"Investing in the Future: Minority Opportunities and the TSP" Thursday, July 10, 2008, 10:00 a.m. Room 2154, Rayburn House Office Building. Presenter: Jesse B. Brown

The Subcommittee

Improving minority access in the management of the Federal Employee Thrift Savings Plan (TSP).

Thank you very much Mr. Chairman. It is my honor to be here to add to the discussion of the importance of improving minority access in the management of the Federal Employee Thrift Savings Plan (TSP). I am giving my perspective from someone who has little if anything to individually gain as a result of this discourse, **but more importantly,** has interest in this topic from fairness in the financial arena perspective.

Because we only have so much time today to discuss this topic, I would like to reserve a right to revise and extend my remarks for the record at a later date with the permission of the Chairman and members of the committee.

Let's be clear. The statement "Improving minority access" implies there **is** access,---------------- but the access is wanting, not good enough, inadequate, ………………………deficient.

But, is that really the case? From where I sit Mr. Chairman , **that access is not deficient, it is simply not there.**

Mr. Chairman, the federal work force is more than 50% historically under represented ethnic and racially diverse individuals; **their investment managers should reflect that same face of diversity.** And likewise, that diversity should be reflected in the enrollment and professional advice available to the plan participant. We all know that advice is very important in the financial arena, so who better to give that advice than people who share culture and common interest.

The dilemma is that the criteria for competing for the opportunity to manage the Federal Employee Thrift Savings Plan (as stated in the RFP) and I quote is "capability of managing billions of dollars" And, the fact of the matter is---

African American and other minority owned companies **do not** manage billions of dollars, manage less than the status quo. Therefore **Minority managers can not bid on these proposals until the criteria for eligibility have been changed.**

What I want to leave with you today is not only a discussion about what has evolved over time where there is now a monopoly if you will, in place; but I want to make sure you understand that there is an opportunity to change the current practices and create so much more good, with just a little more attention, and of course the willingness to embrace diversity at its highest and most significant level. I'm talking about **inclusion Mr. Chairman.**

This is the 21st Century, and I know I don't have to tell you that much has changed—and I must say as one who is traditionally deliberate about change, much of the change we've experienced with diversity has been for the greater good. Let's face it; we all know an inclusive environment can enhance the status of much of what we do in day to day life. We've all read the studies, heard the presentations by experts in the field, from R. Roosevelt Thomas has published several books on Diversity and has a Consulting Firm to Bea Smith founded Kaleidoscope Group years ago and was a leader in Diversity, and more than likely we've all pretty much experienced the positive outcomes of diversity--- so I don't pretend to be telling you anything you don't already know.

If we can just take what we've learned from other arena's and apply it here, I believe we'd all agree that diverse participation at the management level of the Federal Employee Thrift Savings Plan and the investment companies that are the fiduciaries of the accounts can offer the opportunity for inclusion, as well as serve as a catalyst for improved decision making, increased productivity, and a competitive advantage. You might ask the proverbial question, "If it ain't broke, why fix it?" Let's not get too comfortable with the familiar Mr. Chairman ----the practice of offering American businesses RFP's that continue to support the success of the majority, are inherently racially discriminatory, and should no longer exist.

At the very minimum Mr. Chairman I think the principals of Affirmative Action should take force. Even the very large and successful current contractors of the Federal Thrift Savings program have very poor records of diversity in their own work force. I would welcome this committees aggressive demands upon all the contractors to the Federal Thrift Savings Board and the Thrift Savings plan to set and meet goal of internal minority employee hiring and promotion. They should be able to name individual members of minority groups that head major divisions of their firm. They should report back to the committee their hiring practices and recruiting practices. They should show that they are doing everything they can to meet the goals of the industry as a whole and especially as it relates to the management of the federal government employee's money.

For that matter the Federal Thrift Savings board itself is not diverse. Has there ever been an African American appointed to the Board? Why not? Diversity begins at the top.

Mr. Chairman , The Executive Director of the Federal Thrift Savings board should be challenged and directed to begin the diversity movement within his own office and staff and then in the various departments and division . This should be part of every vendors report the number of minorities that are employed and if there are none why and what recruiting efforts are underway.

Reaching these goals should be criteria for compensation at all levels beginning with the Executive Director of the Federal Thrift Savings Board and should be legislated as part of his job description and responsibility.

In closing the Federal Thrift Savings board should be about the federal employees and not just the administration of funds. The employees should be FIRST in the minds of the Thrift Savings Plan. Savings and investment education should be the top priority. With that education the Federal Workforce itself will force the Board to do a better job. Until the 1950s, only the wealthy could expect to retire. In 1951, less than 5% of men said they retired because they wanted to rest and have some time off, and these were the men with the highest incomes. In that same year, over half of older men were working and most of the others were unemployed or unemployable.

Today, over 60% of older Americans, not working actually chose to retire because they prefer free time to paid work. Making retirement available to almost all workers, that is, "democratizing" retirement is one of the greatest achievements of robust market economies. Nonetheless, even in rich societies, conflict persists about who is entitled to pensions and how generous they should be. Reflecting on the debate over Americans' new social insurance programs—Social Security, unemployment insurance, and poor relief programs—philosopher Bertrand Russell wrote in 1935:

The idea that the poor should have leisure has always been shocking to the rich. . . . When I was a child, shortly after urban working men had acquired the vote, a number of public holidays were established. I remember hearing an old Duchess say, "What do the poor want with holidays? They ought to work."

The nineteenth-century duchess reflects a twenty-first-century conviction, deeply held in some circles, that because people are living longer, instead of society shoring up pensions, the elderly ought to work more. Indeed, if trends continue, sixty-five-year-olds in 2010 on average will live longer than sixty-five-year-olds ever lived before; however, perplexingly, the expected months in retirement will fall by 14%. People will live longer but they will work a whole lot more.

This committee can change that sentiment.

At this point Mr. Chairman I would like to stop, answer questions and submit the rest of my remarks for the record.

My home is Chicago, though I was born and raised in San Antonio, Texas. My parents and all my family always owned their homes. When they migrated from the country, or the farm, they came to the city to work. Many times they came to the city to work for the Federal Government. Maybe it was for the Post Office as a mail handler, or perhaps it was for a federal installation like Kelly Air Force base, building components for airplanes or other military machinery. My father worked very hard as a mechanic, and later served in the military in various overseas theaters of war; always a part of the federal employee workforce. Many of my family are proud to display similar experiences-------hard working Americans with faith in their country, their government, and the American dream. Many Americans have that same background. So, I commiserate with Americans like Sarah Harper, another person with family history rooted in the belief and fairness of our country, and the goodness of man despite the exceptions, who is today experiencing emotional setback and shock by what is happening with her investments; she's witnessing the chipping away of her American Dream of prosperity, spoken so eloquently about in the now famous Dr. Martin Luther King speech on the mall, in August of 1965.

Sarah Harper recalls that she once lived in a small, three bedroom brick house identical in layout to most of those on the block. The street was Roseland Avenue, a name that evoked more grandeur than it deserved. But it was her house -- the first and last home that her parents would ever own together. She recalled that she didn't remember much about moving there, but she did remember all that followed: the walk to the first day of kindergarten with her grand father; the smell of fresh jam made with moms tender touch in that avocado-colored kitchen, the sight of the moon while looking through a telescope with her dad; overnights shared with friends....dreaming about the future.

You see homes are unique in the specter of assets that we own; they embody our dreams, sorrows, and our achievements. They are both a nest for our children to flourish and a nest-egg for our futures. They are the largest asset that most people will ever own and as a result enable us to finance everything from cars to college degrees.

So, is our retirement savings? That is what we are talking about today, ladies and gentlemen, life savings, life savings, life savings in the Thrift Savings plan as it is affectionately called. It's personal ladies and gentlemen. It is personal.

Homeownership and retirement savings are inherent societal benefits. I remember as a young man launching my path in life, my mother said to me one evening "why don't you get one of those good government jobs." I knew much later that she said that because of the faith she had in the financial benefits received from a "good government job"--- benefits that I could count on.

Households who own instead of rent, and who save and invest at the lower end of the income strata, report lower rates of teenage pregnancies and higher rates of high school attainment------yet another reason why the downturn in home ownership and investment and savings in the marketplace is so tragic. It not only represents a hit to the economy, but it represents a hit to the American psyche. It is the straw that breaks the back of the working class households who feel that they have already given more than their fair share in an economy that penalizes manual labor relative to educational attainment. That is why the savings rate in America is so important. And that is why minority involvement in the investment process at all levels---from the seat at the table, to the perception on the street is critical. That is why involvement in the Thrift Savings plan is so significant. Mr. Chairman, if for no other reasons, inclusion without a doubt represents an ethical and business imperative. This effort can be a shining example of how the Social Security private account system my work as well should it becomes the law of the land as congress continues to look at the revision and improvement in benefits associated with the Social Security reform legislation.

THRIFT PLAN MODEL

Let's step back for just a very few minutes to review the Thrift Plan facts: The federal thrift plan was created as part of a 1986 reform of the pension for federal civil servants. It is modeled after the 401(k) plans available to many private-sector workers. Covered federal employees may elect to open an account with the thrift plan and have a portion of their salary allocated each payday to that account. The account can be invested in any combination of three thrift plan funds—one tracking a broad stock index (the S&P 500), one tracking an index of fixed-income securities (Lehman Brothers Aggregate bond index), and one paying interest at the rate prevailing on long-term federal debt. At the end of March 2007, accounts in the federal thrift plan had reached an approximate total of $87 billion (U.S. Thrift Savings Board 2007b).

The chief attraction of the thrift plan is its low administrative overhead. Annual overhead charges come to roughly 0.1 percent of the value of the assets managed, which is generally viewed as about the lowest cost for which one could operate a system of individual accounts. Thrift plan management points out that these charges exclude the cost of enrolling and educating workers, tasks that are performed by the employing institutions. The TSP also incorporates a number of features that its proponents believe provide an adequate level of protection from political interference in investment decisions: (1) responsibility for operating the plan is lodged in a board insulated from political influence by having fixed terms of office; (2) members of the board must assume fiduciary responsibility for any decisions, meaning they can be personally liable for losses if they take actions not in the best interest of depositors; (3) investment options are restricted by law to a small number of funds indexed to match the performance of an index defined and calculated by a private-sector company; (4) money is actually managed by a private-sector firm selected by competitive contract; and (5) the investment management firm is required to comingle federal thrift plan monies with funds being managed for other clients.

It's important to know ladies and gentlemen, that the Thrift Savings Plan is not a panacea—yes; there are problems that need attention. In comparison with the 401(k) plans offered by many larger employers, however, the federal thrift plan has some significant limitations. One of the prices paid to achieve political insulation is that investment options are restricted to index funds. While historical experience suggests that index funds may yield higher returns than actively managed funds, the fact remains that under the thrift plan model there is no choice. Federal thrift plan costs are also held down by the existence of greater limits on fund switching than are found in many 401(k) plans. Participants can change their contribution allocations only every six months, during one of the semiannual open seasons. They can move money from one fund to another only once a month and only with at least 15 days' advance notice of their intention. Some of these provisions are under review by the Thrift Savings Board and may have been revised in recent years.

The federal thrift plan is also like a 401(k) in that workers have the options of withdrawing their balances as a lump sum at the time they leave employment (though they may have to pay a surtax if they are under age 59 and don't roll over the balance) and of taking out loans against their account balance.

Certainly the addition of investment options which are restricted by law to a small number of funds indexed to match the performance of an index defined and calculated by a private-sector company, warrants further discussion; particularly substantial discussion around the fact that the money is actually managed by a private-sector firm selected by competitive contract **which has never been opened up to minority owned and/or operated historically under- represented minority investment firms in this country----never been opened up to the minority owned and/or operated minority investment firms in this country Mr. Chairman.**

Even more critical is the fact that the investment or financial education of the various employees is inconsistent and lacking by the various agencies. Thrift plan management points out those enrolling and educating workers, tasks are performed by the employing institutions and frankly in adequate in preparing these individuals for retirement savings and distribution in today's economy.

On the one hand, there is the fear of political interference, usually articulated in the form of a general concern that the government would refuse to invest in tobacco companies, egregious polluters, or other enterprises that were deemed not to be politically correct. So, that is why there is the insulation from political involvement in the investment choice or event the investment companies experienced both here and abroad, which suggests that government interference or controls can have serious consequences for the investment returns on pension portfolios. A number of examples can be cited. In some cases, assets have simply vanished. Even among the better-run systems, returns have not always been as high as would be suggested by market experience.

If you want to avoid putting all your eggs in the one basket of a particular company's shares, it is possible instead to spread the risk of your investment by pooling it (with other investors) into a range of different investments. In this case, the pooled investment is managed by a professional fund manager, who makes decisions on the range and types of investment. Such collective schemes fall - again, broadly - into three different types: unit trusts, investment trusts and Open-ended Investment Companies (OEICs).

Once you have reached this level of investment decision-making, however, the vast range of unit trusts, investment trusts and OEICs available can open up a veritable Pandora's Box of choices. In order to avoid making potentially very costly mistakes or rash investment decisions; this is the stage at which - if you have not done so before - you should consult an independent financial adviser.

Financial investment advice is wisely taken because of the sheer range of investment decisions.   That is where the professional investment advisor comes in.

I am quite aware that almost every decision an individual makes involves risk of some sort. This is especially true in the government labor market where individuals choose career paths, decide about changing jobs, and make decisions about the form of their compensation. The common stereotype is that women are more risk averse than men. Risk adverse behavior in the government labor market may lead to a choice of job with a lower mean and lower variance of salary. Or lower investment potential. If indeed women choose less risky investments, this can explain in part the gender gap in investments. It's the same with racial groups Mr. Chairman.

Even if there were no actual differences in gender or race attitudes toward risk, the belief in the stereotype may by itself have implications for what investment products are offered. **Thus the importance of inclusion Mr. Chairman ; inclusion on all levels, from investment advice to investment management.**

That inclusion has to be a guiding principle of the Federal Employee Thrift Savings Plan.

I would like to suggest that certain ideas from the economist **'**

Teresa Ghilarducci who wrote the book **When I'm Sixty-Four'**

Be considered.   She is a professor of economic policy analysis at the University of Notre Dame, where she specializes in pension benefits. She is also the director of the Higgins Labor Research Center and a Wurf fellow at the Labor and Worklife Program at Harvard Law School.

Her book explores the basis of the belief that the elderly have too much retirement leisure; and asks the question, Who loses and who wins if and when pension income becomes less secure and the elderly work more as a consequence?

Older people, who must work longer than they want to make ends meet, lose. Employers, who avoid raising wages as older workers stay in the labor pool, win. Financial managers, eager to manage individual retirement accounts, defined contribution or 401(k)-type plans, which could be newly created from converted traditional company pensions (defined benefit plans) and privatized Social Security, also win.

This book also covers the sources of retirement income, the distribution of retirement time, and ways to rescue the pension system.

This opening chapter argues several issues: that civilized societies enable people to retire; that the United States has achieved much toward ensuring entitlement to retirement for ordinary workers; and that moves toward individual retirement accounts—defined contribution pension plans, 401(k)-type pension plans, and Social Security commercial personal accounts—are flawed responses to pension troubles and to the decreasing ratio of workers to retirees.

The financial industry and political groups, devoted to making government smaller, promote the replacement of employer pensions and Social Security accounts with individual accounts—while ignoring what public policy has accomplished for retirement security. Their vision of a reformed U.S. retirement income system moves away from what good reform should do—that is, make the system more fair, enhance productivity, and be more efficient. No pension system should waste people's money.

Principles for a Pension Rescue Plan

In 1960, half of the nation's private sector workforce and almost all of the public sector were covered by a traditional pension plan, commonly referred to as a defined benefit pension plan. Forty-seven years later at the beginning of the twenty-first century, the same share of the private sector workforce is offered a pension plan at work. But the type of plan they are offered has changed dramatically: the defined contribution 401(k)-type individual account plan is now dominant. Public sector workers still have defined benefit plans.

There are many differences between defined benefit and defined contribution plans. One is particularly stark: In defined benefit plans, employers make all the investment decisions and must pay the pension regardless of the pension fund's investment earnings. In a defined contribution plan, the employee makes all the decisions and accepts the risk that the accumulations in her account could be lower than expected. Here is how the plans work.

A defined benefit (DB) pension plan credits every year of service with a certain percentage of salary earned, which is usually some average of the salary over the final years on the job. For example, a typical defined benefit plan pays a retiree an annual benefit equal to 2% for every year of service multiplied by an average of the last three years of salary. Therefore an employee who earned, on average, $40,000 in his last three years of his twenty-year service would have an annual pension of $16,000, calculated as follows: 2% of $40,000 is $800; twenty years at $800 per year of service is $16,000. That annual pension payment comes to 40% of the $40,000 average of the last three years' annual earnings. (Keep in mind that 40%!) The employer contributes annually to a fund to pay for these defined benefit pensions as they come due, according to federal regulations.

In a defined contribution (DC) plan, the employee and most employers pay a defined amount into the employee's individual retirement account. Whatever the account accumulates and earns on its investments is what is available. A savings account and an individual retirement account are fairly similar, except an individual is advised to invest the retirement account in many different investment vehicles and there are certain rules about withdrawing money from it. A worker can borrow against or withdraw funds from her or his retirement account before age fifty-seven-and-a half, but must pay a tax penalty—a 10% tax rate is added to the employee's ordinary federal tax rate—on the amount of funds withdrawn. Many employees do withdraw their money and pay the tax penalty. Until the 1990s, defined contribution plans were mostly used as supplements to defined benefit plans. Now, many companies have replaced their traditional pension plans with defined contribution plans.

As 401(k) plans overtook traditional company pensions, Social Security emerged as the only reliable source of income for the elderly. During the same time period, wage income emerged as the elderly’s fastest-growing source of income. As you will see, this means that more of the elderly will be poor, and many more of those who don't fall into poverty will experience a significant fall in living standards after they retire.

Making people work longer and look for work at older ages to augment inadequate pensions may be a reasonable proposition. But to ensure that older people freely choose work over retirement and that future generations are not downwardly mobile, facing a retirement future as bleak as retirement was before the 1970s, the following needs to happen:

Workers must be required to save 5% of their salary (up to the Social Security earnings cap) in a guaranteed retirement account. The accumulations in these accounts should become available after age sixty-five; the government must guarantee the rate of return; and a government agency, not a commercial money manager, must administer the accounts.

Tax subsidies for 401(k) plans must be replaced with a $600 refundable tax credit for each worker, to help offset the financial sacrifice of having to save 5% of earnings. The replacement will equalize government tax subsidies between high- and low-income earners.

Social Security payroll tax increases must be scheduled for 2020 and general revenues—from the estate tax particularly—used to eliminate old-age poverty.

Worker representation on employers' pension boards should be mandatory. This will help workers save because they will be engaged in the management of their money; worker representation will also inhibit employers from managing the company's pension plan to serve their own interests.

These policies could make it easier and less costly for anyone, especially low- and middle-income workers, to save for retirement. More importantly, these changes would avoid the problems of the narrow interests of the financial industry and having employers steering pension reform. Historically, workers have better pensions when both their political influence and their bargaining power are strong, and when workers feel entitled to income and leisure after a lifetime of hard work.

The Successes of the U.S. Retirement System

So far, at the beginning of the twenty-first century, Americans expect time off at the end of their working lives. Americans consider that it is reasonable to expect paid retirement time—a concept that has evolved, just as the entitlement to any time off has evolved, as implicit in overtime, the eight-hour day, and "the weekend." These entitlements resulted from compromises between workers, organized labor, firms, and federal and state governments. Workers throughout the post–World War II period have continued to want, and to pay for, holidays and vacations, paying in the form of forgone increases in cash wages and/or increased productivity. The New York City transit workers risked public ire and severe consequences when they stranded millions of commuters in chilly December 2005 in a strike over a proposed cutback in their pension benefits. Not only is entitlement to paid time off important, American workers and their unions have come to regard pension plans as a way for ordinary workers, many of whom are and were immigrants, to achieve middle-class status by obtaining some of the same kinds of income security arranged for their managers and bosses.

Gains in retirement time were quite large before the start of the twentieth century (before the year 1900).Men born after the Civil War lived much longer—their average time in retirement leaped approximately 9% compared to men born five years earlier (these calculations are explained in chapter 2). From 1900 to 1999, the largest gains in retirement time were for those people born around 1911; women enjoyed a more than 12% boost in retirement time compared to women five years older, and men an 8.2% boost.

This age group retired in the mid-1970s, when Social Security benefits increased rapidly and company-provided pension plan coverage was growing. The rates of increase in retirement time for each successive group of people born five years later gradually fell; the increases may have gotten smaller, but they nevertheless were increases! Not until the late 1990s did the growth in retirement time begin to turn downward. Both men and women retiring around 1999 could expect less retirement time (about 1% fewer years) than people just a few years older. Clearly, people are living longer, but they seem to be using the longevity increases to engage in paid work, not to experience retirement leisure.

Perhaps workers are freely choosing to use their longer lives to work more. Or it could be that people increasingly feel forced to work longer because their retirement income has become less adequate and secure. The reality is somewhere in between. And because the gap in retirement leisure between different groups is growing as middle-class retirees and lower-income retirees suffer from less secure and smaller pensions, the changes are hurting some groups and helping others

Again, Even if there were no actual differences in gender or race attitudes toward having a pension and the risk associated with it, the belief in the stereotype may by itself have implications for what investment products are offered. **Thus the importance of inclusion Mr. Chairman ; inclusion on all levels, from investment advice to investment management.**

That inclusion has to be a guiding principle of the Federal Employee Thrift Savings Plan.

Thank you for your time. I would be happy to answer questions now or at a later time.