5 COMMON TSP MISTAKES

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WEALTH PARTNERS

The Thrift Savings Plan (TSP) was developed in 1986 as part of the Federal Employee's Retirement System Act.

It was formed as a supplement to the current defined benefit (pension and Social Security) offering for Federal employees. As a defined contribution program, employees may contribute up to the allowable limits and take full advantage of the matching provided by their respective retirement system. TSP currently has over four million participants, making it one of the largest work-sponsored retirement programs in the United States.

The benefits of TSP are widely known and evidenced within the financial services industry. It serves as a low-cost and accessible way for Federal employees to save retirement monies. TSP offers a limited range of options, ease of use, and an overall moderately comprehensive guide to equity and bond markets. However, with a system as robust and large as TSP, there are bound to be some inefficiencies and mistakes that Federal employees make when handling their largest asset. Benefit Wealth Partners has compiled a list of what we feel are the five most common mistakes Federal employees make with their TSP.

Mistake #1

NOT PROPERLY ALLOCATING YOUR TSP

The term "proper" is somewhat subjective. What is proper for one Federal employee may not be proper for the next. When we look at the system created for Federal employees to invest in, there are some limitations and rules that they should consider, such as transfer limits, contribution limits, and limited fund choices. With the market becoming more volatile, stress being added by international and domestic conflicts, interest rates, and ongoing business cycles, it is becoming more difficult to decide what actions to take and when. Furthermore, at a time when the validity and intentions of the financial services industry are called into question, it makes the task of doing it yourself seem daunting and insurmountable.

The above scenario makes it seem so overwhelmingly difficult that most employees choose to neglect their TSP funds and how those fund choices are impacted by the current market conditions. Being mindful of what is coming, rather than evaluating returns and making investment decisions, can make a large difference between the balance that you have and the balance you wish you had.

So, you may be asking, "How is a TSP properly allocated?" There is no concrete, easy way to answer that question, but a starting point would be to look at your current risk, your long-term goals, and the role that your TSP income will play into your retirement. The main objectives a Federal employee needs to take with their TSP is to approach it well-informed of the unique rules and restrictions; to analyze, to some degree, the temperature of the market; and to assign a formula to their plan. After assigning your plan, execute and revisit that plan so it can be updated with any changes that arise; for example, in the market, change to risk tolerance, death, inheritance, etc. Relying solely on luck can work some of the time, but studies show that an active rebalancing produces better long-term results on your investments.

Mistake #2

TAKING WITHDRAWALS PRIOR TO RETIREMENT

One question that our representatives are frequently asked is, "Should I take money out of TSP and pay off my house or buy a vehicle?" While all Federal employees have access to their TSP funds when they turn 59 ½, please use measured caution when pulling money out of your qualified investments to pay off debt or to make a big purchase. These types of investments, deemed retirement assets, are just that; assets to be used at retirement. The initial intention of such assets was to take small distributions over your life expectancy to help offset some of the overall tax consequences that you may encounter in your retirement. The rationale being that when you are working you are in a much higher tax bracket, because you are making significantly more money than you will be in retirement. By waiting until retirement, you are reducing the amount of taxes you will be paying on that block of investments, thus saving yourself some tax liability.

That strategy becomes difficult for a federal retirement because your federal tax bracket may not significantly change as a retiree. In some cases, especially when introducing disbursements and RMDs from qualified accounts, such as an IRA, 401(k), TSP, etc., you may even encounter a higher tax bracket.

All of these various methods are complicated when pulling a large amount of money from TSP. Not only are you putting yourself at risk of a tax consequence, you are also surrendering those funds for future gains in the market. The high opportunity cost in those cases can take an entire retirement to earn back. In positive market years, the returns in the market may be able to do that, but with the uncertainty that presents itself within the market, it may be too big a gamble. In most circumstances, it is better to budget purchases from your income and allow your TSP and other qualified investments to continue to grow.

Mistake #3

CHOOSING THE WRONG PAYOUT OPTION

TSP offers a wide range of payout options for their participants. Some are aware of all the options they have, but most rely on the option shown on the middle right of their TSP statement. TSP uses the single life annuity option starting at age 62. This option, while providing the highest amount of overall guaranteed income, has some significant drawbacks. The main one being the lack of a beneficiary in the event of the participant's death. So, in the case of a TSP participant selecting this option and passing away prior to the exhausting of their funds, the system retains possession of the remaining assets and keeps that for itself. There is risk for both parties; your risk in this scenario is that you do not live long enough and the insurance company's risk is that you live too long.

TSP also offers other, more flexible, and reasonable options for access to your money, but it does take some time to find what payout will work best for you and your family. Each payout option that TSP offers has advantages and disadvantages when looking through a lens of objectivity. There is no right answer to give someone when it comes to that decision, as there are a variety of factors that come into play. Low interest rates influence the payout you will receive from the variety of annuity options and can substantially reduce the stream of income you will permanently receive from this asset. Conversely, the risk and volatility in the market can greatly reduce longevity of payments in the fixed dollar option and the dollar amount of the payments in the life expectancy option.

When looking at all the variables with income from your TSP, the best choice is the one that provides you with the necessary amount of money needed to properly retire and live comfortably while still making sure that money passes through to your beneficiaries, rather than back into the system.

Mistake #4

NOT UNDERSTANDING WHAT YOU HAVE

As a firm, we have seen, helped, and set up retirement plans for a significant number of Federal employees at various stages in their careers. One common theme is that many employees do not seem to understand their TSP and the relationship that they have with the institution. For many Federal employees, it is often sold that TSP is a separate arm of the government, which isn't the case. If the presumption is that TSP is a gold-plated building on top of a perfect grassy knoll in Washington D.C., you will be greatly disappointed in your next visit to our nation's capital. TSP uses a five-person executive board of directors led by an executive director. The board is tasked with selecting the money managers and fund options for the participants of the TSP, as well as developing the rules and regulations for interfund transfers, matching, and any other changes that need to take place.

Prior to retirement, the participant is in a Professional Money Manager-Investor relationship. They are deciding to invest their money in the fund of their choice, and, in the case of TSP, they can select from the different options laid out to them via the TSP board. At retirement, when the participant goes to utilize their funds, depending on the option, they are transitioning to a different type of relationship. If an annuity payout option is chosen, they move to an Investor-Insurance Company relationship. The insurance company is again chosen by the TSP board, which, at the time this article was written, is MetLife. The insurance company dictates the rates and payout options along with the beneficiary access on their end.

When we talk about the investment world in a broad sense beyond TSP, you are sharing a similar relationship to the one you currently have with TSP. In the accumulation stage, you are still in a Professional Money Manager-Investor relationship, with the biggest difference being that you are in control of selecting the advisor and/or manager you would like to work with. When we look at the distribution phase and the selecting of an annuity payout, you are again working in an Investor-Insurance Company relationship, but again, you are choosing that company and choosing it based on what you are looking for.

With all the options that exist in the market, there is no right or wrong answer. The common denominator, with all things considered, is choice. The more information you have about the various options available the better and more confident your retirement decisions will be. Not understanding what you have and what your current relationship is will most certainly have an impact on your retirement. Whether that impact is positive or negative is something that may not be known for some time.

Mistake #5

CHOOSING THE WRONG PAYOUT OPTION

The easiest way to plan for retirement is not to think about it. Retirement is always a hard topic to address, but we can begin by acknowledging that it is difficult and taking a proactive approach to properly plan years from retirement age. The long-term implication of not facing the reality that at some point you will need to retire is that you may or may not have enough money to live on. If you realize that too late, then you may or may not be able to change it. Some people go into retirement and never worry about needing money, and some people have never thought longer than 10 minutes about what funds they should be using and how much they should be contributing. While commending those people for the ability to live worry-free, in most cases, if their retirement works properly, they lucked out. There does not need to be a complicated strategy in place to help you time markets, reduce risk, and collect a proper rate of return. Sometimes all that is required of you is to show up and participate by putting money away. However, taking a little extra time and developing a strategy on how you are going to approach retirement, no matter what stage of the game you are in, will lead to more success, or, at a minimum, the ability to make more confident choices.

The biggest takeaway that we hope you gain from our experience as financial advisors who spend a significant majority of our time devoted to helping Federal employees retire is to develop a simple, easy-to-follow plan for your retirement. Make sure you are mindful of what your pension will be, how it's changed by working longer and retiring sooner, and how the long-term costs of health insurance, life insurance, and survivor benefits can drain your income. Also, changes to Social Security, your life, and the system can affect your TSP. Increasing and decreasing interest rates can have a bearing on your investments and income. As market conditions fluctuate, you can see a change in your retirement income and long-term sustainability. And, as health insurance costs rise and long-term health deteriorates, you might need more money to retire. All these factors affect more than just your TSP, but all play a crucial role. The more you understand and plan for any of the above-mentioned contingencies, the easier and more confident you will be in making retirement choices. Having a plan in place that you are happy with can go a long way to producing your desired result.

The fad in the mainstream now is do-it-yourself. We have entire TV networks devoted to DIY home improvements, not to mention online videos that show consumers how they can fix their own home or car, perform electronic repairs, do their taxes, prepare a will, etc. A lot of you have plenty of internal and external resources that can help you achieve your retirement and income goals. However, reaching out to a professional who can help accomplish your net goal is sometimes more efficient and can achieve a higher degree of success. It's important for all retirees to consider this option, but be fully aware of the angle and intent of the financial professional. It is important to know all conflicts of interest up front, so there are no surprises. Always enter a professional relationship with your eyes wide open, know all information and conflicts of interest, and make sure that both parties are working toward similar goals.

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