STATEMENT BY GREGORY T. LONG
EXECUTIVE DIRECTOR
FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
BEFORE THE
HOUSE SUBCOMMITTEE ON THE FEDERAL WORKFORCE, POSTAL SERVICE,
AND
THE DISTRICT OF COLUMBIA

APRIL 29, 2008

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.

The Board is an independent Agency with responsibility to act solely in the interest of TSP participants. Consequently, our statements to the Congress are not submitted for clearance by the Office of Management and Budget.

You requested my views today on two proposals we transmitted for consideration by the Congress to improve the Thrift Savings Plan for Federal employees. We appreciate your holding this hearing to examine these proposals.

The Board strongly supports amending the Federal Employees' Retirement System Act of 1986 (FERSA) to authorize automatic enrollment of all newly hired Federal and Postal employees into the Thrift Savings Plan (TSP) and to change the TSP default fund for new enrollees from the Government Securities Investment (G) Fund to an age-appropriate Lifecycle (L) Fund.

The TSP is a retirement savings and investment plan for Federal and Postal employees and members of the uniformed services. It is a "defined contribution" plan that offers the same type of savings and tax benefits that many private sector employers offer their employees under so-called "401(k)" plans. The TSP is available to employees covered by the Civil Service Retirement System, the Federal Employees' Retirement System (FERS), and members of the uniformed services.

Under FERSA, employees and service members who wish to participate in the TSP must submit a contribution election to their employing agencies or services. FERSA also requires employing agencies to create an account for non-contributing FERS employees following the completion of a statutory waiting period. Agencies must deposit an amount equal to one percent of FERS employees' basic pay (i.e., Agency Automatic (1%) Contributions) to the accounts. Participant contributions by FERS employees are matched by the Agencies based on a statutory formula. Since FERSA designates the G Fund as the TSP's default fund, all initial contributions from employees and agencies are invested in the G Fund. Thereafter, participants may submit a request to direct their contributions and/or reallocate their investments among the other TSP funds. For participants who do not submit a request, their accounts remain invested in the G Fund by default.

Following passage of the Pension Protection Act of 2006 (PPA), the Board undertook a review of the TSP's policies in light of that legislation. Particularly, that review focused on provisions of the PPA which applied to private sector qualified plans but not to the TSP, including automatic enrollment and Qualified Default Investment Alternatives (QDIA).

The Board conducted significant research and data collection on automatic enrollment and QDIAs. The research and analysis included a review of 401(k) industry data and trends, a review of TSP-specific data, consideration of TSP participant survey findings, consultation with the statutory Employee Thrift Advisory Council (ETAC), the solicitation of feedback from employing agencies, and a cost analysis.

The TSP is an integral part of the retirement package for FERS employees. Agency Matching Contributions provide a strong incentive for employees to contribute their own funds. Voluntary participation stands at 86 percent, which compares very favorably to private sector 401(k) plans.

However, the 14 percent of FERS employees and 73 percent of uniformed services members who are not contributing to the TSP are less likely to be financially self-sufficient in retirement than their counterparts who do contribute. Furthermore, non-contributing FERS participants are failing to collect Agency Matching Contributions which the Congress authorized for their benefit.

TSP data and participant feedback further reveal that, while some non-contributors intentionally decide against participating, a significant number simply place a low priority on returning election forms or fail to undertake any retirement planning. Automatic enrollment addresses these issues by making inertia work in favor of participation.

The statutory ETAC expressed support for automatic enrollment in its June 12, 2007, meeting. Feedback from civilian agencies was generally favorable. Our analysis indicates that the systems, communications, and staffing modifications required to implement these proposals will be minimal.

The legislative proposal authorizes immediate automatic contributions from all newly hired eligible employees who do not affirmatively decline to contribute a portion of their pay to the TSP. The initial contribution rate would be three percent of basic pay, but employees may opt out or change their contribution amount at any time. This approach would be similar to the Federal Employees' Group Life Insurance (FEGLI) model used successfully in the Federal government for many years. Participants would also have a 90-day grace period from the date of the first contribution in which to withdraw the funds. Such refunds would be treated as taxable income, but would not be subject to any early withdrawal penalty. Agency Automatic (1%) and Matching Contributions would still begin only after the statutory waiting period.

I am aware that, under Congressional budget rules, the automatic enrollment proposal could generate a potentially significant cost. I hope that a way can be found to overcome that obstacle so that more employees will make full use of the TSP in order to be better prepared for their retirement.

With regard to the TSP's default fund, the Board reviewed the Department of Labor's proposed implementing regulations for QDIAs. These regulations alleviate liability concerns for plan sponsors and fiduciaries by providing safe harbor protections for the selection of an appropriate default fund. The Congress believed that providing plan sponsors and fiduciaries with a safe harbor would free them from liability concerns which necessitated selection of a money market or stable value fund with lower projected returns over time. The three types of QDIAs defined by the proposed regulations are lifecycle or target date funds (which are similar to the TSP's L Funds), balanced funds, and managed accounts.

Significantly, the Board's review of the TSP's data revealed that, of those participants whose contributions were initially invested in the G Fund during the first quarter of 2004 (the first full plan year under the new daily-valued system), only 26 percent submitted a request to move their money to other funds by the end of the following calendar quarter. Tracking that same group through the first quarter of 2007, we found that 48 percent never made an investment decision after they enrolled. They simply remain 100 percent invested in the G Fund. Of most concern, 62 percent of these participants are under 40 years of age.

These participants, like the vast majority of newly hired Federal employees and uniformed service members, are unquestionably long-term investors. The L Funds are asset allocation funds designed to take advantage of long-term equity market performance while lowering risk as the draw-down date approaches. For these participants, L Fund investments are a more appropriate default option and will enhance their retirement security.

Changing the default fund will not require agencies or services to modify any procedures or systems, and the cost for

TSP modifications is minimal. Like automatic enrollment, the statutory ETAC expressed support for changing the default fund to an age-appropriate L Fund at its June 12, 2007, meeting.

The legislative proposal would authorize the investment of all contributions from all newly hired eligible employees in an age-appropriate L Fund as determined by their date of birth. The TSP will assume age 65 as the draw-down date and invest contributions in the particular L Fund with the time horizon that most closely matches the draw-down date. For example, a newly enrolled participant who was born in 1967 will reach age 65 in 2032. This participant's contributions would be invested in the L 2030 Fund until the participant makes a different investment election. At the time of their enrollment participants would be informed of the benefits and risks of the L Funds as well as how to move their funds to the risk-free G Fund or other asset allocations of their choosing.

As the fiduciaries of the TSP, the Board Members and I believe favorable Congressional consideration of these proposals would enable the Plan to continue to meet the needs of employees as reliance on the TSP for retirement income security continues to increase over time.

Uniformed Services

During our examination of this matter last year, we became aware of differing concerns among the various uniformed services. With extraordinary assistance from the leadership at the Department of Defense, Board members, senior staff, and I were invited to make a presentation at the Pentagon on this matter to the leadership of all seven uniformed services. The Department of Defense is currently working hard to finalize its position on automatic enrollment of service members. We look forward to receiving their views and accommodating any special concerns which they identify.

Roth Feature

The Board last summer also considered the potential addition of a Roth feature to the TSP. As you know, the PPA made the "Roth 401(k)" feature a permanent provision of tax law, replacing an earlier temporary provision. This change has caused some retirement plan managers to reconsider this offering.

The addition of a Roth feature would allow participants to select different tax treatments for their future TSP contributions. Standard (non-Roth) employee contributions are made on a pre-tax basis and reduce a participant's income subject to Federal and (most) state taxes. These contributions and their related earnings are then taxed as ordinary income when withdrawn.

Roth contributions, on the other hand, are after-tax contributions -- they are not excluded from current taxable income. The intended benefit of a Roth account is that these contributions and their associated earnings are withdrawn tax-free. Roth contributions generally are considered more favorable for participants who expect that their tax rates in retirement will exceed their current levels.

Contributions to a Roth account would count against the elective deferral and other Internal Revenue Code limits (e.g., $15,500 for regular contributions and $5,000 for catch up contributions in 2008) just as pre-tax contributions do. Consequently, a Roth account would not allow a participant to contribute any more money than the law currently allows. The amount of any Agency Matching Contributions credited to the participant's TSP account would not be affected by whether the employee elects to contribute to a Roth account or not.

While Roth accounts may be viewed as beneficial by a number of participants, the scope, impact, and costs to participants for this project would be huge. As of now, I am not convinced that this feature would have broad appeal, and it is not clear how participants would react to the educational efforts needed for complex tax planning issues. Therefore, I recommended that we not seek legislation to add a Roth 401(k) feature at this time, but that we continue to review private-sector experience with Roth accounts. I advised the Board members that we will revisit this issue in mid-2009.

I believe this timeframe will allow us to survey TSP Plan participants on how they will view a Roth feature, analyze the demographics of TSP participants to determine how many participants are likely to find Roth accounts beneficial and finally examine how Private Sector plans are faring with their implementation and operating of Roth 401(k) features.

I am aware that members of Congress, the Judiciary, and the uniformed services have voiced an interest in adding a Roth feature. I want to assure all interested parties that we will proceed with deliberate speed.

In conclusion, Mr. Chairman, I would like to thank you for holding this hearing today. I would also like to thank the Subcommittee and full Committee staff members for their work on these proposals over the past few months. Like you and I, they are committed to making sure Federal employees and uniformed service members in the TSP enjoy the same benefits enjoyed by private- sector 401(k) participants.