

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IRA, which would have allowed them to spread out the taxes over many years, keeping them in the lower bracket.

Consider the Costs (and Potential Losses)

Limited access to TSP funds is only part of the story. While the expenses are low because the TSP offers only a few broad index funds, your opportunity costs can be high. By limiting you to five options, you can't take advantage of the universe of products and vehicles that offer comparable rates of return with less risk. You'll also miss out on a variety of wealth management strategies – Roth conversions, penalty-free 72(t) distributions prior to age 55, qualified charitable distributions, etc. – that can significantly reduce your tax burden.

Cyber security, or a lack thereof, is another important consideration. The G Fund, where 43% of all TSP participants have 100% of their money, is worth over $200 billion. Without basic security protocols such as two-factor authentication and security monitoring (which most retail brokerages offer), the G Fund is a particularly attractive and vulnerable target.

If someone were to hack into your TSP account to steal funds, there is no guarantee you'll get it back, at least not in a timely manner. In 2011, over 120,000 TSP accounts were hacked and personal and banking information was stolen. However, IRA accounts held at any brokerage firm (Charles Schwab, TD Ameritrade, etc.) are covered by the Securities Investor Protection Corporation (SIPC) up to $500,000. If your money is stolen under their watch, they are accountable.

My Advice: Opt for Freedom and Flexibility

If there's one thing you need over the course of a 20- or 30-year retirement, it's full control over your assets. You need the freedom and flexibility to enjoy opportunities as they come and to be able to pay for unexpected, large expenses.

By rolling your assets over to IRAs, you can manage, move and spend your money as you see fit. You can still use low-cost index funds. But, you can take advantage of strategies like the ones we employ for our middle class millionaire clients to continue building your wealth, manage and potentially reduce your taxes, and ensure a tax-deferred inheritance for your beneficiaries. Most importantly, you can rest easy knowing your account is secure. MM