STATEMENT FOR THE RECORD BY THE HONORABLE TERRENCE DUFFY BEFORE THE HOUSE SUBCOMMIMTTEE ON THE FEDERAL WORKFORCE AND AGENCY ORGANIZATION
APRIL 26, 2006

Mr. Chairman and members of the Subcommittee, my name is Terrence Duffy. Since June 20, 2003, I have served as a member of the Federal Retirement Thrift Investment Board after having been recommended for this position by the Speaker of the U.S. House of Representatives. In this part-time role, I am one of five Board members required by law to develop and establish the investment policies of the Thrift Savings Plan (TSP) for Federal employees. In my full-time job, I serve as Chairman of the Board of the Chicago Mercantile Exchange. I welcome the opportunity to submit my statement for the record.

The purpose of this hearing is to discuss a legislative initiative that would establish a Real Estate Investment Trust (REIT) fund in the TSP. I and the five other TSP fiduciaries (all Board members plus the Executive Director) oppose this legislation.

In his January 18, 2005, letter to the Subcommittee, the Executive Director provided a technical analysis demonstrating that the proponents of the REIT fund had overstated the case for such a fund. Additionally, in their testimony of April 19, 2005, the Executive Director and the Chairman of the Board explained why the proposed REIT fund would be the wrong fund at the wrong time for the TSP. They also described the appropriate process which fiduciaries should use to determine whether and which investment options should be added or removed from a plan like the TSP. I support what has been stated in this regard by my fellow fiduciaries.

As one who has spent his entire professional career in the private U.S. financial markets, my purpose today is twofold. First, I would like to elaborate on the role of a fiduciary in a plan like the TSP. Second, I would like to discuss my experience regarding what makes a plan like the TSP successful for its participants.

Role of a Fiduciary

Fiduciary relationships require the highest duty of care under law. In the case of the Thrift Investment Board, the enabling legislation requires that Board members “establish” and “develop” TSP investment policies. 5 U.S.C. § 8472(f), 8475. In discharging these responsibilities, we must act “solely in the interest of plan participants and beneficiaries.” 5 U.S.C. §§ 8472 and 8477. This requirement provides Federal employees with the assurance that I and the other fiduciaries will perform our duties as investment experts exclusively in their interests as we make any and all decisions regarding TSP policies.

This arrangement is quite unusual in the environment of Washington, D.C., where elected leaders must daily make judgments and identify compromises necessary to do the public’s work. The difference is that in doing the public’s work, political leaders must balance the interests of various constituencies in deciding how taxpayer resources will be deployed. The TSP has no taxpayer resources; only participant funds. The Board does not compromise with regard to participants’ interests in its policy deliberations.

Board members are the primary actors in devising TSP policies, and are particularly suited to carry out these responsibilities. In order to qualify for their positions, Board members must “have substantial experience, training, and expertise in the management of financial investments and pension benefit plans.” Id. § 8472(d). Each of the members serving on the Board must satisfy this standard, be nominated by the President, and confirmed in the position by the U.S. Senate.

I have learned that throughout its 20-year existence, the Board has competently discharged its investment policy responsibilities. Between 1987 and 1991, the Board developed policies regarding the initial three funds. Between 1992 and 1995, the Board developed investment policy requiring the addition of two new funds and proposed authorizing legislation to Congress. Congress approved the legislation and, in 2001, the Board established the Small Capitalization Stock Index Investment Fund and the International Stock Index Investment Fund.

Since my arrival in 2003, the Board determined that the Thrift Savings Plan should offer asset allocation models. It developed an investment policy that provided for five additional models. These “lifecycle” models were established in August 2005, and have already attracted more than $10 billion or five percent of TSP fund totals.

Thus, investment policy establishment and development have been and remain ongoing core requirements for the Board members. Our future plans in this regard were detailed in the August 11, 2005, letter signed by all six fiduciaries and sent to all eight Congressional committee and Subcommittee leaders.

Elements of Success

In my view, the TSP has been extraordinarily successful because of its simplicity. I am aware of no other large plan that can point to the high voluntary participation rate of 86 percent and the low cost of five basis points (or one-twentieth of one percent) for participants in 2005. The basis of our success is no secret. It was clearly articulated by Jane Bryant Quinn on August 19, 2002, when Newsweek magazine carried her cover story entitled “5 Ways to Fix the 401(k).”

Ms. Quinn’s first example of how to fix 401(k) plans was to cite the TSP and its limited choice of broad-based funds. In Ms. Quinn’s estimation, it provides “a perfect 401(k).” She goes on to say the TSP’s “plain vanilla approach saves you from obsessing over six different growth funds.”

Her mantra is echoed and enlarged upon by CNBC’s Mad Money guru James J. Cramer in his November 29, 2004, article in New York Magazine. According to Mr. Cramer,

> ...there is, ironically, one way in which we could cut the costs, keep fees low, offer strict diversification, and make sure that nobody gets ripped off: Do it the federal way. That’s right -- the much-maligned federal government, which administers the Thrift Savings Plan for all federal employees. The plan strikes a perfect balance of choice with responsible investing. It’s a simple menu of diversified stocks, fixed-income investments, government bonds, and international equities. The TSP doesn’t let individuals screw it up with reckless speculation or let Wall Street jam individuals with high fees and crummy mutual-fund offerings. It’s a better program than just about any 401(k) offering out there.

> Of course, the TSP doesn’t enrich the big brokerage firms, and it doesn’t allow you to shoot the lights out.

Both Quinn and Cramer are sharp-eyed observers of the financial world, and I agree with them. In my full-time position, we offer a fast-paced marketplace for sophisticated investors with an interest in complex financial transactions. However, these are not the elements for success in the 401(k) world.

Rather, the recent interest in legislation to provide investment advice to 401(k) participants shows that even the Congress has recognized that the mix and complexity of investment options in many 401(k) plans has already outpaced the ability of participants to make their retirement investment choices with confidence. Apparently, existing 401(k) education efforts are not generally up to the task of educating participants about how to successfully fold multiple instruments, including a separate REIT fund, into their retirement portfolios.

This may explain the absence of a strong appetite for REIT funds in retirement plans where they are already available. Three recent published surveys have shown that REIT funds are not widely embraced by private sector 401(k) plans or their participants. Depending on the survey examined, a REIT option is only available in 10[1], 13[2], or 15.6 percent[3] of the plans surveyed. Perhaps more importantly, in plans where they are offered, these REIT funds have attracted very small amounts of participant investment: one-half[4], one[5] and two percent[6], respectively.[7]

As a professional in the business and financial world, I have no reason to believe that Federal employees would behave any differently than their private sector counterparts if a REIT fund were offered in the TSP. Participation would be consistent with the very low rates shown in the surveys. More importantly,

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[1] 2005 Trends and Experience in 401(k) Plans, Hewitt Associates, p. 39.
[2] IOMA’s Annual Defined Contribution Survey, 2004, Institute of Management and Administration, p. 89 (Figure 11-6).
[3] 48th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2004 Plan Experience, Profit Sharing/401(k) Council of America, p. 28 (Table 44).
[4] 48th Annual Survey, p. 31 (Table 49)
[5] IOMA’s Survey, p. 90 (Figure 11-7).
[6] Hewitt Survey, p. 41.
[7] In its submission of May 13, 2005, to the Subcommittee, NAREIT cites unpublished results of one survey. However, even this special analysis of unpublished survey data places the allocation at only 3.6 percent of plan assets.

a REIT fund would be inconsistent with the otherwise broad-based portfolio of TSP funds. Since our broad-based funds already include REIT securities, the legislation would create overlapping TSP choices for the first time. In my estimation, this would unnecessarily complicate the plan, create confusion, and undermine the simplicity of the TSP. None of these potential outcomes would enhance investor confidence or voluntary participation.

I stand with the other Board members and the Executive Director in pledging our intention to continue considering all opportunities to further improve the TSP. After we complete the process of competing the investment management contracts for our four existing index funds, we will have our investment consultant review the universe of potential investment options and plan features to help us begin to prepare for consideration of future improvements. This is the correct approach for the financial professionals with a fiduciary duty to the 3.6 million public servants, uniformed service members, and retirees who depend on the TSP for their retirement security.