STATEMENT BY

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BEFORE

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

REGARDING

PROPOSED CHANGES TO THE FEDERAL EMPLOYEE THRIFT SAVINGS PLAN

ON

APRIL 29, 2008

Thank you, Chairman Davis and distinguished Subcommittee members, for the opportunity to submit the following testimony.

My name is Richard N. Brown. I serve as the National President of the National Federation of Federal Employees, an affiliate of the IAMAW, as well as the Vice Chairman for the Employee Thrift Advisory Council, or ETAC. ETAC is comprised of 15 individuals from 15 different organizations, including employee organizations, unions, and the uniformed services, which represent active and retired federal employees. ETAC serves as an advisory body to the Federal Retirement Thrift Investment Board. The five presidentially-appointed members of the Board and its Executive Director oversee the Federal Government's Thrift Savings Plan, or TSP. It is in my capacity as ETAC Vice Chairman that I submit this testimony.

I will address two specific Board-proposed legislative changes to the TSP: an automatic enrollment provision for new employees, and a change in the default fund for new enrollees who do not make an investment decision. It is my intention to accurately share with you the views of the Council as a whole regarding these two issues.

Automatic Enrollment

In accordance with the Federal Employees' Retirement System Act of 1986, or FERSA, the TSP is an opt-in, defined contribution retirement savings and investment plan for federal and postal employees, and members of the uniformed services. The TSP provides federal employees with the same type of savings and tax benefits that many private corporations offer their employees through 401(k) plans. Employees who want to participate in the TSP must complete and submit a contribution election to their respective agency. New employees do not have contributions to the TSP deducted from their paycheck unless they specifically choose to do so. Therefore, the retirement income that an employee receives from his or her TSP account depends on how much the employee (and his or her respective agency) has contributed to the account during his or her working years and the earnings on those contributions.

According to the Board's proposed plan, all newly eligible federal employees who do not affirmatively decline to invest a portion of their paycheck in the TSP would automatically have 3 percent of their base pay deferred on their behalf, the level at which they would receive a 100 percent agency match when covered by the Federal Employees' Retirement System, or FERS.

A 90-day grace period from the date of the first automatic contribution is included in the proposal. Any automatically enrolled participants who did not wish to participate in the TSP could withdraw the current market value of their employee contributions at any time during this period. The withdrawal would be taxable as ordinary income in the year it was distributed, but would not be subject to early withdrawal penalties. A participant could still stop or change their contributions at any time after the grace period expired, but the account would then be subject to normal withdrawal rules.

The Board hired an independent consultancy, Watson Wyatt Worldwide, to conduct a survey gauging participant satisfaction with the TSP and input on proposed changes, including automatic enrollment in the program. The survey revealed strong support for the automatic enrollment of new employees. Nearly two-thirds of all respondents agreed that automatic enrollment of new employees "is a good idea," compared with only 20 percent who disagree. Neither age nor income made a large difference in respondents' support for automatic enrollment.

ETAC discussed the automatic-enrollment issue at our June 12, 2007 meeting, and there was widespread support for this proposed change. There was some minimal concern about the administrative costs and work involved in implementing the change, but the overall sense of the Council was that the benefits of automatic-enrollment outweighed the implementation costs.

Council members made a number of arguments in favor of automatic enrollment. Starting the habit of saving early on in one's career increases the likelihood that an employee will continue contributing throughout his or her career. Through compound earnings, even a modest automatic three percent contribution may lead to a sizable account balance over time, particularly when that three percent is combined with the automatic one percent agency contribution and additional three percent in matching funds that the employee will receive. Initiating automatic enrollment will ensure that those employees who do not intentionally refrain from investing in the TSP will not continue to miss out on the dollar-for-dollar matching funds to which they are entitled.

The TSP was intended to play an important role in generating retirement income for participants. The 14 percent of FERS employees who are not currently contributing to the plan are doing a great disservice to themselves down the road, as they are less-likely than plan participants to be financially self-sufficient in retirement. Given that FERS employees are eligible to receive matching funds from their agencies, the opportunity cost of not investing in the plan as early as possible is even greater.

The Council feels that all federal employees should invest in the TSP. However, new hires will be educated on this change and presented with the necessary information to make an informed decision about their participation in the plan. We do not believe this information will be difficult for them to access or understand, and the grace period and related opt-out provision ensure that they will have time to make these decisions without penalty.

For all of these reasons, ETAC strongly supports automatic enrollment in the TSP for new employees.

Default Elections

The second change to the TSP proposed by the Board is that all new enrollees in the plan who do not make an investment election will have their contributions defaulted to the age-appropriate Lifecycle, or "L", Fund.

Currently, TSP participants may choose how their money is allocated. They have a number of funds to choose from, specifically the G, F, C, S and I Funds. When participants do not make allocation choices, their contributions are automatically invested in the Government Securities, or "G" Fund. The G Fund earns interest and does not incur any losses, but due to its low level of risk, it may not provide a substantial rate of return to meet an employee's long-term retirement goals.

According to the Board's proposed plan, employees would have the same set of funds to choose from, but the default election would change from the G Fund to the age-appropriate L Fund, based on the specific participant's estimated retirement date as determined by their agency-reported date of birth. The L Fund allocates assets among the individual TSP funds and is designed to maximize expected performance for the amount of risk taken. The L Fund automatically addresses changing asset allocation needs as employees get closer to retirement. In the L Fund, money is allocated more heavily toward stocks for younger participants, which may lead to greater asset fluctuation and more risk, but is also expected to produce a higher rate of return. The closer a participant gets to retirement, the more heavily the L Fund is invested in Government securities and bonds.

In the previously mentioned survey, respondents were asked whether the G Fund or an age-appropriate L Fund should be used as the default fund for those TSP contributors who do not specify how their funds should be allocated. The study found that 49 percent of respondents preferred the L Fund as the default, while 27 percent preferred the G Fund and 24 percent had no preference. When respondents were broken down by age group, those under 40 expressed the strongest preference for the L Fund as the default at 55 percent, those 40-49 at 53 percent, and those over 50 at 45 percent. It is worth noting, though, that every age group preferred the L Fund over the G Fund as the default fund.

This issue was also addressed by ETAC at our June 12, 2007 meeting. There was some hesitation about changing the default election to the age-appropriate L Fund. The primary concerns were that the L Fund does not yet have a long history, and that the change would expose enrollees to risk. Participants may lose money in the L Funds, particularly in the short-term. However, ETAC members were largely in favor of a change to the L Fund for default allocations.

Committee members expressed support for the change to an L Fund default for a number of reasons. Many of us expressed our wish that we had diversified our investments and taken more risk when we were younger. Many of us were initially skeptical of the plan, but were much more supportive after reading the survey results and talking to our own members, who are generally supportive of and understand the change. The TSP is intended to be a long-term investment vehicle for participants, so a default fund that maximizes the chance for growth in the long-term makes sense.

Furthermore, TSP plan participants are able to change their future investment allocations to a different fund or funds within the plan, as well as move their existing account balance via an interfund transfer. Any employee who does not wish to invest in the L Fund would be able to easily make a different investment decision.

For all of these reasons, ETAC also supports legislation which would change the default fund from the G Fund to the age-appropriate L Fund for all newly enrolled TSP participants.

Conclusion

I would like to conclude by pointing out the great pride the Council takes in how responsibly and cost-effectively the TSP is run. We feel that the current system, under which we advise the Board, which takes our opinions into consideration and in turn proposes program policy changes to Congress, works extremely well. We strongly support the Board and Congress working together and reaching a consensus before making any substantive changes to the law governing the TSP. By all working together we have operated, and will continue to operate, a plan that represents the best interests of federal employees, postal workers, and our uniformed service members.

Thank you for the opportunity to present the views of the Employee Thrift Advisory Council regarding this matter.