

THRIFT SAVINGS PLAN



INCLUDES UPDATES ON THE
TSP MODERNIZATION ACT
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TSP WITHDRAWAL OPTIONS

Choose the One That Fits Your Needs

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National Active and Retired
Federal Employees Association

TSP WITHDRAWAL OPTIONS



*Retiring Employees Seek
The Strategy That
Fits Their Needs*

FINANCIAL ADVISERS ARE GETTING USED TO THE CALLS FROM FEDERAL EMPLOYEES APPROACHING retirement. The workers have estimated their basic retirement annuity and Social Security checks if they are in the Federal Employees Retirement System. But they are not sure what to do with their Thrift Savings Plan (TSP) accounts, and many ask for advice at the last minute.

“Everyone says: ‘I wish we had done this sooner,’” says Micah Shilanski, a certified financial planner with Shilanski & Associates in Anchorage, AK. “They don’t want to outlive their money. And they don’t want to lose their money.”

THRIFT SAVINGS PLAN WITHDRAWAL OPTIONS

Fortunately, it turns out that there really are few bad decisions about what to do with your TSP account. “It all boils down to: What are the goals and financial circumstances of the individual?” says Mark Keen, a *narfe* magazine columnist and a certified financial planner in Fairfax, VA.

Some retirees focus on buying or paying off their dream house. Others plan to travel extensively. Many want to provide a financial legacy for their loved ones. There are TSP options that can help retirees reach these goals.

The thrift plan is the “third leg” of the retirement package under the Federal Employees Retirement System (FERS), after the basic retirement annuity and Social Security. Because the basic annuity and Social Security are outside the control of the employee, it is through the TSP that he or she can make big improvements to retirement savings.

For FERS employees, the government contributes 1 percent of basic pay, matches employee contributions dollar-for-dollar up to 3 percent of pay and matches 50 cents on the dollar for the next 2 percent. Employees who were hired before 1987 are under the Civil Service Retirement System

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(CSRS); they receive no employer contribution and no match if they contribute to the TSP.

Many employees keep their TSP accounts on autopilot, other than to tweak the investment mix to be more conservative as they approach retirement. “There’s a great uncertainty that exists with everybody I meet. They don’t know how the three retirement sources are going to work,” says Michael Mattison, a consultant at PlanVest Federal in Gaithersburg, MD. He urges workers to start thinking several years before retirement about what they will do with their TSP funds.

A VARIETY OF CHOICES

There are several primary choices for using TSP funds in retirement, though there are many variations on them. They are:

- Leaving the money in the TSP until age 70½, when required minimum distributions must begin;
- Taking a partial, one-time withdrawal;
- Taking a full withdrawal as a single, lump-sum payment, often transferred into an individual retirement account (IRA);
- Taking a full withdrawal with a series of monthly payments (either at an amount the participant chooses, or as calculated by the TSP using life-expectancy tables);
- Taking a full withdrawal as an annuity;
- Taking a full withdrawal as a combination of options.

To determine which is best for you, consider your goals and “discuss your risk tolerance with a professional,” says Bob Hill, a district adviser at First Command Financial Services in Arlington, VA. “How does this account fit with your other investment accounts?” He urges employees and retirees to keep in mind that “as your life changes, you make new choices” that impact retirement needs. “You need to have your eyes open.”

Based on TSP payment statistics, a single full payment and monthly payments are the two leading withdrawal choices – and are virtually tied for the top spot. “The monthly payment participants are likely interested in replicating a regular stream of income while retaining the bulk of their accounts in the TSP, while the single-payment participants are satisfying a different set of needs,” says Kim Weaver, director of external affairs for the Federal Retirement Thrift Investment Board (FRTIB), which manages the TSP. Partial withdrawals are the third most popular option, followed well behind by annuities.

“Ultimately, only you are going to know what your decision should be,” says Weaver. She notes that the TSP does not provide retirement planning advice but tries to educate participants. It conducts training for agency representatives who discuss retirement options with employees; speaks to employees at conferences; and provides substantial support through its website and call centers.

Many federal employees and retirees turn over their TSP money to outside financial advisers without realizing that they might be getting advice that is not substantially better than the information offered by the TSP. And, in most cases, the TSP charges much less to manage investments than do private retirement planners and advisers.

In April 2016, the U.S. Department of Labor issued a regulation requiring private planners and advisers overseeing retirement accounts to put their clients' interests ahead of their own. Known as the "best interests" or "conflict of interests" rule, the regulation establishes that financial advisers had a fiduciary duty to their clients and must make recommendations for clients' investments that are not influenced by the advisers' manner of compensation.

The rule was supported by NARFE and by some consumer protection organizations. It will become fully effective in January 2018.

Among the popular features on the TSP website are calculators that help estimate TSP account payouts under various scenarios.

In a *narfe* magazine survey, members expressed support for each of the available options for using TSP funds. A few of the more than 2,000 respondents conveyed concern about the viability of TSP accounts if the government were to default on its debts and/or the stock market were to decline sharply. Under law, however, the G Fund, one of several TSP investment funds and the one that is protected by the government, will be restored to its full value, even if it is impacted temporarily by unusual events.

Ignoring your TSP account upon retirement is not an option. Says Shilanski: "Your money is a tool, and it needs to do a job."

KEEP TAXES IN MIND

While financial advisers say many factors should drive decisions about TSP accounts, "Taxes will be a big part of it," says Shilanski. (See sidebar, p. 6.) This is one area where the wrong decision can be painful, if not catastrophic. Withdrawing the full amount of one's TSP account will subject it to federal and possibly state taxes unless the money is transferred into an IRA account, it comes from a Roth TSP account or certain other factors apply. Other penalties apply in some situations for withdrawing funds too soon – before age 59½ – or too late – after age 70½.

Financial planners point out that for retirees, transferring a TSP account to an IRA has advantages in terms of asset allocation and diversification. Says financial planner Keen: "The TSP is limited to large U.S. stocks (C Fund), small U.S. stocks (S Fund), large international stocks from developed countries (I Fund), and bonds and bond equivalents (F and G Funds). There are many more asset classes to invest in – value stocks, midsize

NEED HELP?

Federal workers approaching retirement can contact their Human Resources Office and can seek advice from private investment firms, some of which offer free seminars.

In addition, pre- and post-retirement federal employees can obtain information from the Thrift Savings Plan (TSP). Its website features a comprehensive downloadable brochure titled "Summary of the Thrift Savings Plan." The TSP can be contacted by several means.

WEBSITE:

www.tsp.gov

TELEPHONE TOLL-FREE (THRIFTLINE):

Call **TSP-YOU-FRST (877-968-3778)** between 7 a.m. and 9 p.m. Eastern time.

TDD TOLL-FREE (FOR HEARING-IMPAIRED PARTICIPANTS):

Call **TSP-THRIFT5 (877-847-4385)**

International callers who cannot use the toll-free numbers, call **(404) 233-4400** (not toll-free).

FAX NUMBER:

866-817-5023

MAILING ADDRESS:

Thrift Savings Plan

P.O. Box 385021

Birmingham, AL 35238



companies, real estate stocks, emerging market stocks, etc. All of these investments are available in an IRA." In addition, he notes, with the exception of the G Fund, the TSP funds can be replicated within an IRA.

One of the quirks when making certain withdrawals from the TSP – such as through a one-time payment or monthly checks calculated by the TSP or the retiree – is that the money comes proportionately from each fund in which the retiree has invested money. That can even lead to penalties, including, for example, when the retiree has had part of his or her money in a Roth TSP account for less than five years.

Weaver notes "reasons of simplicity and minimizing costs" behind the structure of such TSP withdrawals.

THRIFT SAVINGS PLAN WITHDRAWAL OPTIONS

However, monthly payments have strong defenders among retirees, even though the payments can be adjusted only once a year, in January.

Leaving one's money in the TSP after retirement also has its proponents. The biggest red flag comes when the account holder reaches age 70½. At that point, the retiree must begin to take payments – known in the tax code as Required Minimum Distributions (RMDs) – or face huge penalties. “RMDs are something that people forget about a lot,” says Shilanski.

CONFUSION ABOUT ANNUITIES

The decision whether or not to place TSP funds in an annuity is one of the most difficult. There are advantages and disadvantages, as with all the options. And annuities take many forms.

In general, the purchaser of an annuity gives up all rights to manage his or her money in exchange for a lifetime of guaranteed payments. With some annuities, once the retiree dies, the money is gone. However, some annuities – including options offered by the TSP and many outside companies – offer a spousal or other survivor benefit in exchange for lower monthly payments.

With an annuity, “if the market goes down, you're not going to lose any money,” says Shilanski. However, he adds, “the more guarantees, the less money. Find something that really works for you.”

Many retirees who responded to the *narfe* survey said the TSP should offer more choices.

“I would like to see more flexibility for withdrawals of TSP funds in retirement,” says Judith Pasek, a retiree living in Laramie, WY. “The existing withdrawal options largely assume that a person wants a steady stream of income throughout retirement or an expected lifetime. However, financial needs do not remain constant throughout a lifetime or post-retirement.”

In July 2015, the FRTIB directed its staff to provide TSP participants with more flexibility in how they withdraw money from their accounts and to allow federal workers to invest in mutual funds. However, these opportunities will not be available immediately.

Congress must approve any changes in TSP withdrawal rules. Among improvements that the thrift board is considering are:

- Allowing multiple age-based, in-service withdrawals;
- Allowing withdrawal from one investment, rather than a pro-rata distribution;

- Allowing multiple partial post-separation withdrawals;
- Eliminating the withdrawal election deadline for post-separation withdrawals.

Thrift plan officials have said that while they would like to allow more flexibility, they also want to help participants avoid exhausting their retirement savings through withdrawals while they are working. The risks of investing in mutual funds would likely be emphasized to TSP participants if such a program is implemented.

Bruce Julian, a retiree who lives in the Northern Neck of Virginia, believed that he could do better outside of the TSP than staying in it. He withdrew all the money from his account and rolled it over into an IRA. In addition to estimating the value of keeping his money in the TSP and the value of an IRA rollover, “I did my comparative analysis with two or three private annuities,” he says. But he wasn't satisfied with the expected returns and with the potential downsides of annuities.

He says he has no problem with the administrative fees he pays on his investments in his IRA, which typically are higher than those assessed on TSP accounts. “I'm interested in performance.”

Edward Vela, Jr., a retiree from Granbury, TX, has different advice for federal employees approaching retirement: “Leave the money in the TSP account. The fund managers will do a better job of managing your money than you ever could.”

Vela, who is in his 70s, takes out the minimum distribution required by the tax code to avoid penalties. “I'm going to keep doing this. The return on investment is good,” he says, adding that he likes the fact that the administrative fees charged for TSP accounts are “very modest.”

John L. Warr, a retiree living in Fort White, FL, opted for a full withdrawal with a monthly payment at a rate that the TSP calculates. He based that decision on a seminar he attended prior to his retirement.

The TSP computes his monthly check using life expectancy tables, and every January the agency recalculates it. He says his payments have grown but his account balance has largely remained steady. “I especially like that I am able to manage my TSP account investments, just as I did before retirement,” says Warr. “I'm extremely happy with this.”

Retiree Ronald Corte of Draper, UT, had considered purchasing an annuity, but he was concerned about the account balance being forfeited upon his

death. Instead, he opted for full TSP withdrawal at a monthly rate that he calculated.

However, after several years of these payments, “I could see my balance shrinking.” He decided to switch gears and withdraw the remainder of his TSP account as a lump sum. The TSP “was more than happy to change it,” he recalls.

Corte used the funds to refinance his home mortgage and pay off his debt, leaving him with “more money in my pocket than I had even when working.”

MAKE REALISTIC PROJECTIONS

Paul Anderson, a retiree from Aiken, SC, contributed to his TSP account as a CSRS employee. Like many federal workers approaching retirement age, he was invested heavily in the G Fund. He expected that the fund would average returns of at least 4 percent after he retired, which turned out to be far too optimistic. In addition, he says, he underestimated his expenses in retirement.

He says he returned to work as a consultant to avoid major lifestyle changes. He urges workers nearing retirement to “overestimate your planned living expenses by 20 percent and underestimate your planned investment returns by 20 percent.”

For Lorton, VA, resident Sidney Sachs, an annuity seemed to be the best option, given his family’s

long lifespans. However, he chose an annuity that would provide a benefit for his wife if he died first.

Not long after he locked in the annuity, the stock market experienced a major downturn, and his decision to go with an annuity seemed even better, he recalls. “My timing was perfect.”

The TSP program is not static. In 2012, the TSP introduced Roth accounts, for which taxes are paid when money is contributed. And it’s always possible that the federal government will cut back on retiree benefits or alter tax laws impacting them.

Financial planner Hill says that, for decades, many federal employees have believed that “I work for the government and therefore all is well.” However, he says, “the ship is turning.” Pay freezes, furloughs and threats of even more significant hits to federal workers and retirees should prompt TSP participants to think ahead and manage their finances more deliberately than ever. “I strongly recommend that all federal employees have a plan in place,” says Hill. “It will change; but they will have confidence that their retirement funding will be okay.”

—STEVE BATES IS A FREELANCE JOURNALIST IN THE WASHINGTON, DC, AREA. HE IS A FORMER WRITER AND EDITOR FOR NUMEROUS PRINT AND ONLINE PUBLICATIONS, INCLUDING THE WASHINGTON POST.



THE TSP AND TAXES

Tax bills are not the only issue to consider when determining how to use Thrift Savings Plan (TSP) funds in retirement, but they can be one of the most significant. TSP rules, the Internal Revenue Service Code and various other applicable federal and state provisions should be part of every retiree’s calculations.

Just ask Patrick Garel. A recent federal retiree, Garel took a one-time partial TSP withdrawal in 2012 as part of his strategy to sell his existing house and pay off a new, less expensive house. He knew that the TSP would withhold 20 percent of his withdrawal for federal income taxes. But he didn’t realize that this withholding would fall so short, and he didn’t account for the state tax bite from the withdrawal.

“It has been a disaster,” says Garel, who lives in Bernalillo, NM. He says he was forced to come up with about \$25,000 more than what he expected to pay in 2012 taxes, in part because his withdrawal bumped him into a higher tax bracket.

There are so many little-known tax provisions and penalties, it doesn’t take much of a slip-up

to get into hot water. Even savvy retirees such as Garel, who at one time was a tax preparer, can overlook something critical.

Some tax issues to keep in mind when devising a TSP strategy for retirement:

- TSP funds withdrawn and rolled over into an IRA will not be taxed until the funds are withdrawn from the IRA.
- Most TSP funds withdrawn before age 59½ are subject to a 10 percent penalty.
- Participants must make certain Required Minimum Distributions (RMDs) beginning April 1 of the year in which they turn 70 1/2, or separate from government service, whichever is later, or face penalties.
- Qualified distributions from a TSP Roth account will not be subject to federal taxation.
- TSP federal tax withholding rates vary based on the type of withdrawal.

The TSP website, www.tsp.gov, provides information on tax issues. Look in particular for the downloadable brochure “Important Tax Information About Payments From Your TSP Account.”

TSP Modernization Act of 2017

Frequently Asked Questions

ON NOVEMBER 17, 2017, PRESIDENT TRUMP SIGNED THE TSP MODERNIZATION ACT INTO LAW. The new law provides more flexible withdrawal options for Thrift Savings Plan (TSP) participants, giving them more control over their own retirement savings. The legislation passed Congress with NARFE's endorsement, and NARFE members are anxiously awaiting implementation of the new withdrawal options.

Here are answers to questions NARFE members have asked about the TSP Modernization Act:

Q: What are the new withdrawal options provided by the law?

A: The law does the following:

- Allows multiple, partial post-separation withdrawals, which individuals can time to their individual needs.
 - Current rules allow only one partial post-separation withdrawal.
- Permits multiple, age-based withdrawals for participants who are still working and are older than age 59-1/2, and subsequent post-separation partial withdrawals.
 - Current rules allow only one age-based withdrawal while actively employed in federal service.
- Provides greater flexibility for those receiving periodic payments by: (a) allowing the election of quarterly or annual payments, (b) allowing periodic withdrawals to be changed at any point during the year, (c) allowing periodic payments to be stopped while leaving the account balance in the TSP and (d) permitting the purchase of an annuity or a partial withdrawal while in periodic payment status.
 - Under current rules, periodic payments may be made only on a monthly basis. These payments can be changed only once per year, just prior to the beginning of the next calendar year. They cannot be stopped without withdrawing the entire balance. Also, if in periodic payment status, the participant cannot select a partial withdrawal or annuity purchase.
- Eliminates the withdrawal election deadline.
 - Current rules require participants to make a decision on how they would like to withdraw their funds by April 1 of the year following the year they turn age 70-

1/2 and are separated from service. This deadline often has been confused with the IRS' required minimum distributions, leading individuals to withdraw their entire balance at that time.

Q: When can I take advantage of the new withdrawal options?

A: Under the law, the Federal Retirement Thrift Investment Board (FRTIB), which oversees the TSP, has two years to make the expanded withdrawal options available. But they are working to implement them as soon as possible.

Q: Why would it take up to two years to implement these new options?

A: According to a TSP fact sheet (www.tsp.gov/PDF/formspubs/tspsfs10.pdf): "There are substantial programming changes and form revisions that must be made to allow participants to begin using these new options. There are many publications and web pages that will need to be changed to reflect the new policy and changes."

In addition, pursuant to administrative law, the FRTIB must publish any new regulations necessary to implement the new options. Once published, a 30-day period for public comments will take place, and then all comments will be considered prior to making any final regulatory changes.

The FRTIB is very motivated to enact these new options as soon as possible. Based on feedback that the FRTIB obtained from plan participants, the board expressed its desire for more flexible withdrawal options. Although Congress has given FRTIB two years to implement these

changes, it intends to have the changes in place before the deadline.

As of the printing of this FAQ, FRTIB has not yet released a specific timeline for having the new options in place, but the board plans to release each new option as soon as possible even if some options aren't ready to be released yet.

Q: If FRTIB asked Congress for these changes, why didn't FRTIB begin working on this before the new law was passed?

A: FRTIB did begin work on this before the new law was passed. However, "it would have been inefficient to spend the substantial resources necessary for this project before knowing whether the bill would become law or what exactly would be included in it," according to the TSP fact sheet. The FRTIB says it was "prepared as we could prudently be for the passage of the law and are are working to make the transition as quickly as possible while ensuring that the processes work correctly and in the best interest of [TSP] participants."

Q: I'm separated from federal service, and the deadline for withdrawing my account is arriving. What happens?

A: The current withdrawal deadline remains until new regulations are put in place. You still must make a decision on how you would like to withdraw your money (e.g., via periodic payments, or an annuity) prior to the deadline. However, current withdrawal options do not require that you withdraw the entire amount of your TSP account in one payment. You can elect monthly payments as low as \$25 per month and leave your remaining balance in the TSP until the new options become available. If subject to the required minimum distribution (RMD) by the IRS, your monthly payments will count toward satisfying your RMD, and if necessary, the TSP will give you a supplemental payment to satisfy your RMD each year.

Q: What happens if I want to use one of the new withdrawal options before the FRTIB has implemented the changes?

A: Unfortunately, you will need to wait. Nothing changes until new regulations are put in place, so you are limited to the current withdrawal options, using either the TSP-77, "Request for Partial Withdrawal When Separated" (www.tsp.gov/PDF/formspubs/tsp-77.pdf) or the

TSP-70, "Request for Full Withdrawal" (www.tsp.gov/PDF/formspubs/tsp-70.pdf). Again, current withdrawal options do not require that you withdraw the entire amount of your TSP account in one payment. You can elect monthly payments – as low as \$25 per month – and leave your remaining balance in the TSP until the new options become available.

Q: How will I know when the new options become available?

A: As they become available, TSP will widely announce the new options on its website, social media, email, and postal mail. NARFE also will share these announcements in communications with members.

Q: Can I withdraw money from my TSP account now, before the changes are made?

A: Yes. You continue to have the same withdrawal options that you had before the law was passed. You can view your current options, depending upon whether you are employed or separated from federal service, using either the "In-Service Withdrawals" booklet (www.tsp.gov/PDF/formspubs/tspbk12.pdf) or the "Withdrawing Your TSP Account After Leaving Federal Service" booklet (www.tsp.gov/PDF/formspubs/tspbk02.pdf).

Q: If I'm already receiving monthly payments from my TSP account, or if I elect to receive payments before the new options are available, will I still be able to take advantage of the additional withdrawal options?

A: Yes. As long as you have an account balance when the new options become available, even if you've begun receiving monthly payments or have taken a partial withdrawal before then, the new withdrawal options will be available for you. Please be aware that if you make changes to the duration of your monthly payments, there may be tax consequences. For more details, refer to the TSP tax notice "Important Tax Information About Payments From Your TSP Account" (www.tsp.gov/PDF/formspubs/tsp-536.pdf).

Q: If I have already taken a partial withdrawal (either in-service or post-separation), would that prevent me from taking advantage of the expanded flexibility provided by the law to take more partial withdrawals in the future?

A: Once the new rules go into effect, you will be

allowed to take additional partial withdrawals.

Q: I have separated from federal service. If I have already transferred my entire TSP account to an individual retirement account (IRA), will I be allowed to transfer money back to TSP once these new rules are implemented?

A: No. If you have already closed your TSP account by transferring 100 percent of your balance to an IRA, there is nothing in the new legislation that would allow you to reopen your TSP account to receive any transfers from a traditional IRA or eligible employer plan. If you had left at least \$200 in your vested account balance, this could have kept your TSP account open and available for these transfers using the TSP-60, "Request for a Transfer Into the TSP." (www.tsp.gov/PDF/formspubs/tsp-60.pdf). However, if you return to federal service under a position that allows you to contribute to TSP, you could then use the TSP-60 form to make these qualified transfers back into TSP.

Q: Most of my TSP account is held as a traditional TSP balance, as taxes on my contributions are tax-deferred until I take a withdrawal. Some of it is held as a Roth TSP balance, in which I paid taxes on my contributions, but withdrawals are tax-free. Once these new options are implemented, will I be able to choose between my traditional and Roth balances when I exercise my withdrawal options?

A: Yes. In addition to the changes made by the new law, the FRTIB is also adding the ability to specify how much of your withdrawal should come from your Roth TSP balance and how much should come from your traditional TSP balance. Current rules require that withdrawals are made proportionally from each balance.

Q: Does the new legislation eliminate the IRS RMD once I'm separated from federal service and have reached age 70-1/2?

A: No. As this is IRS law and not specific to the TSP, this rule will still be in effect once separated from federal service.

This document was prepared by NARFE staff with expertise on the subject matter of the legislation and the Thrift Savings Plan (TSP) generally, and based on information provided by the Federal Retirement Thrift Investment Board (FRTIB), notably through its Thrift Savings Plan Fact Sheet, TSPFS10 (12/2017), (www.tsp.gov/PDF/formspubs/tspfs10.pdf), "Questions and Answers About Changes to TSP Withdrawal Options," from which some of the Q&As were adapted. To obtain the fact sheet, visit www.tsp.gov/PDF/formspubs/tspfs10.pdf

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