Government Executive

Don't Mess With the G Fund

By Tammy Flanagan

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What is unique about the Thrift Savings Plan? Well, first of all, it's a retirement savings plan specifically designed for federal employees and military service members. Another notable fact about the TSP is its very low administrative costs -- 29 cents per $1,000 invested per year. For some 401(k) plans, such costs can be as high as $24.50 for every $1,000 invested.

But more than any of these characteristics, one thing really sets the TSP apart: the G Fund, a short-term Treasury security that is exclusive to the TSP and is guaranteed by the U.S. government. Nearly 40 percent of the money invested in TSP accounts is in the G Fund--almost $200 billion.

The G Fund aims to deliver a rate of return higher than inflation while avoiding exposure to default risk and market price fluctuations. But it's currently at risk of losing that feature. As *GovExec*'s Eric Katz reported in late March, a House Budget Committee report takes issue with how the interest rate on the G Fund is calculated, arguing that "those who participate in the G Fund are rewarded with a long-term rate on what is essentially a short-term security."

Strictly speaking, this is true. The G Fund interest rate calculation is based on the weighted average yield of all outstanding Treasury notes and bonds with four or more years to maturity. Yet it is a short-term security.

But there's more to the story. The G Fund was implemented in the late 1980s, when the Federal Employees Retirement System was created. During a recent appearance on Federal News Radio, Kim Weaver, director of external Affairs for the TSP, said that Congress used the same formula for the G Fund as had been used for the Civil Service trust fund and the Social Security trust fund. So the G Fund is using a method of investment valuation that has been around for more than 100 years.

The House Budget Committee says basing the G Fund on a three-month average yield instead of a four-year average would save $32 billion over 10 years. Weaver told Federal News Radio that such a shift "would drop the interest to virtually zero, which would make the G Fund worthless to our participants. It wouldn't even begin to keep pace with inflation."

So how might this affect your retirement planning? First of all, don't make any decisions based solely on a proposal in Congress. Only a small percentage of bills become law, and this idea isn't even a bill yet.

You should, however, be aware that there's always the possibility that Congress will modify federal benefits. (It's happened more than once in recent years.) So you must take responsibility to stay abreast and informed of potential changes.

We've all heard the saying, "Don't put all of your eggs in one basket." This definitely applies to the nest eggs in your retirement basket. If you currently have all of your retirement money in the G Fund, and you're not about to retire, you should consider diversifying. Not only might Congress make the G Fund less attractive, you can probably get a better rate of return than it provides over the long haul even if nothing changes.

If you have many years before you plan to retire or before you need the money in your TSP account, then the G Fund does have risk. Even without any legislative change, it is subject to inflation risk -- that is, the chance that it will not grow enough to offset a future reduction in purchasing power.

There are five options for diversifying within the TSP. They have varying levels of risk and reward. If you're not comfortable dividing your investments among them yourself, you can always rely on the TSP's lifecycle funds, which rebalance every three months by changing the asset allocation between the five funds to incur less risk as you near your target retirement date.

If this is all a bit overwhelming, I would starting with the TSP's YouTube channel, which features six videos of under two minutes each that will help you understand your investment options.

And always remember the saying attributed to Benjamin Franklin: "By failing to prepare, you are preparing to fail."

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http://www.govexec.com/pay-benefits/retirement-planning/2015/04/dont-mess-g-fund/109732/