Order Code RS22933
Updated July 31, 2008

CRS Report for Congress

H.R. 6500, The Thrift Savings Plan Enhancement Act of 2008

Patrick Purcell
Specialist in Income Security
Domestic Social Policy Division

Summary

On July 16, 2008, the House Committee on Oversight and Government Reform approved H.R. 6500, the Thrift Savings Plan Enhancement Act of 2008, by voice vote. As ordered reported by the committee, H.R. 6500 would

- provide for newly hired federal employees to be enrolled automatically in the Thrift Savings Plan (TSP) at a default contribution rate of 3% of pay, which would be invested in the government securities ("G") fund;
- require the Federal Retirement Thrift Investment Board to establish within the Thrift Savings Plan a qualified Roth contribution program that provides for after-tax contributions and tax-free distributions;
- give the Federal Retirement Thrift Investment Board authority to include self-directed investment options in the TSP; and
- require the Board to submit to Congress an annual report that includes demographic information about TSP participants and fund managers.

The text of The Thrift Savings Plan Enhancement Act was added to H.R. 1108, the Family Smoking Prevention and Tobacco Control Act, which was passed by the House of Representatives by a vote of 326 to 102 on July 30, 2008.

Automatic Enrollment in the Thrift Savings Plan

Federal employees initially hired into permanent employment on or after January 1, 1984, participate in the Federal Employees Retirement System (FERS). The FERS comprises three elements: Social Security, the FERS basic retirement annuity, and the

Thrift Savings Plan (TSP).[1] Employees can contribute up to $15,500 to the TSP in 2008. Employees aged 50 and older can contribute an additional $5,000. Each employee's employing agency automatically contributes an amount equal to 1% of pay to the TSP on his or her behalf. In addition, employee salary deferrals up to 5% of pay are matched by the employee's employing agency dollar-for-dollar on the first 3% of pay contributed to the TSP and at fifty cents on the dollar for the next 2% of pay contributed. The Federal Retirement Thrift Investment Board reports that 52% of employees enrolled in FERS voluntarily contribute to the TSP program in their first year of eligibility and that 86% contribute by their sixth year of employment.

Under current law, employees must elect to defer salary into the TSP. H.R. 6500 would require newly hired federal employees to be enrolled automatically in the TSP at a default contribution rate of 3% of pay, which would be invested in the government securities ("G") fund. The Federal Retirement Thrift Investment Board, which oversees the operations of the Thrift Savings Plan, would be authorized to set the default rate of contribution no lower than 2% of pay and no higher than 5% of pay and to designate another fund (or funds) within the TSP as the default investment fund. Employees would have the option to increase or decrease their contributions, to direct their contributions to one or more other funds within the TSP, or to opt out of participating in the TSP.

Qualified Roth Contribution Option

H.R. 6500 would direct the Thrift Board to add to the TSP a qualified Roth contribution program.[2] Currently, employee salary deferrals into the TSP are made with pre-tax dollars. Income taxes are deferred until money is withdrawn from the account. Under a qualified Roth contribution program, employee salary deferrals are made with after-tax income. Under federal tax law, only employee contributions can be allocated to a designated Roth account. Employer matching contributions must be allocated to a pre-tax account. When money is withdrawn at retirement, the part of the distribution that is attributable to the employee's designated Roth contributions, and investment earnings on those contributions, will be tax-free. The part of the distribution that is attributable to employer matching contributions and investment earnings on the employer contributions will be subject to income taxes.

Self-Directed Investment Options

Under current law, new investment funds can be added to the TSP only if authorized by Congress. H.R. 6500 would give the Federal Retirement Thrift Investment Board the authority, in consultation with the Employee Thrift Advisory Council, to include

---

[1] For more information on FERS, see CRS Report 98-810, *Federal Employees' Retirement System: Benefits and Financing*, by Patrick Purcell.

[2] The Roth Individual Retirement Account, named for the late Sen. William Roth, was authorized by the Taxpayer Relief Act of 1997, P.L. 105-34. Roth treatment of employee salary deferrals into 401(k) plans and 403(b) retirement annuities was authorized, beginning on January 1, 2006, by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16). For more information, see CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by John Topoleski.

self-directed investment options in the TSP without further congressional approval. The bill would require any such funds to be "low-cost, passively-managed index funds that offer diversification benefits." The Board could add other investment options if it determines that those options are appropriate for inclusion in the TSP. Any additional administrative expenses that result from adding investment options to the TSP would be required to be borne exclusively by participants who invest in those options.

Reporting Requirements

H.R. 6500 would require the Federal Retirement Thrift Investment Board to submit to Congress, no later than March 31 of each year, an annual report on the operations of the TSP. The report must include information on the number of participants, the median balance in participants' accounts, demographic information on participants, the percentage allocation of amounts among investment funds, the status of the implementation of self-directed investment options, and whatever other information that the Board considers appropriate. As amended by the committee, the bill would require the annual report to include information on the demographic makeup of TSP fund managers. A copy of the annual report would be made available on the TSP website.

The Board would be required to include in employees' TSP statements the amount of investment management fees, administrative expenses, and any other fees or expenses paid with respect to each investment fund in the Thrift Savings Plan. The statement would also be required to include the employee's estimated income replacement rate, on the basis of the employee's most recent account balance and rates of contributions, and a statement that informs participants how they can access the annual report submitted to Congress.[3]

Background Information on the Federal Retirement Thrift Investment Board

The Thrift Savings Plan was authorized by the Federal Employees' Retirement System Act of 1986 (P.L. 99-335). The TSP is a retirement savings plan similar to the "401(k)" plans provided by many employers in the private sector.[4] TSP accounts are individually owned by the plan participants. The assets of the TSP are maintained in the Thrift Savings Fund, which invests the assets in accordance with participant instructions in the five investment funds that Congress has authorized to be included in the plan. As of December 31, 2007, the Thrift Savings Plan had 3.7 million participants among the federal civilian workforce, the military services, and former federal employees who continued to hold retirement assets in the TSP. In its annual report for 2007, the plan reported administrative costs of $78.6 million and assets of $231.6 billion. Thus, the administrative expenses of the Thrift Savings Plan were about 34 cents for each $1,000

---

[3] The income replacement rate is a measure of retirement income adequacy that expresses retirement income from one or more sources as a percentage of the individual's pre-retirement income. The income replacement rate from the TSP could be estimated as the annual income from an annuity purchased with the TSP account as a percentage of the worker's final salary.

[4] "401(k)" refers to the section of the Internal Revenue Code that authorizes deferral of income taxes on contributions to retirement savings plans.

invested. The Thrift Board has contracted with Barclays Global Investors to manage the funds in which TSP assets are invested.[5]

The Thrift Savings Plan is administered by an independent government agency, the Federal Retirement Thrift Investment Board.[6] The Thrift Board is charged in statute with operating the Thrift Plan prudently and solely in the interest of the participants and their beneficiaries.[7] The Thrift Board is responsible for developing the investment policies of the Thrift Savings Plan and overseeing the management of the plan, which is under the day-to-day direction of an Executive Director appointed by the Board. Three of the five members of the Board — including the Chairman — are appointed by the President. The President chooses a fourth member of the Board in consultation with the Speaker of the House and the House Minority Leader and a fifth member in consultation with the Majority and Minority Leaders of the Senate. Members of the Board serve 4-year terms. All nominations are subject to Senate confirmation. The law requires nominees to the Board to be individuals with "substantial experience and expertise in the management of financial investments and pension benefit plans."[8]

Background Information on TSP Investment Options

As provided for in statute, TSP participants are offered five investment funds. Three funds were authorized by the 1986 FERS Act. These three funds were the government bond ("G") fund, the corporate bond ("F") fund, and the common stock index ("C") fund. Two additional funds were authorized by the *Thrift Savings Investment Funds Act of 1996* (§ 659 of P.L. 104-208). These two funds were the small capitalization stock index ("S") fund and the international stock index ("I") fund.

Participants may allocate their contributions among any or all of the five investment funds, and they may reallocate their account balances among the five funds. One fund invests exclusively in U.S. government securities. The other four funds invest in private-sector stocks and bonds. The four funds that invest in private-sector securities are all index funds. Index funds purchase securities in the same proportion as they are represented in an index of stocks or bonds, rather than through the decisions of an investment manager. As a result, index funds have lower administrative costs than actively-managed funds. Moreover, because they purchase securities in the same proportion as they are represented in an index, there is little or no opportunity for the purchase of securities by the fund to be influenced by third parties who might benefit from having the fund invest in particular companies or sectors of the economy.

The five investment funds in the Thrift Savings Plan are as follows.

---

[5] The contracts for each fund are open to competitive bids by qualified investment managers every three to five years.

[6] See 5 U.S.C. § 8472.

[7] See 5 U.S.C. § 8472(h).

[8] See 5 U.S.C. § 8472(d).

(1) The *Government Securities Investment Fund* (the “G” Fund) invests only in U.S. Treasury securities and other securities backed by the full faith and credit of the United States. As of December 31, 2007, the G Fund held assets of $83.9 billion.

(2) The *Fixed Income Investment Fund* (the “F” Fund) invests in a bond index fund that tracks the performance of the Shearson Lehman Brothers Aggregate (SLBA) bond index, consisting of government bonds, corporate bonds, and mortgage-backed securities. As of December 31, 2007, the F Fund held assets of $12.9 billion.

(3) The *Common Stock Index Investment Fund* (the “C” Fund) invests in stocks of the 500 large American corporations that are represented in the *Standard and Poor’s 500* index in the same proportion as they are represented in that index. As of December 31, 2007, the C Fund held assets of $79.4 billion.

(4) The *Small Capitalization Stock Index Investment Fund* (the “S” Fund) invests in the stocks of small and medium-sized companies incorporated in the United States. Stocks in this fund are held in the same proportion as they are represented in the *Wilshire 4500* stock index. As of December 31, 2007, the S Fund held assets of $18.8 billion.

(5) The *International Stock Index Investment Fund* (the “I” Fund) invests in the stocks of foreign corporations represented in the Morgan Stanley Capital Investment EAFE (Europe, Australia-Asia, Far East) index. As of December 31, 2007, the I Fund held assets of $29.6 billion.

In 2005, the TSP added five new “L” (lifecycle) funds, which invest in the five authorized TSP funds in allocations that are based on the employee’s expected date of retirement.[9] The “L” funds include an income fund and four funds that allocate investments based on expected retirement dates of 2010, 2020, 2030, and 2040. By allocating assets among the five authorized TSP investment funds based on workers’ expected dates of retirement, assets are gradually moved from higher-returning but more volatile investments when they are young to lower-returning but more stable investments as they approach retirement age. In July 2008, for example, the L2040 fund holds 18% of its assets in bonds and 82% in stocks. The L2010 funds holds 68% of its assets in bonds and 32% of its assets in stocks.

Legislative History of TSP Investment Options

The legislative history of the Federal Employees’ Retirement System indicates that Congress designed the TSP to permit employees to diversify their investments among assets with significantly different risk and return characteristics at low cost to the participants. The opportunity for participants to diversify their investments was provided by including a government bond fund, a corporate bond fund, and common stock fund. Low costs to the participants were achieved by requiring the corporate bond fund and the common stock fund to be index funds rather than actively managed funds.

---

[9] Because the “L” funds are invested in the five authorized TSP investment funds, they did not require congressional authorization. The “L” funds are methods of allocating assets, not new funds.

Index funds provide participants with low-cost investment options and also minimize the opportunity for political influences to affect the management of the investment funds. As the House Committee report on the FERS legislation stated

> Most importantly, the three funds authorized in the legislation are passively managed funds, not subject to political manipulation. A great deal of concern was raised about the possibility of political manipulation of large pools of thrift plan money. This legislation was designed to preclude that possibility.[10]
>
> An index fund ... allocates its investments to the stocks in the index in the same or similar ratio that the value of a given stock has to the total value of all of the stocks in the index. Thus, the actual decision to buy or sell a given stock is determined by the market place, i.e., the ratio of values of stock within the index. As the relative values change, the investments from the fund change. Hence, no individual or group of individuals are capable of manipulating investments.[11]

Likewise, the Senate committee report stated

> Another concern the Committee wrestled with was the potential for market manipulation through political pressure.... The Committee specifically designed the plan to avoid this problem. [The legislation] provides for three investment funds that are essentially self-managed.[12]

From 1993 to 1995, the Thrift Board evaluated options for adding new investment funds to the TSP. In 1995, the Board recommended that Congress authorize two additional investment options: a small capitalization stock index fund and an international stock index fund. The Board concluded that these two funds would offer opportunities for participants to diversify their assets into broad classes of equities not represented in the "C" fund, which represents 500 large American corporations. In the absence of empirical evidence that actively-managed funds outperform index funds over the long term, the Board recommended that the two new funds should be index funds, because indexing "allows investors to hold a broadly diversified portfolio at lower cost than active management."[13] The Board's analysis noted that "indexing is less expensive than active management because of minimal research costs, reduced transaction costs from lower turnover, and lower management fees."

Section 659 of P.L. 104-208, the Omnibus Consolidated Appropriations Act for Fiscal Year 1997, authorized the addition of a small capitalization stock index fund and an international stock index fund to the Thrift Savings Plan. The "S" fund and the "I" fund were added to the TSP in 2001. Congress has not authorized any other TSP investment funds since the "S" and "I" funds were added to the TSP in 2001.

---

[10] United States House of Representatives, Report 99-606 (May 16, 1986), p. 136.

[11] United States House of Representatives, Report 99-606 (May 16, 1986), p. 137.

[12] United States Senate, Report 99-166 (October 30, 1985), p. 18.

[13] *Analysis of Additional Thrift Savings Plan Investment Funds*, Federal Retirement Thrift Investment Board, Washington, DC, May 19, 1993.