FINANCIAL ADVISOR

Brokers Lure Soldiers Out Of Low-Fee Federal Retirement Plan

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John Turner suspected that brokers were encouraging federal workers to ditch their top-flight retirement plan. So he went under cover.

The former U.S. Labor Department economist called representatives at companies such as Bank of America Corp., Charles Schwab Corp. and Wells Fargo & Co. He identified himself as a potential client grappling with what to do with his own nest egg.

Turner thought he knew the right answer: Leave it alone. As a legacy of his government service, he kept his money in the Thrift Savings Plan, considered the gold standard of 401(k)-type programs for its rock-bottom fees. Yet all but one company told him to roll over all his money into individual retirement accounts. On average, stock funds charge almost 50 times more than the government plan.

“It’s a scandal,” said Turner, director of the Pension Policy Center in Washington. “They are trying to sell me an IRA clearly not in my interest. It’s in their interest. They want to get the fees.”

The pitches are persuasive. Workers who leave jobs with the federal government transferred $10 billion last year out of the Thrift Savings Plan. Forty-five percent of participants who left federal service in 2012 removed all of their funds from the plan and closed their accounts by the end of 2013. To investigate this exodus, the government expects to survey departing workers later this year.

‘Popular Target’

“Swayed by the financial industry’s marketing efforts,” Thrift Savings Plan members in recent years “have become an even more popular target” for companies luring them into higher-cost IRAs, Gregory Long, the plan’s executive director, wrote in a May memo to board members.

Companies offering IRAs said they aren't advising Thrift Savings Plan holders to leave and are merely offering attractive options, such as funds with superior returns. Former federal employees and other customers roll over their retirement money because they want more choices and advice and are seeking to consolidate accounts in one place, they said.

"If they want the relationship and advice, then they will have the expenses and fees of an IRA," said Wells Fargo Advisors spokeswoman Rachelle Rowe.

Bloomberg News found one company that caters to the military promised "no-fee" IRAs -- language that the financial industry's own self-regulatory group has called misleading -- and another offered a $200 bonus to roll over. Other companies are advertising "Gold IRAs," which invest in precious metals that can subject buyers to huge price swings and markups.

Cash Flood

The federal departures are part of a flood of cash cascading out of 401(k) and similar plans. Former employees transferred $324 billion into individual retirement accounts in 2013, up about 60 percent in a decade, according to Cerulli Associates, a Boston-based research firm. As a result, IRAs hold $6.5 trillion, more than the $5.9 trillion in 401(k)-style accounts.

Former employees at major companies such as AT&T Inc., Hewlett-Packard Co. and United Parcel Service Inc. have complained that sales representatives persuaded them to roll over their 401(k)s into high-cost, unsuitable IRA investments, according to a three-month Bloomberg News investigation in June.

The Labor Department has said it will propose rules in January that brokers and other advisers act in clients' best interest during rollovers, a so-called fiduciary standard. Brokers are generally held to the lower standard of selling products that are suitable for their customers, meaning they don't have to put their clients' interests first as long as they select appropriate investments.

Tempting Target

Federal employees are a tempting target for financial companies. To supplement their traditional pensions, they participate in the Thrift Savings Plan, the largest 401(k)-type plan in the U.S. It oversees $418 billion for 4.6 million current and former federal employees, including the armed forces, park rangers, FBI agents and members of Congress. As in a 401(k), an employee sets aside money in a menu of mutual funds that isn't taxed until withdrawal.

Benefiting from economies of scale, the Thrift Savings Plan offers funds far cheaper than most 401(k)s. Its average fee is .029 percent -- or 29 cents per $1,000 invested. The average 401(k) plan participant pays about 20 times as much for a stock mutual fund, according to a July study by the Investment Company Institute, a Washington-based mutual-fund trade group.

Investors who bought mutual funds on their own pay even more; stock funds charge almost 50 times as much, on average. An investor with $500,000 in the government plan who shifted to retail stock mutual funds with average expenses would pay almost $7,000 a year more.

The government program has 10 options. Employees can build a portfolio from five low-cost vehicles: three stock funds tracking U.S. and international indexes, a bond index fund and a “G Fund” that invests in government securities. The federal government guarantees that the G Fund won’t lose principal, unlike options available to the general public.

Workers can also choose from five “life-cycle funds.” These offerings invest in the same five options in proportions reflecting the years that employees have left until retirement, growing more conservative as they age.

Funds Outperform

Aided by their low expenses, the funds in the government plan generated superior investment performance. In the 10 years ended in 2013, all five underlying funds outperformed the average return of similar offerings, according to an analysis by Morningstar Inc., the Chicago-based fund-tracker. The G fund and the option that invests in an index of small and medium-sized companies bested more than 90 percent of similar funds.

Like most plans, the federal program offers general education on its website about investing but leaves decisions to workers. Current and former employees can choose to roll money from other sources into the plan, as well as out. To fight against defections, Thrift Savings officials are considering adding more investment options.

“Why are people taking money out when they don’t need to?” said Kim Weaver, a spokeswoman for the plan. “Our concern is the Thrift Savings Plan is the lowest cost plan in the country. To move out, you should be doing it for a good reason.”

‘Don’t Move Out’

Alicia Munnell, director of Boston College’s Center for Retirement Research, has some simple advice for anyone approached by a broker seeking to roll over money from the government plan: “Don’t move out. You can’t duplicate those fees anyplace else.”

That’s not the advice that federal employees are likely to find on the Internet. From January through April, the Navy Federal Credit Union, which caters to the military, offered up to $200 to those rolling over their retirement plans and opening their first IRA, which would be invested in certificates of deposit.

“Time is running out!” the ad on the credit union’s website said, next to a photo of a hand grasping two $100 bills. “Start saving today!”

The Vienna, Virginia-based company, the largest U.S. credit union, says the campaign was aimed at getting young soldiers to open their first IRAs. They could have received $100 for starting an account with as little as $50.

Older Clients

Those who rolled over retirement plans tended to be older and looking for the convenience of consolidating their investments, as well as the safety of certificates of deposit that paid as much as 3 percent annually, said Sharon Sutherlin, who manages Navy Federal’s IRA business.

“It depends on what’s right for the member,” Sutherlin said. “That’s what the bottom line is here.”

In his memo, Long, the Thrift Savings Plan executive director, expressed concern about another financial company focusing on the military: the United Services Automobile Association. Its website cites the advantages of an IRA over the federal plan, such as “thousands of investment choices, including stocks, bonds and no-load mutual funds." It also provides a link to the government forms needed to transfer.

USAA's stock mutual fund that tracks the Standard & Poor's 500 Index costs about 9 times as much as the one in the government plan. Funds with managers who pick stocks are even more expensive.

Until recently, a military retirement guide that the company distributed online urged service members to roll over their thrift savings plan to a "USAA no-fee IRA."

Misleading Term

In 2013, the Financial Industry Regulatory Authority, the industry's self-policing group, said the term "no-fee IRA" could be misleading when there are management fees and other expenses associated with the account.

In an e-mail, Laura Propp, a USAA spokeswoman, said the company had distributed the guide from 2005 until September 2012, when it published a new guide without the "no-fee" language. On Aug. 1, after Bloomberg News asked about it, the company removed a link to the older guide that USAA had intended to deactivate, she said.

"The advice given in the new guide shows that USAA recommends a member contact an adviser to get advice that is tailored to their situation," Propp said. Its website features a pro and con list for customers considering rolling over from the Thrift Savings Plan that mentions its low fees, she said.

'Ridiculously Cheap'

Scott Halliwell, a financial planner at San Antonio, Texas- based USAA, said the government plan is "ridiculously cheap" and his company wouldn't "go out and say, 'Just roll it over.'"

Still, Halliwell said many former federal employees don't have the time, expertise or inclination to manage money themselves and could benefit from a rollover to USAA.

Companies such as Regal Assets LLC are encouraging Thrift Savings Plan members and others to put their retirement money into "Gold IRAs," which invest in bullion and coins. Under a banner headline, "Rollover your IRA or 401(k) into inflation- proof gold and silver," the company's website provides a testimonial from a former Thrift Savings Plan participant who transferred money to

Regal Assets. Identified as “Dennis R.,” he is quoted as saying that he was “very happy with the outcome and would recommend Regal Assets to anyone wanting to invest in precious metals.”

Finra and the Federal Trade Commission warn investors about gold’s price swings and the possibility that dealers may be selling at inflated prices.

Regal Assets

Regal Assets customers typically pay a markup on gold coins of 5 percent to 9 percent, Tyler Gallagher, chief executive officer of the Waco, Texas-based company, said in an interview. In addition, they pay $250 annually for storage and an administrative fee, he said. Investors are looking for a hedge against inflation and a decline in the dollar.

“People are paying for peace of mind,” Gallagher said.

Among those forsaking the federal plan is John R. LaRandeau, a civil engineer from Omaha, Nebraska, who left the Army Corps of Engineers last year and rolled over $200,000 into an IRA. First, he chose a brokerage account he managed himself and then an account with Omaha-based Carson Wealth Management Group, which charges 1.8 percent of assets under management for accounts up to $2 million.

LaRandeau’s adviser at Carson, Phil McBride, said customers want to protect themselves because bonds, the traditional choice for conservative investors, could lose value when interest rates rise. Carson hedges against that risk, he said.

Downside Risk

“If you’re looking for active management -- something that really protects you from downside risk -- we have strategies that make sense,” McBride said.

Worried about such losses, LaRandeau, 67, said he is pleased with the arrangement. Still, he’d advise 95 percent or more of account holders in the government plan to stay put, he said.

"It's very inexpensive," LaRandeau said of the Thrift Savings Plan. "There are a lot of sharks out there taking your money, and pretty soon it's gone."

Few people are as knowledgeable about the government plan as Turner, 65, who has devoted his life to studying pensions.

Turner, an economics Ph.D. from the University of Chicago, worked more than 20 years for the Labor Department and Social Security Administration before heading the Pension Policy Center. Its clients for research and consulting include AARP, the U.S. Chamber of Commerce, the International Brotherhood of Teamsters, the United Nations, Canada and Norway.

Calling Brokers

For two months, starting in January, Turner called up customer-service lines listed on the websites of nine financial companies, including T. Rowe Price Group Inc., Charles Schwab and Bank of America's Merrill Edge. He told them he had $200,000 in his Thrift Savings Account and asked what he should do with it.

A representative of Baltimore-based T. Rowe Price recommended a rollover, Turner said. Part of the pitch: Turner would have access to small-company stock funds closed to new investors. Turner figured one of the funds had expenses more than 30 times that of a similar offering in the government plan.

Because Turner sought advice anonymously and did not note names of the employees he spoke with, the companies said they couldn't determine what he was told. They said that their representatives provide appropriate information to callers.

'Qualifying Questions'

T. Rowe Price noted in a statement that its small-company stock funds, after expenses, have outperformed the index tracked by the federal plan. Dennis Elliott, head of individual investor channels, said representatives determine prospective customers' goals and offer options.

"We ask qualifying questions, but we do not provide advice," Elliott said.

In an e-mail, Schwab said it educates potential clients about fees and services "to help them make an informed decision based on their specific circumstances." Bank of America's Merrill Edge said each customer's goals are different and it provides information about choices, "including keeping their assets in place."

Vanguard Group, known for its low-cost index funds, stood out for a more balanced approach, Turner said. The company's representative asked about Turner's tolerance for risk, he said. If it were low, the representative told Turner, he should stay with the government guaranteed fund. Otherwise, Vanguard could be a better choice.

Melissa Nassar, a principal with Vanguard's retail investor group, said Turner would likely have been eligible for Vanguard funds with costs as low as .05 percent. While almost twice the price of the government plan, the increase would amount to only $40 a year. Turner then would have received the benefits of consolidated accounts and free advice from a financial planner - - something that could cost $100 to $200 an hour if done separately, she said.

Turner, who hopes to publish an academic paper based on his findings, isn't following the brokers' advice himself. Since his investigation, he took another $200,000 he had saved from other employers and rolled it over -- into the Thrift Savings Plan.
