Statement of the Honorable Andrew M. Saul, Chairman
Federal Retirement Thrift Investment Board
Before the House Subcommittee on the Federal Workforce and Agency Organization
April 19, 2005

Good afternoon Mr. Chairman and Members of the Subcommittee. My name is Andrew Saul and I am the Chairman of the Federal Retirement Thrift Investment Board. The Board administers the Thrift Savings Plan for Federal employees and members of the uniformed services. I am accompanied today by Gary Amelio, the Board's Executive Director. My four fellow Board members and I serve in a part-time capacity. Gary serves as the full-time Chief Executive Officer of the Agency. The five Board members and the Executive Director are established by statute as the Plan fiduciaries and, as such, are required to act solely in the interest of Thrift Savings Plan participants and beneficiaries.

When Gary and I last appeared in this room to present testimony in July 2003, we were newly appointed to our positions and in the midst of implementing a new TSP record keeping system. In response to concerns expressed by Committee Chairman Tom Davis and other members, I provided assurances that the new system would dramatically improve service to participants. This has been done. Transactions which used to take up to six weeks are now executed each day. The ThriftLine queues have been eliminated. Web-based access has been dramatically expanded and operates in less than a third of the pre-conversion time, and the transaction capacity has been increased exponentially.

After implementing the new system, the Board approved Gary's plan to continue to drive service levels up and costs down on all fronts. The TSP data center was upgraded for speed and capacity ten-fold and a back-up facility which can be activated within hours to provide seamless service has been brought on line. We instituted a parallel call center to improve response times and ensure uninterrupted service during emergencies. Calls are now routinely answered within the service standards of the largest and best private sector providers. For the first time we are in the process of soliciting bids for record keeping services, thus ensuring that participants are getting the best quality and price that competition can secure. Agency staff has been reduced by 10 percent through attrition and our budget has been reduced by $15 million, about 14 percent. This is especially important since participants pay the costs of running the Plan and these savings all accrue to their bottom line account balances.

The total cost of the TSP for Plan participants was down to 6 basis points or 60 cents per $1,000 of account balance in 2004. This includes both asset management and administrative expenses. Gary is promising to bring costs down even further, perhaps by another 15 percent, this year. In terms of industry comparisons, we are off the charts when it comes to preserving participants' funds in their accounts rather than spending them on unnecessary administrative expenses or investment fees.

We have aggressively pursued our statutory obligation to develop policies which are suitable for long-term investment. We have reviewed the performance of the current TSP investments each calendar quarter and have expanded ongoing efforts to remain current on industry practices. The other Board members and I have conducted due diligence site visits to our major vendors. Where appropriate, Gary and the Agency staff have met with industry and government officials, conducted site visits at facilities run by the major national financial services providers, and kept the Board members fully apprised.

At Gary's recommendation, we have established the most important new TSP investment policy in at least 10 years by approving five new Lifecycle Funds for the TSP. These funds, which debut this summer, will provide participants with the benefits of professional asset allocation. Consistent with the fundamental policy twice approved in statute by the Congress, these investments will use the broad-based index and government securities funds now offered by the TSP. Once in place, the Lifecycle Funds will generate no additional charges to participants other than the minimal costs for periodically reviewing the asset allocation model design.

As would occur with the introduction of any new fund, there will be costs for systems modifications as well as substantial costs associated with the comprehensive design, development, and distribution of materials to educate participants. Indeed, we have budgeted $10 million for this effort, in recognition of both its critical importance and the enhanced focus on financial literacy established by the Congress last year in Public Law 108-469. The education effort will be designed to meet what we consider to be the major challenge for TSP investors, i.e., optimizing investment performance by aligning the individual's risk/return profile with his or her investment horizon. In the financial world, this is known as investing on the "efficient frontier." We are very excited by the prospect of providing the Lifecycle Funds to participants and would be pleased to discuss this initiative in detail at the appropriate time.

The purpose of this hearing is to discuss an investment that in many ways is quite different from the existing TSP investments. The Real Estate Stock Index Investment Fund proposed in H.R. 1578 would establish an index fund exclusively comprising Real Estate Investment Trust (REIT) securities. Simply stated, for the TSP this would be the wrong fund at the wrong time:

- First, investment policy should not be developed one fund at a time on a case-by-case basis. Sound investment policies can only be developed in a comprehensive fashion.

- Second, investment policy should not be developed absent consideration of fundamental plan design issues. We are well aware of the arguments for overweighting in risk-optimized portfolios. However, including REITs would represent a departure from the very broad asset classes offered by TSP and endorsed by Congress in the past.

- Third, at this time, it is essential that we focus participants' attention on the Lifecycle Funds that we are introducing this summer.

Over the past year, the Board has been kept apprised of the interest expressed in REITs by both the Congress and industry representatives. Gary and the Agency's professional staff have met with industry representatives, received the industry association's analysis, and performed an independent review of that analysis for the Board. They have also met with Congressional staff and shared with the Subcommittee the results of their review. The Board strongly endorses the open process in which the Executive Director and the Agency's professional staff engaged the proponents of a REIT fund, as well as the findings and conclusions of the review by the professional staff.

For the reasons detailed in that review, as well as what I have said and Gary will say today, the Board unanimously recommends against the addition of a REIT fund at this time.

If new investment funds are to be offered by the TSP, consideration must be given to the appropriateness and investability of any new type of investment, how well that type of investment complements the current mix of investment funds, and how it compares with other possible additions and/or deletions.

TSP participants already have more than $1.1 billion invested in REIT securities through our broad-based index investment funds. The REIT proposal is premised on the view that investors could achieve more diversification by holding a higher percentage of REIT securities than is currently provided in the market weightings of the Common Stock Index Investment (C) Fund or the Small Capitalization Index Investment (S) Fund. However, if one were attempting to devise a more diversified portfolio, several classes of assets are now completely unrepresented in the current TSP investment options. Such asset classes include high-yield debt, inflation-protected bonds (TIPS), commodities, and emerging market equity. Some TSP participants might also benefit from the ability to overweight their TSP portfolios toward growth stocks or toward value stocks (i.e., “tilt” their portfolios), which could be accommodated by offering growth and value index funds. All of these options should be considered in addition to REITS in any evaluation of additional funds.

Further, the policy and practical impact of offering “slices” of the markets at the same time we already offer the total market through the existing broad-based index funds previously authorized by the Congress requires very careful consideration. This is particularly important in the case of REITs, because a separate REIT fund would, for the first time, expose TSP participants to overlapping investment choices.

In the long term, the statutory responsibility of Board members to develop TSP investment policies requires continued evaluation of existing TSP funds and consideration of additions from the broad universe of available options. We will balance the possible benefits of additions to the Plan against concerns that too many offerings might complicate education or administrative activities, or lead to investor behavior that is deleterious to long-term financial security. In terms of priorities, our plan is to install the Lifecycle Funds in the TSP, evaluate the impact of the TSP’s education efforts and the new funds on participant behavior (including a participant survey later this year), and evaluate other potential funds/asset classes along with the existing offerings.

A broad and considered approach such as this is the way in which the Congress identified the need for, and ultimately authorized, the current TSP investment funds. We recommend that this highly successful approach be continued. If and when new investment funds are an appropriate addition, please be assured that the Plan’s fiduciaries would indeed recommend Congressional action (as was done with the S and I Funds) or take administrative action (as we are doing with the Lifecycle Funds).