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BEFORE THE
HOUSE SUBCOMMITTEE ON THE FEDERAL WORKFORCE, POSTAL SERVICE, AND THE DISTRICT OF COLUMBIA

AUGUST 2, 2007

Good afternoon Chairman Davis and Members of the Subcommittee. My name is Greg Long. I am the Executive Director of the Federal Retirement Thrift Investment Board and, as such, the managing fiduciary of the Thrift Savings Plan, or TSP. I welcome this opportunity to appear before the Subcommittee.

You have invited my testimony as part of a comprehensive look at Federal employee pay and benefits. The TSP is a voluntary savings and investment plan that allows Federal and Postal employees (and, since 2002, members of the uniformed services) to accumulate savings for their retirement. It was created by the Congress in the Federal Employees' Retirement System Act of 1986 (FERSA). It offers employees of the Federal Government savings and tax benefits similar to those offered by many private corporations under 401(k) retirement plans. The TSP currently has approximately 3.8 million individual accounts, and the Thrift Savings Fund has grown to $224 billion. Each month, participants add more than $1.6 billion in new contributions. Participants may invest in any or all of five core investment funds and five lifecycle funds; transfer their monies among the funds; borrow from their accounts; transfer money into their accounts from other eligible employee plans or individual retirement accounts; and receive distributions under several withdrawal options. TSP administrative expenses are borne by the participants, not by the taxpayers.

The Government-wide Federal Employees' Retirement System (FERS) employee participation rate is 85.8 percent. TSP participation by Civil Service Retirement System (CSRS) employees is currently about 69 percent. Additionally, after only five years, more than half a million members or 25.6 percent of the uniformed services now have TSP accounts.

PLAN STRUCTURE

Employees who are covered by FERS, CSRS, or members of the uniformed services contribute via payroll allotment to the TSP. The maximum amounts they may contribute are prescribed by law. These limits are currently $15,500 annually for most employees, and $20,500 annually for those age 50 and over.

FERS employees receive an automatic contribution to their TSP accounts, paid by their employing agency, which is equal to one percent of their basic pay each pay period. Their employing agency also matches the first five percent of basic pay contributed -- dollar-for-dollar on the first three percent and fifty cents on the dollar for the next two percent. CSRS employees and members of the uniformed services receive the same tax benefits as FERS employees, but generally receive no automatic or matching contributions from their agencies. (A pilot program of matching contributions for uniformed services members authorized by the Congress is currently underway in the Department of the Army.)

GOVERNANCE AND ADMINISTRATION

The TSP is administered by the Federal Retirement Thrift Investment Board, which was established as an independent Federal agency. There are approximately 70 employees of the Board. Governance is carried out by six individuals who serve as fiduciaries of the Plan. Five are part-time presidential appointees (one recommended by the House, one recommended by the Senate) who serve four-year terms as Board Members. The sixth is a full-time Executive Director. The latter is selected by the Board members and serves an indefinite term. Each of these persons is required by FERSA to have "substantial experience, training, and expertise in the management of financial investments and pension benefit plans." 5 U.S.C. §§ 8472(d), 8474(a)(2). With input from the Executive Director, the statutory Employee Thrift Advisory Council, and Board staff, the five Board members establish the policies under which the TSP operates.

The Executive Director carries out the policies established by the Board members and otherwise acts as the full-time chief executive officer of the agency. The Board members, the Executive Director and the senior staff convene monthly meetings open to the public to establish and assess policies, practices, and performance.

FERSA provides that all monies in the Thrift Savings Fund are held in trust for the benefit of the participants and their beneficiaries. As fiduciaries, the Executive Director and the Board members are required to act prudently and solely in the interest of TSP participants and their beneficiaries. This fiduciary responsibility gives the Board members and the Agency a unique status among Government agencies.

Congress wisely established this fiduciary structure because it recognized that all Plan funds belong to the participants, not the Government, and thus must be managed independent of political or social considerations.

In keeping with the intent of Congress that the Plan be administered in accordance with fiduciary standards derived from those applicable to private sector employee benefit plans -- as distinct from the usual administration of an executive branch agency -- Congress exempted the Board from the annual appropriations process and the legislative and budget clearance processes of the Office of Management and Budget. The testimony I am presenting today was not subject to clearance by the OMB.

The Plan's independence is critical to ensure the fiduciary accountability envisioned by FERSA. So long as the Plan is managed by the six fiduciaries named in FERSA (the members of the

Board and the Executive Director) in accordance with the statute's strict fiduciary standards, Federal employees and members of the uniformed services can be confident that their retirement savings will not be subject to political or other priorities which might otherwise be imposed.

FERSA protects the Thrift Savings Fund through more than just the independent fiduciary governance by the Board members and the Executive Director. Additional safeguards to protect TSP participants include FERSA provisions relating to (1) the role of the Secretary of Labor in establishing a program of fiduciary compliance audits; (2) the requirement that a private accounting firm conduct an annual audit of the TSP on the basis of generally accepted accounting principles; and (3) the participation of the 15-member Employee Thrift Advisory Council, which includes representatives of the major Federal and Postal unions, other employee organizations, and the uniformed services.

The TSP has benefited greatly from hundreds of audits conducted by the Department of Labor over the past twenty years. These audits, which have covered every aspect of the TSP, are reported to the Congress annually under the Inspector General Act of 1978, as amended.

The independent accounting firm has conducted annual reviews as required. The result has been twenty unqualified audit opinions.

The Advisory Council meets with the Executive Director and advises on investment policy and the administration of the TSP. These meetings are very helpful in providing the Executive Director with insights into employee needs, attitudes, and reactions to the various TSP benefits and investments.

The TSP also benefits from the cooperation of every agency and service in the Federal establishment. Although the Board is independent, successful administration of the TSP is highly dependent upon coordination with all Federal agencies and the uniformed services, which have direct responsibilities under FERSA for the administration of the TSP.

RELATIONSHIP WITH THE OFFICE OF PERSONNEL MANAGEMENT

Since its earliest days, the Agency has enjoyed an extraordinarily cooperative relationship with the Office of Personnel Management. OPM is the authority for the Administration with regard to pay and benefits in the Executive Branch. It is OPM that has statutory responsibility for the overall retirement education of the Federal workforce and the training of retirement counselors at Federal employing agencies. OPM is comparable to private sector "plan sponsors," the employers who offer benefit plans to employees. As such, OPM, in conjunction with the Administration and the Congress, looks at the overall level of benefits necessary to attract and retain a qualified workforce to conduct the public's business. In this regard, I note that OPM annually surveys employees to determine attitudes about the importance, adequacy, value, and competitiveness of the various benefit programs. I am pleased that the attitudes toward the TSP reported in those survey results are quite positive.

As an independent establishment, the Board is comparable to a private sector "plan administrator," which is the entity that ensures the efficient delivery of benefits and services to plan participants. We are located in the Executive Branch, but operate with extraordinary independence. We are not part of the Administration, and we carry out our activities solely in the interest of participants and beneficiaries.

One might anticipate friction from the different but closely related roles of the Board and OPM. However, our experience has been just the opposite. We are grateful for the many courtesies extended by OPM, and know that the Plan and its participants have benefited from this excellent relationship.

PLAN SERVICES AND BENEFITS

Employees and service members who participate in the TSP are served primarily by the personnel, payroll, and other administrative employees in their own agencies. The agencies are responsible for distributing TSP materials, providing employee counseling, and accurately and timely transmitting participant and employer contributions and necessary records to the TSP record keeper.

Additionally, the Board has contracted with private firms for TSP record keeping, call center and data center services. TSP record keeping services are currently provided by SI International, a contractor located in Fairfax, Virginia. In addition, SI maintains one of the TSP call centers which is located in Clintwood, Virginia. A second TSP call center is operated by InfoSpherix, Inc., in Cumberland, Maryland. Participants with questions may call the ThriftLine, our toll-free number, which routes calls to participant service representatives at one of these sites. Further, to support continuity of TSP operations, we maintain one primary data center and one back-up data center.

Actively employed participants may borrow a portion of their own contributions and earnings from their accounts according to rules established by the Executive Director and regulations of the Internal Revenue Service. Participants repay the loans, with interest, and the money is reinvested in their TSP accounts. A $50 fee is charged to cover the costs of loan processing. During 2006, the TSP issued more than 240,000 loans to participants.

The other major benefit program is the TSP withdrawal program. Participants may withdraw funds from their TSP accounts before separation after reaching age 59½ or in cases of financial hardship. Upon separation, a participant may:

- withdraw his or her account balance in a single payment (and have the TSP transfer all or part of the payment to an Individual Retirement Account (IRA) or other eligible retirement plan);
- withdraw his or her account balance in a series of monthly payments (and, in certain cases, have the TSP transfer all or part of each payment to an IRA or other eligible retirement plan);
- receive a life annuity; or
- keep his or her account in the TSP, subject to certain limits.

Participants may also elect a combination of these withdrawal options. During 2006, more than 850,000 withdrawal payments were issued to participants.

COMMUNICATIONS

The Board maintains its communication program on a number of levels within the Federal establishment in order to achieve employee understanding of the investment choices, benefits, and the administration of the program. This is especially important given the voluntary nature of the Plan and the participants' degree of individual control over investments and benefits.

The communication effort is initiated through the issuance of a "new account letter" to each new participant after the employing agency establishes his or her account. Employing agencies distribute program information, including the *Summary of the Thrift Savings Plan*, which provides a comprehensive description of the Plan, as well as booklets describing the loan and withdrawal program for employees to review at the time they are examining those benefits. Investment information is provided by the TSP Fund Sheets and the *Managing Your Account* leaflet which discusses operations. Copies of these publications are also available on our Web site at www.tsp.gov or through the ThriftLine. We have also designed pamphlets to support specific campaigns to increase TSP participation. An example would be the leaflets provided to the uniformed services to include with their retirement materials.

In addition, we issue materials related to specific events. For example, the *TSP Highlights* is a newsletter issued with the quarterly participant statement. Copies of the newsletters, which address topical items and convey rates of return, are provided on the TSP Web site. Participants can also use the Web site to obtain their daily balances, request contribution allocations and interfund transfers or, in some cases, loans and withdrawals, and use various calculators as convenient planning tools.

The ThriftLine, the Board's toll-free automated voice response system, also provides both general plan and account-specific information and allows participants to perform some transactions via the phone as well as speak to a representative.

In connection with the new lifecycle funds we introduced in 2005, we revised all of our communications materials and now feature the benefits of the asset allocation approach used in "Life" funds as discussed below. We also issued a DVD explaining the L Funds to all participants.

Because of the importance of the agencies and services in administering the TSP for their employees and members, the Board conducts quarterly interagency meetings. These have proven to be an effective means of communicating program and systems requirements to Federal agency administrative personnel. These meetings also allow the TSP to hear and address representatives' concerns and to incorporate their suggestions in the establishment of TSP policies and operations. We also issue TSP Bulletins regularly to inform agency personnel and payroll specialists of current operating procedures.

INVESTMENT FUNDS

The TSP is a participant-directed plan. This means that each participant decides how the funds in his or her account are invested.

As initially prescribed by FERSA, participants could invest in three types of securities -- U.S. Treasury obligations, common stocks, and fixed income securities -- which differ considerably from one another in their investment characteristics. In 1996, on the Board's recommendation, Congress authorized two additional investment funds, which allow further diversification and potentially attractive long-term returns. The Small Capitalization Index Investment Fund and the International Stock Index Investment Fund were first offered in May 2001.

The Government Securities Investment (G) Fund is invested in short-term nonmarketable U.S. Treasury securities guaranteed by the full faith and credit of the U.S. Government. 5 U.S.C. § 8438(b)(1)(A), (e). There is no possibility of loss of principal from default by the U.S. Government and thus no credit risk. These securities are similar to those issued to the Social Security trust funds and to other Federal trust funds. See 42 U.S.C. § 401(d) (Social Security trust funds); 5 U.S.C. § 8348(d) (Civil Service Retirement and Disability Fund).

The Fixed Income Index Investment (F) Fund, which by law must be invested in fixed income securities, is invested in a bond index fund, chosen by the Board to be the Lehman Brothers U.S. Aggregate (LBA) index. The LBA index represents a large and diversified group of investment grade securities in the major sectors of the U.S. bond markets: U.S. Government, corporate, and mortgage-related securities.

The Common Stock Index Investment (C) Fund must be invested in a portfolio designed to replicate the performance of an index that includes common stocks, the aggregate market value of which is a reasonably complete representation of the U.S. equity markets. The Board chose the Standard & Poor's 500 (S&P 500) stock index in fulfillment of that requirement. The S&P 500 index consists of 500 stocks representing approximately 73 percent of the market value of the United States stock markets. The objective of the C Fund is to match the performance of that index.

The Small Capitalization Stock Index Investment (S) Fund must be invested in a portfolio designed to replicate the performance of an index that includes common stocks, the aggregate market value of which represents the U.S. equity markets, excluding the stocks that are held in the C Fund. The Board chose the Dow Jones Wilshire 4500 Completion index, which tracks the performance of the non-S&P 500 stocks in the U.S. stock market. The objective of the S Fund is to match the performance of the Wilshire 4500 index. The Wilshire 4500 index represents the remaining 27 percent of the market capitalization of the U.S. stock market. Thus, the S Fund and the C Fund combined cover virtually the entire U.S. stock market.

The International Stock Index Investment (I) Fund must be invested in a portfolio designed to track the performance of an index that includes common stocks, the aggregate market value of which represents the international equity markets, excluding the U.S. equity markets. The Board chose the Morgan Stanley EAFE

(Europe, Australasia, Far East) index, which tracks the overall performance of the major companies and industries in the European, Australian, and Asian stock markets. The objective of the I Fund is to match the performance of the EAFE index. The EAFE index was designed by Morgan Stanley Capital International (MSCI) to provide broad coverage of the stock markets in the 21 countries represented in the index.

In August 2005, the TSP introduced Lifecycle Funds. The Lifecycle Funds are invested in various combinations of the five statutory funds. Participants benefit from having professionally designed asset allocation models available to optimize their investment performance by providing portfolios that are appropriate for their particular investment horizon. This is known in the financial world as investing on the "efficient frontier." We are very pleased with the reception of the L Funds by participants. As of the end of June, over 515,000 TSP participants have invested more than $21 billion of their retirement savings in the L Funds.

One likely concern associated with a Federal agency's investing in equities is the potential for the Government to influence corporate governance questions and other issues submitted to stockholder votes. FERSA wisely provides that the voting rights associated with the ownership of securities by the Thrift Savings Fund may not be exercised by the Board, other Government agencies, the Executive Director, a Federal employee, Member of Congress, former Federal employees, or former Members of Congress. 5 U.S.C. § 8438(f). Barclays Global Investors (BGI), the manager of the C, S, and I Fund assets, has a fiduciary responsibility to vote company proxies solely in the interest of its funds' investors.

The fund assets held by the F, C, S, and I Funds are invested in passively managed indexed funds; that is, they are invested in portfolios of assets in such a way as to reproduce market index returns. The philosophy of indexing is that, over the long term, it is difficult to improve upon the average return of the market. The investment management fees and trading costs incurred from passive management through indexing generally are substantially lower than those associated with active management. Passively managed index funds also preclude the possibility that political or other considerations might influence the selection of securities.

The manager of the assets held by the F, C, S, and I Funds has been selected through competitive bidding processes. Proposals from prospective asset managers were evaluated on objective criteria that included ability to track the relevant index, low trading costs, fiduciary record, experience, and fees.

The Board has contracts with BGI to manage the F, C, S, and I Fund assets. BGI is the largest investment manager of index funds in the United States, which had over $1.99 trillion in total assets under management as of May 31, 2007.

Although we have invited proposals from all qualified providers, only those asset management companies capable of efficiently handling our very large cash flows could satisfy the minimum qualifications required. We know that there are many excellent vendors who would like to perform services for the TSP, but who are unable to demonstrate that they can satisfy the extraordinary demands which an operation of our size requires. In this regard, Mr. Chairman, you and others have expressed an interest on behalf of smaller companies. We appreciate that interest and do all that we can properly do in fashioning our requests for proposals to achieve the broadest possible competition consistent with the needs of the fund and the fiduciaries' duty to act solely in the interest of the participants.

The centralized management of TSP investments was carefully considered in FERSA by Congress. The Congress clearly expected the fiduciaries to use the size of the Plan for the benefit of its participants. According to the Joint Explanatory Statement of the Committee of Conference on the TSP enabling legislation, Congress designed the plan to preserve "the economic advantage of this group's purchasing power derived from its large size...." H.R. Rep. No. 99-606, at 137-38, reprinted in 1986 U.S.C.C.A.N.

1508, 1520-21.

INVESTMENT RETURNS

By law, TSP investment policies must provide for both prudent investments and low administrative costs. From the beginning of the G Fund's existence (April 1987) and the beginning of the F and C Funds' existence (January 1988) through December 31, 2006, the G, F, and C Funds have provided compound annual returns net of expenses of 6.57 percent, 7.25 percent, and 11.86 percent, respectively. The related BGI funds closely tracked their respective market indexes throughout this period. Since the S and I Funds were introduced in May 2001, they have produced compound annual returns of 10.04 percent and 9.69 percent, respectively.

For calendar year 2006, the net Plan administrative expenses were .03 percent. This means that the 2006 net investment return to participants was reduced by approximately $.30 for each $1,000 of account balance. The expense ratio would be approximately .01 percent higher in the absence of account forfeitures and loan fees, which offset expenses. These costs compare very favorably with typical private sector 401(k) service provider charges.

FUTURE IMPROVEMENTS

I believe that the Thrift Savings Plan has effectively and efficiently realized the numerous objectives Congress thoughtfully established for it twenty years ago. Further, I believe that the many improvements made by the Congress during the Plan's twenty year history have kept pace with the best features of 401(k) plans offered by private sector employers. Earlier, I noted that the annual OPM benefits survey reported positive views of the TSP by respondents. Our own survey last year showed a high level of satisfaction, with only 3 percent of participants providing an unfavorable assessment of the TSP.

I further note, however, that neither participant expectations, nor the Congress, stand still. Last August, Congress approved and the President signed into law the Pension Protection Act (PPA) which authorized certain new benefits and encouraged private sector plans to adopt design changes intended to increase voluntary participation and improve investments. After carefully examining this new law and making those appropriate changes which we could on our own authority, the Board voted at its June 19, 2007, meeting to seek statutory authority to institute automatic enrollment and to make default investments in an age-appropriate L Fund. Both of these changes, which private sector plans are encouraged to make under the PPA, will improve the TSP. They were widely supported by participants in the survey noted above. We hope that the Congress will favorably consider these proposals.

The Board further decided at its June meeting to more carefully examine the possibility of establishing a Roth feature for the TSP and to revisit that issue in two years. A Roth

401(k) feature could first be implemented by private plans in 2006, with expiration scheduled for 2010. The PPA made it permanent. While our initial review found that some participants might benefit from a Roth feature, it is still not clear whether it would generate enough support to justify its expense. In those few 401(k) plans offering a Roth feature, participant utilization remains in the low single digits. Moreover, a Roth feature would add significant complexity to the TSP. We strongly believe that more experience and information is needed on this matter.

We are also aware of interest expressed by various individual members of Congress and interest groups in establishing new TSP investment funds or in removing certain companies from the existing TSP funds. Congressional proposals have included a REIT fund, a precious metals fund, and a corporate responsibility fund. On the divestment side, proposals to exclude companies doing business in Darfur, the Iran energy sector, or those marketing tobacco products, have also found congressional sponsorship.

There are many good products or meritorious causes that some in Congress support for many legitimate reasons. However, in determining TSP investment policy, the Congress directed the Board fiduciaries to make their decisions solely in the interest of TSP participants. With the assistance of our investment consultant, Ennis Knupp + Associates, the Board last year conducted a comprehensive review and determined that we should not add any additional investments to the TSP at this time. We will, of course, continue to monitor industry best practices and products in this regard in the future.

In addition to these legislative matters, the Board continues to pursue administrative program enhancements. Most notably, we continue to implement more sophisticated security protections to guard against the constant threat of computer fraud. Early this year we replaced our 4 digit PIN with an eight character alpha-numeric password for the TSP Web site. Later this year we will replace our current Social Security number identifier with a computer generated account number. (The latter may generate some participant complaints during implementation, but we consider it to be essential to protect participants and the Plan.)

In addition to our own security enhancements, we need to continuously remind participants that they need to keep their personal information secure. Last December, a number of individuals were victimized by thieves who, using "keylogging" techniques, were able to "eavesdrop" and steal personal information from some participants' personal computers. These thieves then used that information to initiate TSP withdrawals.

We quickly recognized the problem and took action. I would like to thank the U.S. Secret Service for its investigation of this matter, and, also, thank various financial institutions who made affected participants whole. I hope this incident, which we reported to participants on our Web site, has helped them better appreciate the need for constant vigilance.

We also continue to improve the TSP Web site at www.tsp.gov. Most recently, we have instituted a search engine to help visitors more easily navigate and locate precisely the information they seek. We plan to send a new annual statement to all participants beginning early next year, and we are examining other potential improvements suggested during my first meeting with our Employee Thrift Advisory Council.

In closing, Mr. Chairman, I would like to thank you and the members of the Subcommittee for your interest in the TSP and all of the benefits provided to Federal employees. We understand the key role which these benefits serve in attracting and retaining an outstanding workforce capable of performing the many important services which the American public deserves. Since leaving the private sector and coming to the Agency last year, I have gained an appreciation of how well this program, designed by the Congress, meets the needs of employees. As I noted earlier, this does not mean that we can rest on our laurels. Rather, I remain committed to moving forward together -- the Board, the Congress, the Administration, the Employee Thrift Advisory Council, the Office of Personnel Management, the employing agencies and others -- to continue to meet the evolving retirement savings needs of Federal employees and members of the uniformed services.