08-U-4

Thrift Savings Plan BULLETIN for Service TSP Representatives

Subject: Interfund Transfer (IFT) Program Change — Limits on IFT Requests

Date: April 30, 2008

The Thrift Savings Plan (TSP) has announced a change to the interfund transfer (IFT) program which will impose limits on the IFT requests a participant may make each month. The final regulation for the IFT limit was published in the *Federal Register* on April 24, 2008; the change will be implemented on May 1, 2008.

I. Background

Last year, it became clear that a few thousand of the 3.9 million TSP participants were making frequent IFT requests. Because this activity was clearly accelerating, and in light of its detrimental effect on fund performance and transaction costs, the Agency is implementing limits on IFTs effective May 1, 2008.

In February 2008, when the Agency mailed the new annual participant statements, the Agency notified all participants of the proposed change and the reasons for it. On March 10, the Agency published the proposed final regulation in the *Federal Register* and allowed a 30-day comment period. After considering all of the comments received, the Agency decided upon limits that provide for a broad, system-wide solution. As indicated above, the final regulation was issued April 24th.

II. The New IFT Rule

Currently, participants may make unlimited IFTs during each month.* Beginning May 1, however, the following rule will take effect.

A. **IFT Rule.** For each calendar month, the ***first two*** IFTs can redistribute money in a participant's account among any or all of the TSP funds. After that, for the remainder of the month, IFTs can ***only*** move money into the Government

(continued on next page)

* However, pursuant to an interim regulation, participants who made more than three IFTs in October, November, December, and February were required to submit their IFT requests by mail during April 2008.

Inquiries: Questions concerning this bulletin should be directed to the Federal Retirement Thrift Investment Board at **202-942-1460**.

Chapter: This bulletin may be filed in Chapter 2, General Information.

Securities Investment (G) Fund (which will increase the percentage of the account held in the G Fund by reducing the percentage held in one or more of the other TSP funds).

(1) The transfer counts in the calendar month we process it, not in the month it is submitted. For example, if a participant were to submit an IFT request at 12:15 p.m. eastern time on July 31, it would be after the TSP's noon cut-off for same-day processing. Therefore, we would not process the request until August 1 (the next business day), and the IFT would count against the IFT limit for August.

(2) If the first or second transfer in a month moves money only to the G Fund, it still counts toward the two (2) unrestricted interfund transfers per calendar month limit.

(3) This rule change does not affect contribution allocations.

(4) If the participant has both a civilian and a uniformed services account, the IFT limits apply to each account separately.

B. **Example.** If, on May 10, John made an IFT which increased the percentage of his account invested in the F Fund, and on May 17, he made a second IFT which increased the percentage of his account in the G Fund, John will have reached the unrestricted IFT limit for May — he has made two IFTs. For the remainder of May, John may transfer amounts in his TSP account to the G Fund only (i.e., John may only increase the percentage of his investment in the G Fund by decreasing the percentage(s) of his investment(s) in one or more of the other TSP funds). Let's look at the details:

	John's 1st IFT		**John's 2nd IFT**	
Fund	May 10 Account Balance	May 10 IFT Request	May 17 Account Balance*	May 17 IFT Request
G Fund	50%	50%	52%	60%
F Fund	0%	50%	48%	0%
C Fund	30%	0%	0%	20%
S Fund	10%	0%	0%	15%
I Fund	10%	0%	0%	5%

Because John has made two (2) IFTs, he may only transfer amounts to the G Fund for the rest of the month.

		CAN	CANNOT
Fund	May 22 Account Balance*	May 22 IFT Request	May 22 IFT Request
G Fund	65%	90%	75%
F Fund	0%	0%	25%
C Fund	18%	4%	0%
S Fund	14%	3%	0%
I Fund	3%	3%	0%
		This IFT increases only the G Fund; the percentages held in the other funds are either the same or lower	This IFT increases both the G and F Funds; this is not permitted.

* Remember that the percentage of each fund in which the participant is invested relative to his or her total account balance fluctuates due to changes in the share prices as well as how new money is invested (the participant's contribution allocation). The percentages used for the account balances in this example are illustrative only.

III. Uniformed Services Impact

A. **IFTs are requested directly through the TSP.** Because participants make their IFT requests directly with the TSP (via the TSP Web site, the ThriftLine, a TSP participant service representative, or Form TSP-U-50, Investment Allocation), this new regulation should have minimal impact on TSP representatives. However, you should be able to explain the new IFT rule to your participants and direct them to the TSP Web site for more information (see below).

B. **Notification to Participants.** In February 2008, participants were notified of the proposed changes in the Executive Director's letter which accompanied the annual participant statements. We will also notify TSP participants about the new limits via the TSP Web site and the ThriftLine; we will not have a special mailing. In addition, participants who have signed up for the TSP's e-mail update service on the TSP Web site will be alerted that there is a new announcement on the TSP Web site. We will explain the IFT limits to new TSP participants in the "Welcome to the TSP" letters we send them.

Uniformed services representatives may wish to include information about this rule change in their communications to members. If so, we suggest that you refer them to the Questions and Answers available from the link "Information About Interfund Transfer Limits" on the TSP Web site home page.

C. **Revisions to TSP materials.** The TSP is updating the relevant materials, including the Investment Allocation (Form TSP-U-50), and the TSP Web site to reflect the new rule.

(1) The revised materials will be available from the TSP distribution warehouse through the normal distribution process.

(2) Because we encourage participants to submit their IFT requests electronically, the Investment Allocation form is **not** available on the TSP Web site. We are attaching a copy to this bulletin for your use if your members ask for the form.

(3) The *Summary of the Thrift Savings Plan* has not yet been updated. We are planning a major revision for later this year. The revision will encompass not only this rule change but updates on other topics as well (e.g., TSP account numbers, Web site security enhancements).

IV. Resources

Attached for your reference are copies of the *Federal Register* notice announcing the IFT restriction limits and the Questions and Answers that are posted on the TSP Web site. If you have questions about the change that are not addressed in the Qs and As, please contact us. We also encourage the services to direct participants to the TSP Web site for the most up-to-date information available.

Pamela-Jeanne Moran

PAMELA-JEANNE MORAN
Director
Office of Participant Services

Attachments

THRIFT
SAVINGS
PLAN

TSP-U-50
Investment Allocation

May 2008

Choosing Your Investment Option

The Thrift Savings Plan (TSP) offers two types of investment options: Lifecycle Funds and individual TSP funds. Ideally, you will choose **either** the Lifecycle Fund that is appropriate for your ***time horizon*** (that is, when you will begin to use the money), **or** individual TSP funds that will support your personal investment strategy. However, you may invest in any fund or combination of funds. If you are uncertain whether to choose a Lifecycle Fund or individual TSP funds, the following questions may be helpful in guiding you to a decision:

1. Is it hard to find time to make financial decisions?
2. Do you feel confused by the investment choices?
3. If the TSP is your primary retirement investment, are you investing in only one or two of the individual TSP funds?
4. Are you unsure when to rebalance your account?
5. Would you like to have an investment strategy based on your time horizon?

If you answered **Yes**	If you answered **No**
to these questions, consider investing in one of the **Lifecycle Funds**.	to these questions, then the **Individual TSP Funds** may fit your investing style.

Lifecycle Funds

Lifecycle Funds (L Funds) are an appropriate choice for those participants who may not have the time, knowledge, or interest to manage their TSP investments. Participants select an L Fund based on when they anticipate needing the money (their time horizon).

L Funds are invested in various combinations (asset allocations) using the five individual TSP Funds — the G, F, C, S, and I Funds. Professional investment experts determine the asset allocation that is appropriate for each Lifecycle Fund, both initially and over time as the fund moves towards its time horizon.

L Funds are automatically rebalanced, and the proportions of stocks, bonds, and securities are gradually adjusted to become more conservative as you get closer to your time horizon.

If you want to take advantage of the Lifecycle Funds, select a fund from the list below. (Your time horizon may be later than your retirement date.)

- **L 2040** (For time horizons of 2035 and later)
- **L 2030** (For time horizons of 2025 through 2034)
- **L 2020** (For time horizons of 2015 through 2024)
- **L 2010** (For time horizons of 2008 through 2014)
- **L Income** (For participants who are now withdrawing)

Individual TSP Funds

The TSP offers five individual investment funds which provide opportunities for you to diversify your account among several asset classes, including Government securities, bonds, and foreign and domestic stocks.

The individual TSP funds are appropriate for those participants who:

- understand the risks and objectives of each investment option;
- know how they want to diversify their accounts among the asset classes;
- periodically review their investment strategy and rebalance as necessary.

If you choose to manage your own TSP account, you can invest in the five individual TSP funds in any combination or percentage. Your choices are:

- **G Fund** (Government Securities Investment Fund)
- **F Fund** (Fixed Income Index Investment Fund)
- **C Fund** (Common Stock Index Investment Fund)
- **S Fund** (Small Capitalization Stock Index Investment Fund)
- **I Fund** (International Stock Index Investment Fund)

Visit the TSP Web site, **www.tsp.gov** for more information about the Lifecycle Funds and the individual TSP investment funds. Before making your investment decision, be sure to read the *Summary of the Thrift Savings Plan* and the TSP Fund Information sheets, and review the historical and recent rates of return. Your service TSP representative can also provide you with materials. If you are separated from the uniformed services, you can request publications from the TSP by calling the (toll-free) ThriftLine at 1-TSP-YOU-FRST (1-877-968-3778) or the TDD at 1-TSP-THRIFT5 (1-877-847-4385). Callers outside the U.S. and Canada should call 404-233-4400 (not toll free).

THRIFT SAVINGS PLAN
INVESTMENT ALLOCATION

TSP-U-50

Please read the information about your investment choices on page 2 and the instructions on the back of this form before making your investment allocation.

This form is designed to be read by an optical scanner. To avoid processing problems, type or print using black or dark blue ink. Please use **BLOCK** letters that fit within the boxes, or numbers as shown in the example on the back.

I. INFORMATION ABOUT YOU

1. Your Last Name | First Name | Middle Name

2. TSP Account Number

3. __ / __ / 19__ Date of Birth *(mm/dd/yyyy)*

4. Daytime Phone *(Area Code and Number) (Not DSN)*

II. YOUR INVESTMENT ALLOCATION — To allocate future contributions, complete Column 1.

(This will affect all new money coming into your account — contributions, transfers, loan payments.) **To request an interfund transfer, complete Column 2.** This request will affect your existing account balance. Read the Note in the instructions about the rules governing interfund transfers before you make your request. Indicate your investment allocations in whole percentages. Do not use dollar amounts. If you do not want to invest in a fund, leave the boxes blank. The total of the percentages you enter in each column must equal 100%.

The TSP investment options are designed for participants to invest in **either** a single Lifecycle Fund based on their time horizon (see page 2), or the individual TSP funds (G, F, C, S, and I) of their choice. However, you can invest in any fund or combination of funds.

	1 Allocate future contributions	2 Request an interfund transfer
Lifecycle Funds		
L 2040	.0%	.0%
L 2030	.0%	.0%
L 2020	.0%	.0%
L 2010	.0%	.0%
L Income	.0%	.0%
Individual TSP Funds		
G Fund (Government Securities Investment Fund)	.0%	.0%
F Fund (Fixed Income Index Investment Fund)	.0%	.0%
C Fund (Common Stock Index Investment Fund)	.0%	.0%
S Fund (Small Capitalization Stock Index Investment Fund)	.0%	.0%
I Fund (International Stock Index Investment Fund)	.0%	.0%
TOTAL	**1 0 0 .0%**	**1 0 0 .0%**

III. SIGNATURE

You must sign and date this form; otherwise, your request will not be processed. If you invest in any Lifecycle Fund or in the F, C, S, or I Fund, you are acknowledging the risk of investing in those funds by signing this form. (Read the complete Acknowledgement of Risk statement in the instructions.)

5. Participant's Signature

6. __ / __ / 20__ Date Signed *(mm/dd/yyyy)*

Mailing Address

GENERAL INFORMATION AND INSTRUCTIONS

Before you make any investment decisions, you should review the TSP Fund Information sheets. These are available from the TSP Web site, your service, or, if you have left the uniformed services, from the TSP. Recent and historical rates of return for the TSP funds and related indexes are available on the TSP Web site (www.tsp.gov).

HOW TO MAKE YOUR INVESTMENT ALLOCATION

The TSP Web site and the TSP ThriftLine (1-877-968-3778) are the fastest and most efficient ways to make your investment allocation. Requests made on the Web site or ThriftLine by noon eastern time on any business day will ordinarily be processed that day. Requests made after noon will ordinarily be processed the next business day. To make your request on the ThriftLine, you will need your TSP account number and your 4-digit ThriftLine Personal Identification Number (PIN). To make your request on the TSP Web site, you will need your TSP account number and your 8-character Web password.

You may also complete this form and mail it to: **Thrift Savings Plan, P.O. Box 385021, Birmingham, AL 35238.**

Do not submit this form to your service. Your service cannot process it. Forms TSP-U-50 are ordinarily processed within five business days of receipt.

This form is designed to be read by an optical scanner. Carefully type or print your information within the boxes. Use black or dark blue ink. If you hand print, use block letters and try to make your numbers look like the sample numbers below.

1	2	3	4	5	6	7	8	9	0

I. INFORMATION ABOUT YOU

Provide the information requested. **Do not** fill in leading zeros on the Date of Birth (Item 3) or Date Signed (Item 6). Include a daytime phone number where you may be reached, if necessary. The phone number you provide should not be a Defense Switched Network (DSN) number. Your TSP account number is the 13-digit number that was issued to you. For security purposes, the TSP account number is used instead of your Social Security number to identify your account.

II. YOUR INVESTMENT ALLOCATION

Use this form to allocate the way your contributions are invested each pay period, **or** to request that the money already in your account be redistributed among the funds, **or** both. Enter the percentage you would like to invest in each fund. If you do not want to invest in a fund, leave the boxes for that fund blank. Do not use leading zeros (for numbers less than 100).

Note: If you are newly enrolled in the TSP and you are making your first contribution allocation, wait until you have received a letter confirming that your account has been established before you make a contribution allocation or an interfund transfer.

Allocate Future Contributions. Complete **Column 1** to specify the way your future contributions (as well as loan payments and transfers from other plans to your TSP account) should be invested. The total of the percentages in this column must equal 100%. Your election will stay in effect until you change it. This election will not change the investment of your current account balance.

Request an Interfund Transfer (IFT). Complete **Column 2** to change the way your current account balance is invested in the TSP funds; the total of the percentages in this column must equal 100%.

Note: An IFT allows you to redistribute all or part of your account among the different TSP funds. For each calendar month, your ***first two*** IFTs can redistribute money in your account among any or all of the TSP funds. After that, for the remainder of the month, your IFTs can ***only*** move money into the Government Securities Investment (G) Fund (in which case, you will increase the percentage of your account held in the G Fund by reducing the percentage held in one or more of the other TSP funds).

For example, if on May 10 you made a transfer which increased the percentage of your account invested in the F Fund and on May 17 you made an IFT which increased the percentage of your account in the G Fund, you have reached your unrestricted IFT limit for May. For the rest of May, you may transfer amounts in your TSP account to the G Fund only (i.e., you may only increase the percentage of your investment in the G Fund by decreasing the percentage of your investment(s) in one or more of the other TSP funds).

The transfer counts in the calendar month we process it, not in the month you submit it. For example, if you were to submit your transfer request at 12:15 p.m. on July 31, that would be after our noon cutoff for same-day processing. Therefore, we would not process your request until August 1 (the next business day), and it would count against your IFT limit for August.

Each IFT is a one-time transaction that affects your entire account balance as of the effective date of the transfer. Your IFT request is processed ***after*** your account has been valued using that day's closing share prices and after all other transactions (contributions, loans, withdrawals, etc.) have been completed.

This election does not change the way new contributions are invested. If you have both a civilian and a uniformed services account, this applies to each account separately.

III. SIGNATURE — ACKNOWLEDGEMENT OF RISK

Your signature in Item 5 indicates that you have read and understood the statement below:

I understand that if I invest in the F, C, S, or I Fund, or in any TSP Lifecycle Fund, I am making this investment at my own risk. I also understand that I am not protected by either the U.S. Government or the Federal Retirement Thrift Investment Board against investment loss in the F, C, S, or I Fund, or any Lifecycle Fund, and that neither the U.S. Government nor the Federal Retirement Thrift Investment Board guarantees a return on my investment.

CONFIRMATION

If you complete your request on the TSP Web site, you may elect to receive your confirmation via e-mail. Requests made on the ThriftLine or by mailing Form TSP-U-50 to the TSP will generate a mailed confirmation, which will be mailed to you at the address in your TSP account record. You can also review the result of your contribution allocation or interfund transfer on the TSP Web site or the ThriftLine.

PRIVACY ACT NOTICE. We are authorized to request the information you provide on this form under 5 U.S.C. chapter 84, Federal Employees' Retirement System. We will use this information to identify your TSP account and to process your transaction. In addition, this information may be shared with other Federal agencies for statistical, auditing, or archiving purposes. We may share the information with law enforcement agencies investigating a violation of civil or criminal law, or agencies implementing a statute, rule, or order. It may be shared with congressional offices, private sector audit firms, spouses, former spouses, and beneficiaries, and their attorneys. We may disclose relevant portions of the information to appropriate parties engaged in litigation and for other routine uses as specified in the Federal Register. You are not required by law to provide this information, but if you do not provide it, we will not be able to process your request.

Rules and Regulations

Federal Register

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FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

5 CFR Part 1601

Participants' Choices of TSP Funds

AGENCY: Federal Retirement Thrift Investment Board.

ACTION: Final rule.

SUMMARY: The Federal Retirement Thrift Investment Board (Agency) amends its interfund transfer (IFT) regulations to limit the number of interfund transfer requests to two per calendar month. After a participant has made two interfund transfers in a calendar month, the participant may make additional interfund transfers only into the Government Securities Investment (G) Fund until the first day of the next calendar month.

DATES: This rule is effective on May 1, 2008.

FOR FURTHER INFORMATION CONTACT: Megan Graziano, 202–942–1644.

SUPPLEMENTARY INFORMATION:

Preamble

Under the Federal Employees' Retirement System Act of 1986, the Thrift Savings Plan (TSP) was created to offer passive long-term investments designed to improve the retirement security of Federal employees. As a result of analysis performed in 2007, it became clear that a small number of TSP participants were pursuing ''market timing'' active investment strategies in the TSP. These activities were diluting the earnings of the long-term investors, and adversely affecting the ability of TSP managers to replicate the performance of selected indexes as required by law.

The Chief Investment Officer reported these findings to the Executive Director on November 6, 2007. The Executive Director presented the information to the Federal Retirement Thrift Investment Board members at their public monthly meeting on November 19. Subject to the input from the Employee Thrift Advisory Council (ETAC), the Board authorized the Executive Director to put in place both interim and structural restrictions on frequent interfund transfer activity.

The 15 members of the ETAC were advised that same day and presented with the information developed by Agency staff. Under longstanding custom, ETAC members were also provided an advance copy of the Agency's interim proposed rule. Two ETAC member organizations voiced some concerns, and the Agency decided to withhold publication of the proposed interim rule until a public meeting of the ETAC and the Executive Director could be conducted on December 19. After extensive discussion at the meeting, no ETAC member objected to the Agency's implementation of its interim plan. The proposed interim rule was forwarded to the **Federal Register** on December 21, where it was published on December 27. The rule took effect on January 7, 2008.

On January 24, 2008, under the interim rule, the Executive Director sent letters to 3,775 TSP participants who had been identified as frequently requesting IFTs. The letters explained the need to reduce this activity and asked recipients to voluntarily reduce their IFT requests. The letters also warned each individual that a failure to practice self-restraint could result in the imposition of restrictions. Eighty-five percent of those who received a letter voluntarily complied. However, 549 individuals continued their frequent IFT activity during February. These individuals were subsequently notified by certified mail that they would be restricted to requesting IFTs by mail, effective April 1, 2008. Their option to request IFTs via the TSP Web site or over the Thriftline was suspended until plan-wide structural restrictions are implemented. However, some have appealed their restrictions, and, in appropriate cases, the Agency has approved their appeals.

On March 10, 2008, the Agency published a proposed rule with request for comments in the **Federal Register** (73 FR 12665, March 10, 2008). The Agency received comments from three Federal employees' unions and from 354 TSP participants. One comment purported to include the views of over 4,000 participants. Additionally, the Agency received and reviewed 110 comments prior to the Agency's publication of its January 7, 2008 interim regulation; these comments were reconsidered as a part of this rulemaking process.

Comment Summary

Summary

Commenters raised a number of issues and a detailed response to each one is provided below. By way of summary, those individual respondents who have personally made frequent interfund transfers and oppose the proposed limits display a fundamental misunderstanding of the statutory TSP design. They also present two overarching arguments which deserve discussion at the outset, because they obscure the damage which their frequent IFTs inflict on other plan participants.

Misunderstanding

By misappropriating language used in the capital markets (buys, sells, trades), some TSP participants give the impression that their frequent interfund transfers are trades in and out of the markets which affect only their own funds. This is incorrect. All TSP assets are in a pooled investment which is designated by statute as the Thrift Savings Fund.

In this regard the TSP funds are like mutual funds regulated by the Securities and Exchange Commission (SEC). In 2005 the SEC took steps to reduce activity in mutual funds. It did so after finding that: ''Excessive trading in mutual funds occurs at the expense of long-term investors, diluting the value of their shares. It may disrupt the management of a fund's portfolio and raise the fund's transaction cost because the fund manager must either hold extra cash or sell investments at inopportune times to meet redemptions.''

Congress established the Thrift Savings Fund as a long-term, passive investment. The legislative history shows that active investments were considered, but rejected. The Federal Retirement Thrift Investment Board is required by law to develop policies under which four Thrift Savings Fund offerings—commonly known as the C, S, I, and F Funds—are invested to ''replicate'' the performance of selected market indexes at a low cost. Through careful and diligent management, these goals have been achieved for more than twenty years.

Each day the Agency and its contractors tally new contributions, loan activities, disbursements, and IFTs to arrive at net amounts available for investment in each of the Thrift Savings Fund offerings that day. A similar netting process occurs in the TSP asset manager's commingled investment funds, which include the assets of many other institutional investors. Predictable cash flows and offsets due to netting minimize trading costs.

This carefully designed structure, which optimizes achievement of the statutory goals, has been challenged over the past year by a noticeable increase of IFTs by a small group of participants. The Agency's analysis has demonstrated that fewer than 1 percent of TSP participants are engaging in this activity to the detriment of more than 99 percent of participants who are long-term investors (those who requested 12 or fewer IFTs in calendar year 2007).

The actions by the small group have become less random, which suggests coordination and leads to fewer opportunities for cost savings due to offsets. The deleterious consequences of these activities in the TSP are the same as those which the SEC found occurring in mutual funds. Importantly, the clear intent of this activity—to ''beat'' the market indexes—fundamentally conflicts with statutory mandates that the Board provide passive investments which replicate the performance of market indexes.

Claim That Frequent Interfund Transfers Do Not Significantly Increase Costs Is Misleading

Commenters who oppose restrictions cite the very low TSP administrative expenses as evidence that their actions are harmless. Some concede additional costs, but argue that those additional costs are de minimus and only amount to $4 per year, per participant.

While we neither accept this number nor the process by which it is derived, the view that exceptional costs generated by 1 percent of participants should be viewed as inconsequential if they can be charged off to 100 percent of plan participants is troubling. The resulting small average cost obscures a significant problem, *i.e.*, the cost to other individual participants can be very high depending on how funds are invested on a particular day. This issue is discussed further below.

Moreover, the Agency rejects the argument that $16 million in trading costs is small. The entire budget for the TSP in 2007 was just $87 million. In the context of how the TSP fiduciaries run the TSP, this additional $16 million is a very large number.

Costs remain low in the TSP because the Board, exercising due diligence, looks behind broad averages. Indeed, diligent examination led to the discovery last summer of frequent interfund transfer activity by this very small but determined cohort of participants.

As noted above, individual TSP interfund transfers are not ''trades'' and transferees are not ''traders.'' However, frequent IFTs can and do generate expenses which include trading costs at the Fund level. The Agency and its asset manager endeavor to minimize trading costs through offsets, netting, and cost free ''cross-trading.'' Ultimately, if the asset manager must go to the market to buy or sell securities, the associated transaction costs (including commissions paid to the brokers, transfer taxes, and market impact) are borne by all participants in the Fund. These costs are not reflected in the highly publicized and very low TSP expense ratio. Further discussion of transaction costs is featured below.

Recommendation That Interfund Transfer Restrictions Apply Only to the I Fund Obscures Significant Abuse

A number of commenters acknowledge that the analysis presented by the Agency staff makes a compelling case to restrict interfund transfers in the I Fund. However, they argue that the analysis is not as compelling for the other TSP funds. The Agency has decided to apply the restrictions to all TSP offerings for two reasons:

First, the Agency's analysis does demonstrate measurable and growing adverse effects of frequent IFT activity in the S Fund. Moreover, since the analysis was performed, interfund activity in the F Fund increased as well.

Second, the G Fund has been subjected to a frequent transfer/market timing practice that is particularly insidious.

The G Fund is invested in specially-issued Treasury securities which provide a fixed rate of return established monthly. It is considered the TSP ''stable value'' fund, and is especially important to those cautious investors who seek security of principle and interest.

Some of the frequent interfund transferors have determined that by making one-day round trips in and out of the G Fund three to five times each month, they are able to effectively collect a full month's worth of G Fund earnings for just three to five days of actual G Fund investment. The windfall they secure comes at the direct expense of long-term G Fund investors who never anticipated that their safe retirement investment would be subjected to such mercenary treatment by their fellow TSP participants.

Practitioners visit a Web site in order to compare notes and calculations to assist each other in the execution of this scheme. They congregate at a message board which they have aptly titled ''G Fund Payday.'' Indeed, like ghost workers, these individuals only show up in the G Fund on the days when their calculations show that G Fund shares will increase in value. With a finite amount of earnings to be allocated, these individuals unquestionably dilute G Fund value at the expense of long-term investors.

This indefensible practice will be severely curtailed by the limit on interfund transfers. Additionally, the Agency will make a structural change beyond the purview of this rulemaking which will totally eradicate this particularly abusive form of frequent interfund transfer activity.

Union Comments

The Agency received three comments from Federal employees' unions. All acknowledged that frequent IFT activity is detrimental to the performance of the funds and that some action to restrict it is necessary.

One union supports the regulation as written.

One union commented that changes that have already been made address the frequent transfer problem and no further changes are needed. This union is referring to the interim regulation implemented by the TSP in January 2008, whereby the Executive Director identified 3,775 participants who were making excessive IFT requests, thus driving up costs for the participants who are using the TSP in the way it was intended, as a long-term retirement vehicle. Letters were sent to those participants requesting that they voluntarily restrict their IFTs to fewer than four in the month of February. The letter noted that, if the participant did not voluntarily comply, s(he) could be limited to making IFT requests by mail only. This limitation would remain in effect until the Agency implemented structural changes that would automatically apply to all participants.

Thus, the Agency's actions so far were only approved as a temporary measure, to deal with an immediate problem, until the longer-term solution could be put in place. It was an extremely labor-intensive process to identify these individuals, notify them by mail, identify those who did not voluntarily comply, send them certified letters, restrict their online access, and handle their appeals.

Additionally, in all fairness to those individuals, the Agency would have to continue to apply that same labor-intensive process to all participants on a monthly basis.

With this final regulation, the Agency will implement a structural, automated process. While the union asserted that the interim measure was less ''Draconian'' than the proposed regulation, the Agency sees it as the opposite. Under the interim regulation, affected participants must submit IFT requests by mail and, as the Agency processes mail requests in the order received (not necessarily in the order mailed), participants have reduced control over what order their IFTs are executed. (One participant commented against the union proposal and noted that the interim regulation is ''Draconian.'')

This union also suggested that if a change is necessary, it should be ''to allow two transfers per month and after two transfers (if other than the G Fund), attach a fee for servicing the transfer.'' ''While it may be 'impossible to correctly assign the exact costs,' we can follow the leads of other such funds in arriving at a figure.''

In its research, the TSP found no mutual fund or defined contribution plan which allows participants to make a certain number of free transfers and then charges a fee for additional transfers. In fact, fund managers who use trading limitations and fees, do so as a double deterrent, not as a way to accommodate more transfer activity. In recommending this approach at an ETAC meeting, the union noted that TIAA–CREF pursued a similar policy. The Agency contacted TIAA–CREF, and its policy is: A participant who transfers from any fund, transfers back, and then sells it within 60 days may not repurchase that fund for 90 days and, if the transaction involves the international (similar to I Fund), high yield, or small-cap (similar to S Fund) funds, a 2 percent fee is assessed. The TSP regulation is far less restrictive.

The TSP also looked to Vanguard, the largest mutual fund index manager in the country. Holders who redeem shares in any Vanguard mutual fund must wait 60 days before repurchase. For some funds, including the fund that is similar to the TSP's I Fund, if the shareholder redeems a fund that has not been held for 60 days, the shareholder cannot repurchase the fund for 60 days, *and* must pay a redemption fee, which would be 2 percent for the international fund. Again, the TSP regulation is far less restrictive.

The third union suggested two proposals. The first was addressed in the preceding paragraph. Alternatively, it proposed four instead of two unrestricted IFTs per month. TSP studies showed that allowing four IFTs per month would not result in any meaningful reduction in the dollar amount of the daily trades. Allowing three IFTs per month would result in a 31 percent reduction in the dollar value and two per month would result in a 53 percent reduction. Thus, the TSP is expecting a reduction in dollar value of between 31 percent and 53 percent, after factoring in some activity related to unlimited transfers to the safe harbor of the G Fund. TSP research has shown that less than 1 percent of participants make more than 12 IFTs per year. Therefore, the regulation will not affect 99 percent of participants. It will allow participants to rebalance their accounts twice per month, which, in the view of the Plan's two investment consultants, is more than adequate.

Participant Comments

Support for Proposed Regulation

Thirty participants supported the regulation.

Opposition to Proposed Regulation

Some participants suggested there should be a certain number of ''free'' IFTs per month and then a fee per transaction. This proposal was addressed under the union comments discussed above.

Many participants commented that TSP expenses are already very low or that costs are going down. Some noted that TSP Funds are already outperforming their underlying indexes.

TSP expenses are very low. The TSP's enabling legislation requires the Board to develop investment policies which provide for low administrative costs. 5 U.S.C. 8475. Due to efforts by the Board, the net expense ratio for the TSP Funds declined to 1.5 (0.00015%) basis points last year.

However, the Funds also incur transaction costs, which are directly related to the dollar amount of IFTs requested by participants. These transaction costs are investment expenses that reduce investment income *before* deductions for administrative expenses and *are not* included in the expense ratio.

TSP net administrative expenses in 2007 were reduced to $31,392,286. However, costs from trading activity were an additional $13,880,098. Although more than 99 percent of participants made 12 or fewer IFTs last year, all participants shared the full cost of executing the interfund transfers generated by those who made numerous IFTs.

Numerous IFTs increase the dollar amounts of the orders that are given to the investment manager on a daily basis. The investment manager must therefore hold more cash to meet potential redemptions, leading to a greater chance of differences in performance from the indexes tracked by the funds. This difference (tracking error) can be positive or negative, but the TSP is charged by statute to keep this tracking error as low as possible since the funds must, by law, ''replicate'' their respective indexes. 5 U.S.C. 8438. It is indisputable that reducing the dollar amount of IFTs will lower transaction costs and the amount of cash the investment manager must hold and will, therefore, reduce tracking error.

Several participants noted that ''there is no problem;'' that trading costs are going down; that trading costs the average participant $3, $3.55, $3.56, $4, or $4.60. They asked ''Why does it cost $240 to trade a $300,000 account?'' ''Why can't you determine the exact cost and charge participants accordingly?''

The TSP has avoided using averages when averaging can obscure important distinctions. For example, over the years, some have suggested that the Agency develop an average cost per participant. One could devise a simple calculation, i.e., in 2007, net administrative expenses at approximately $32 million spread over approximately four million participants would yield an average annual cost of $8 per participant.

However, this is misleading because costs are borne pro-rata, and increase based on account size. So in order to be precise, the Agency expresses costs in terms of basis points. Thus, with last year's net expense ratio of 1.5 basis points, a new participant with $1,000 on account can easily determine that his cost was 15 cents, while a veteran participant with $1 million on account can quickly know that her share of these expenses was $1,500.

With regard to IFTs, because there are several moving parts each day, an average would obscure important distinctions. For example, on August 16, 2007, participants redeemed 22,219,762 shares of the I Fund. The price they received was $22.48 based on a 4 p.m. market pricing. When the securities were sold at the opening of the foreign markets later that evening and the following morning, they were sold for $9,554,497 less than the prices used to determine the $22.48 share price. This equates to a $0.43 per share trading cost. That is, if the Agency could have determined this in advance, the share price would have been only $22.05. Instead, the $9,554,497 difference was charged to the remaining holders of the I Fund. That is in one DAY, not in one year.

Each day is unique, and the timing of participants' redemptions affects how much of the cost is borne by any given participant. A participant who would have redeemed the day before would not have been impacted at all by this transaction. One who transferred funds into the I Fund just before August 16 and transferred out just after would have experienced the full effect.

On August 16, almost half of the dollar amount of the trade was from participants who were requesting frequent IFTs. The Agency knows from its analysis that a large number of the participants who make frequent interfund transfers were moving $250,000 or more. Each participant who redeemed $250,000 on that day would have sold 11,121 shares, and therefore would have made *an extra $4,782.* (11,121 shares sold multiplied by $0.43 per share trading cost.) *These ''extra'' funds did not come from the market. Rather, they came from the accounts of other participants who remained in the I Fund.* When examined this way, it becomes clear why frequent IFTers would prefer to express this cost as an annual average spread over all participants.

Additionally, because the investment manager's liquidity pool had been depleted on August 16, $452 million of that trade settled on August 21 instead of August 17. That cost the G Fund $235,000 in foregone interest.

The Agency also cannot measure the cost to participants that results from increased tracking error because the investment manager has to keep a larger liquidity pool to meet frequent redemptions.

Every day is different, and different participants are impacted in different ways depending on the timing of their interfund transfer activity. Stating an average cost per participant would be misleading. The goal of this regulation is to reduce IFT activity in order to control the costs borne by the other participants, costs which are different for every participant depending on what days they may be invested in, or not invested in, any particular fund and that are impossible to determine in advance.

Several participants noted that money could be saved by eliminating mailed IFT confirmations and that the DVD for the L Funds was very expensive. Those costs are reflected in the already low expense ratio, which is assigned pro rata to all TSP participants. The trading expenses are not borne pro rata. In fact, a participant, who transfers out of a fund on a day when the cost to complete that trade is very high, bears none of the cost of that trade, while those who remain in the fund bear it all. It is the inequity of the allocation of the trading expenses which the TSP seeks to address, and which, as discussed in the proposed regulation (73 FR 12667, March 10, 2008), the SEC has identified as a problem for mutual funds.

Several participants said (incorrectly) that the L Funds are responsible for the transactions costs and that these funds should also be limited. The dollar amount of trade activity attributable to the L Funds, especially when compared to the dollar amount of trading activity attributable to participants making frequent IFT requests, is very small. For example, in the I Fund, for September and October 2007, the average daily dollar amount attributable to the L Funds' rebalancing accounted for just 7 percent of the total daily trade, while the average daily dollar amount attributable to those making frequent IFTs (defined in this instance as participants who made IFTs into or out of the I Fund eight or more times in the prior 60 days) was 63 percent. The impact of the L Funds' rebalancing is demonstrably minimal. The Agency monitors the L Funds, as it does all its funds, and, in the unlikely event that the dollar volume of the L Funds' rebalancing becomes costly, the Agency can take steps to reduce the frequency or amount of the rebalancings.

Many participants requested that a fee be charged instead of limiting the number of IFT requests. Some of these participants recommended a ''$10 flat fee.'' Others noted that the Agency charges a fee for loans, and therefore, should be able to charge a fee for interfund IFTs. This comment was addressed in the proposed regulation as explained below:

Many fund families charge redemption fees for shares which are redeemed within 30, 60, or 90 days of purchase. T. Rowe Price, for example, levies fees on 27 funds, including a 2 percent redemption fee on shares of its International Index Fund (similar to the I Fund) and a 0.5 percent fee on shares of its Equity Index 500 (similar to the C Fund) and Extended Equity Market Index Funds (similar to the S Fund), if they are sold within 90 days of purchase. TIAA–CREF (with $400 billion of assets under management and 3 million participants) charges a redemption fee of 2 percent on shares of its International Equity, International Equity Index, High Yield II, Small-Cap Equity, Small-Cap Growth Index, Small-Cap Value Index or Small-Cap Blend Index Funds redeemed within 60 days of purchase. We noted particularly that the fee is a percentage of the dollar amount transacted, not a flat processing charge.

When brokerage firms charge $10 to execute a stock trade, they know how much it costs them to make that transaction. Mutual fund managers (and the TSP) cannot determine the exact amount of costs to the plan from IFT activity for the following reasons. First, each day, a price for each fund is determined based on closing stock prices for that day. However, the fund manager does not execute every stock trade at that closing price. Any difference is market impact and is charged or credited to the fund, thus impacting the returns of the long-term holders. Second, to accommodate the large trades which result from frequent IFT activity, managers must keep a larger liquidity pool, which causes performance to deviate from that of the index. Lastly, for the TSP, when the liquidity pool is depleted as a result of a number of large trades in a row, cash due to the TSP is not received for up to three days, costing participants foregone interest. None of these three costs is calculable in advance, and all three are different every single day. Because it is impossible to determine how much to charge for each transaction, mutual fund families assess a percentage of the dollar amount transacted, which is then credited back to the Fund.

Many fund families employ trading restrictions similar to Vanguard's whereby an investor may not repurchase any fund within 60 days after a redemption.

We would also note that both TIAA–CREF and Vanguard, among others, use a double-barreled approach by charging a fee on top of the trading restrictions for some funds. For example, if an investor sells the Vanguard Developed Markets Index Fund (similar to the TSP's I Fund) within 60 days of purchasing it, that investor is charged a 2 percent fee and cannot repurchase the fund for 60 days.

In developing its recommendation, the Agency chose not to pursue redemption fees because it is impossible to correctly assign the exact costs to those who are making IFTs. Additionally, imposing a percentage fee would deny our participants the ability to go to the safe harbor of the G Fund at any time for no charge. The Agency considers that capability to be of paramount importance. A fee-based system would especially punish an infrequent trader who may wish to redeem within 30, 60, or 90 days (depending on the policy) because the market is declining. In this situation, the participant could face losing 2 percent of his/her investment in addition to the market decline, a worst case scenario.

The FRTIB is implementing a procedure to reduce costs to participants. The SEC recommends that all mutual funds take such actions, and according to a 2007 study by Hewitt and Associates, 73 percent of defined contribution plans have adopted policies designed to minimize transaction activities in their funds.

Several participants expressed wanting more than two (e.g., three, four, or more) IFTs per month. Others noted that the Agency should gradually implement its policy (e.g., have a ''trial period'') and start with a limit greater than two. Further, several participants asked ''why two'' trades and stated that the number seemed ''arbitrary.'' According to data compiled by the Agency, limits of four IFTs per month will have very little impact on the dollar volume of daily trades, three IFTs would reduce volume by just 31 percent while two IFTs would reduce volume by approximately half. The Funds in the Plan are index funds. Therefore, the Agency examined the trading policies of the largest index fund manager, Vanguard, and of numerous other mutual fund managers and defined contribution plans. An investor in any Vanguard fund who redeems shares of a Vanguard fund may not purchase any shares of that fund for 60 days. Additionally, in Vanguard's Developed Markets Index Fund (similar to the TSP's I Fund), if the redeemed shares have not been held for 60 days, the investor is charged a 2 percent redemption fee. Thus the approach of two IFTs per month, with unlimited redemptions to the G Fund, is demonstrably more liberal than that provided by the largest provider of index funds.

Some participants expressed a desire to have 24 (or, as suggested by one participant, 12) trades available across the year, as opposed to two per month. The purpose of the regulation is to reduce costs to TSP participants. Transaction costs are highest when the markets are the most volatile. The Agency is seeking to minimize the dollar volume of trades, especially during those times. TIAA–CREF, a very large defined contribution plan provider, tried allowing a certain number of transactions per year and found that it experienced a ''bunching'' of trades during volatile times, precisely the opposite of the intention of the transfer restrictions. That provider then amended its policy to read, ''A participant who transfers from ANY fund, transfers back, and then sells it within 60 days may not repurchase that fund for 90 days,'' *and,* if the transaction involves the international, high yield, or small-cap funds, a 2 percent fee will be assessed.

Some participants commented that it is their money in the TSP and, therefore, the Agency can't limit their activities. Some contend that the policy will prevent them from maximizing their retirement income. Others stated that the TSP is changing the rules mid-course. Some felt it is unfair to younger TSP participants, they assert, who need to be more aggressive; some felt it was unfair to TSP participants who are close to retirement and, they assert, need to be more aggressive. The SEC and 73 percent of defined contribution plans (according to the 2007 Hewitt Associates study) have acknowledged that market timing (frequent IFT) activity is harmful to the performance of funds. The SEC found that this activity ''dilutes'' value for all investors, and has mandated that mutual funds take action to discourage or eliminate such activity. Additionally, 73 percent of defined contribution plans have taken actions to reduce this activity. The Agency's research has indicated that its proposed limits are more liberal than those of many mutual funds and defined contribution plans. For example, the Thrift Plan for the Employees of the Federal Reserve System does not allow participants to redeem shares of any fund for 14 days after purchase.

Several participants commented that the proposed change would prevent them from engaging in dollar cost averaging. Dollar cost averaging is spending a fixed amount at regular intervals (e.g., monthly) on a particular investment *regardless of share price.* Dollar cost averaging is, by definition, not driven by the level of the market. A participant can most certainly employ a systematic investment plan, making IFTs every two weeks regardless of the performance of the market, just as dollar cost averaging is intended. In fact, this would essentially be the same frequency of dollar cost averaging into the TSP via withholding from biweekly paychecks.

Several participants stated that, if the Agency changes its IFT policy, they should be allowed to take their money out of the Plan. Congress has established the circumstances under which a participant may withdraw money from his/her account. According to a survey by Hewitt Associates, 73 percent of defined contribution plans have implemented policies to discourage market timing activities because such activities are detrimental to the performance of the plans. None of the affected participants was permitted a special withdrawal of funds from these plans. Further, the Agency is confident that its proposal is more liberal than most and furthers the TSP's status as a world class retirement vehicle.

Some participants wrote that the new rule should apply to new participants only; current participants should remain under current rules. The Agency's objective in promulgating this regulation was to reduce the impact of frequent IFT activity. Allowing current participants to rebalance using current rules would likely mean that IFT requests would remain at high levels. Thus, this would not reduce the impact of market trading activities and would also be very difficult to program and administer.

Several participants stated that there is no evidence that frequent IFT activity in the C, S, and F Funds has any measurable impact on participants as a whole and that the Agency should restrict only the I Fund. Further still, a handful of participants stated that frequent IFT activity benefits shareholders. While the I Fund transaction costs were the highest, at $16.5 million, the F and C Funds incurred measurable costs of $1.1 million and $605,000, respectively, in 2007. Moreover, the Agency is committed to eradicating the abusive frequent transfer activity in and out of the G fund by which some participants extract earnings which rightfully belong to long-term G fund investors.

As noted above, the TSP cannot determine the exact amount of costs to the plan from IFT activity for the following reasons. First, each day, a price for each fund is determined based on closing stock prices for that day. However, the fund manager does not execute every stock trade at that closing price. Any difference is market impact and is *charged or credited* to the fund, thus impacting the returns of the long-term holders. Second, to accommodate the large trades which result from frequent IFT activity, managers must keep a larger liquidity pool, which causes performance to deviate from that of the index. Lastly, for the TSP, when the liquidity pool is depleted as a result of a number of large trades in a row, cash due to the TSP is not received for up to three days, costing participants foregone interest. None of those three costs is calculable in advance, and all three are different every single day.

Note from above that trading costs may actually be credits. In fact, trading costs in the S Fund in 2007 did benefit the Fund by $4.3 million. However, it is extremely important to highlight that that number could just as easily have been a cost. There is no way for the Agency to control the size of such costs or whether they are costs versus credits. It can only work to minimize the exposure of the TSP to the potential costs by reducing the dollar amount of the trade. The manager of the S Fund did need to increase the liquidity pool for the Fund, and there were several times during the year that the TSP and its participants lost interest income because cash payment was delayed. Due to these uncertainties, the restrictions must be applied to the TSP Funds as a whole.

Many participants suggested changing the time that the I Fund is priced. By statute, the I Fund must be designed to replicate the performance of an international index (5 U.S.C. 8438(b)(4)(B)). The index is priced at 4 p.m. Eastern Time. Therefore, the I Fund must be priced at 4 p.m.

Some participants commented that fair valuation of the I Fund is increasing costs. On the contrary, costs would be even higher without fair valuation. All of the TSP stock funds are priced at 4 p.m. Eastern Time. For the C and S Funds, the prices used are the 4 p.m. closing prices of the stocks. The I Fund comprises international stocks in countries such as Japan and England. Although the I Fund is priced at 4 p.m., the Japanese market actually closed 13 hours earlier, at 3 a.m. Eastern Time, and the British market closed four and half hours earlier at 11:30 a.m. On most days, those closing prices are used to price the I Fund. However, in times of market turbulence, it can become obvious that if the securities had still been trading at 4 p.m. Eastern Time, the prices would be materially different. Fair value pricing is a process (recommended by the SEC) to update those ''stale'' prices to make them a more accurate reflection of the current market environment.

When the investment manager receives the daily trade order from the TSP, the foreign markets are closed. The investment manager cannot process the order until the markets reopen, and any differences in the opening stock prices from the closing stock prices (market impact) are charged back to the I Fund, affecting its performance. Since fair valuation updates the prices, it brings them closer to where the trades are actually executed, thereby lowering the cost to the Fund. Without fair valuation, the exposure to market impact costs would be greater. Fair valuation is an estimate of prices at 4 p.m. It is not meant to be an estimation of where the foreign markets will open.

Some participants said it was misleading to compare the TSP to a mutual fund. Others said TSP funds are more like electronically (the Agency assumes the participant meant exchange) traded indexed funds (or ETFs) that are traded through brokers. Others noted the TSP should not be compared to private sector funds because they have active managers. While the TSP Funds are not mutual funds, they are invested in collective trust funds (CTFs) which are virtually identical to mutual funds in the way they are priced and the way that trades are executed. Collective trusts differ from mutual funds in the following ways. In general, only eligible, tax-exempt assets such as a 401(k) or defined benefit plan can invest in a CTF. CTFs are regulated by the Comptroller of the Currency, not the SEC and Financial Industry Regulatory Authority (FINRA) (which oversee mutual funds). CTFs do not need to provide prospectuses to investors. Management fees tend to be lower with CTFs. This is in part because CTFs, as the preferred institutional account structure, can offer significant scale advantages to the investment manager. CTFs offer absolute fee transparency. There is a single management fee, unlike the multiple layers of fees associated with mutual funds.

There is a marked trend towards using CTFs in the 401(k) industry, particularly among large plans. Furthermore, low-cost transparent vehicles are entirely consistent with the spirit of the Pension Protection Act of 2006. Unlike commingled funds and mutual funds, ETFs can be bought or sold on an exchange throughout the trading day. They can also be shorted. The TSP Funds have an entirely different structure from that of ETFs. While it is true that ETFs track indexes, the first actively-managed ETF was introduced on March 25, 2008. While it is true that there are actively-managed mutual funds, there are also passively-managed mutual funds which track index performance. Like mutual funds, the TSP Funds are priced once per day, and unlike ETFs, they are not traded on an exchange throughout the day.

Hence, the Agency looks to 401(k) plans, the SEC, and the best practices of mutual fund managers when developing policy. The Agency cited figures from passively-managed index funds whenever possible since these most closely resemble the TSP.

Some participants commented that individual retirement accounts (IRAs) do not have trading restrictions. The TSP is not an IRA and is not similar in structure to an IRA.

The Agency received a number of comments about the rulemaking process. Some participants stated that the Agency's notice of proposed rulemaking was deficient because it stated it would not affect either small business entities or members of the uniformed services. This comment is unfounded. The Executive Director certified that ''this regulation will not have a significant economic impact on a substantial number of small entities'' but that it could affect ''members of the uniformed services.'' 73 FR 12668, March 10, 2008. He further certified the regulation would affect ''an insubstantial number of financial advisors who may provide advice in connection with the Fund.'' Id.

Some participants asked ''aren't individual shareholders considered small entities.'' They are not. Small entities are defined at 5 U.S.C. 601(6) as a ''small business,'' a ''small organization,'' and a ''small governmental jurisdiction.''

Some participants commented that the Agency's notice of proposed rulemaking was deficient because the proposed regulation is a major rule. A major rule is one that is likely to result in: (A) An annual effect on the economy of $100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets. 5 U.S.C. 804(2). The proposed rule is not a major rule under this definition.

Some participants asked how the Agency could impose IFT restrictions on some participants when the regulation was still proposed. The interim IFT restrictions are based on a regulation which took effect on January 7, 2008. 72 FR 73251, December 27, 2007. Other participants asked how the interim regulation could be enforced against frequent requestors of IFTs when the comments from the interim regulation had not been posted or considered. The Agency's Executive Director did consider comments submitted in connection with the interim regulation. Additionally, the proposed regulation notes ''[c]omments submitted in response to the interim regulation need not be resubmitted; they will be considered as part of this rulemaking process.'' 73 FR 12665, March 10, 2008. The Agency is not required to post comments in connection with an interim regulation.

One participant commented that the proposed regulation should be published at ''regulations.gov.'' The proposed regulation was published at *www.regulations.gov* and also published at *www.gpoaccess.gov, www.tsp.gov,* and *www.frtib.gov.* This participant also noted that the Agency should participate in the Federal Docket Management System (FDMS) functionality provided at regulations.gov. Because the Agency is cost-conscience (Agency research indicates a fee may be associated with the FDMS starting in 2010) and also because the Agency publishes regulations relatively infrequently, the Agency has not analyzed whether this optional functionality would benefit the Agency. However, the Agency may inquire into this functionality in the future. Regardless of these issues, as each participant was individually notified (in the Executive Director's February 2008 letter) regarding this regulation change, and as the Agency received hundreds of comments, the Agency does not believe participating in this optional functionality impacted the rulemaking process.

Some participants commented that the Agency sent out its regulation during a quiet time so that no one would notice. This comment likely refers to the Agency's interim regulation, which was published in the **Federal Register** on December 27, 2007. On November 19, 2007, at an open Board meeting, the Agency's Board heard a presentation from the Agency's Chief Investment Officer. In response, the Board approved a policy to limit interfund transfers. The Board's decision was the subject of extensive press coverage. Additionally, not long after this November 2007 meeting, the Chief Investment Officer's PowerPoint presentation and policy memorandum and the minutes of this meeting were posted on the Agency's Web site. Further, on November 27, 2007, links to additional information about the interfund transfer restrictions were prominently displayed on the TSP website. Before adopting the Board's policy, the Agency sought the advice of the Employee Thrift Advisory Counsel (ETAC) and on December 19, 2007 held an open meeting with the representatives to discuss the proposed approach of using an initial interim regulation followed by a structural limit. This meeting was also subject to extensive press coverage. As soon as practicable after the ETAC meeting, the Agency submitted its interim regulation to the **Federal Register** which published the interim rule on December 27, 2007. The Agency also forwarded a copy of the interim rule to the President of the Senate, the Speaker of the House of Representatives, the Government Accountability Office, and the U.S. Small Business Administration. Continuing with this spirit of openness, the Agency's Executive Director notified every participant about the proposed regulation in his letter that accompanied the annual participant statement mailed in February of 2008.

Some participants questioned whether this regulation was consistent with the Board's fiduciary obligation. The Board's IFT policy decision is completely consistent with, and, more accurately, mandated by, its fiduciary duty. By law, the Board must adopt investment policies that provide for low administrative costs. 5 U.S.C. 8475. The Board's IFT decision helps it to keep costs low.

A few participants stated that the costs explained in the proposed regulation were not persuasive and suggested that the Agency hire an outside company to do an audit. Some participants also challenged the experience and motivations of the Agency's Chief Investment Officer, Tracey Ray. Ms. Ray graduated summa cum laude from Washington College. She was immediately hired by Merrill Lynch and worked there as an account executive for six years, providing investment advice about stocks, bonds, options and mutual funds to clients. After her tenure at Merrill Lynch, she spent 16 years in the investment department of USF&G Corporation, a Baltimore-based *Fortune 500* insurance company, which was purchased by St. Paul Companies in 1998. While there, she served as a Vice President, portfolio manager and trader for stock, bond, option and short-term cash portfolios, and was responsible for the derivatives program. She also completed the program to earn the designation of Chartered Financial Analyst. She left St. Paul Companies in 2001 to take the position of Deputy Chief Investment Officer for the State of Maryland Pension Fund, where she spent four years evaluating, hiring and firing active money managers until she was hired by the Thrift Savings Plan in 2005. She also serves on the Advisory Committee for the Virginia Retirement System's Defined Contribution Plans.

While Ms. Ray's credentials are impeccable, and her study of the problem facing the TSP was diligent, thoughtful, and thorough, it is important to note that the decision to move forward with IFT restrictions was made by the Board members, after careful consideration and acting in their capacity as fiduciaries for the TSP. The Agency, in its notice of proposed rulemaking, explained in great detail the adverse effects of frequent IFT activity. The Agency also made available, on the TSP Web site, the memorandum and presentation that led its Board to adopt such a policy. Since these comments neither critique the Agency's methodology nor make substantive challenges to the accuracy of its conclusion, the Agency determined it would not be prudent to spend TSP money to have an outside auditor verify its determinations.

Several participants wrote that, as of March 31, the Agency will be effectively discriminating against a select group of TSP members and that all TSP members should be treated equally under the current TSP rules. Others wrote that it discriminated against members of the military (many of whom are stationed overseas where mail service takes longer). This comment is directed at the interim regulation which allowed the Executive Director to require those participants who engaged in excessive trading to request IFTs by mail only. Pursuant to the interim regulation, the Agency analyzed the trading activity of all participants in October, November, and December 2007. In January, the Agency sent a letter to all participants who made more than three IFTs each month. The letter warned that if they made more than three IFTs in February, or the following months, the Agency could require them to request IFTs by mail only. Thus, it is not accurate to state that the Agency is discriminating against a select group. The Agency scanned the IFT activity of all participants and warned those who made four or more IFTs in three consecutive months that they must stop. Only those participants who failed to heed the warning have been restricted. Although the Investment Allocation form used for IFTs is not generally available on the TSP Web site, restricted participants are able to access it via the TSP Web site; the Agency has also mailed a copy of the IFT transfer form to participants and they can reproduce it as necessary (or call the ThriftLine to obtain more copies).

Several participants mentioned that the proposed regulation is against the Agency's policy of encouraging participants to make their own retirement decisions. For example, some characterized the regulation as ''paternalistic'' or ''patronizing.'' Further, several participants stated that this move takes away employees' control over their retirement and cited the Thrift Savings Plan Open Elections Act of 2004 (Act). This Act allowed Federal employees and members of the uniformed services to begin or alter their TSP contributions at any time instead of limiting such changes to biannual open-season periods. The Act did not alter the requirement in 5 U.S.C. 8438(d) that the Executive Director prescribe regulations allowing at least two interfund transfers per year. This regulation affords participants many more opportunities to make IFTs than the minimum Congress determined necessary and, further, does not change the Agency's continuing policy of educating its participants so that they can control their own retirement.

Several participants commented that the proposed regulation was contrary to an existing Federal regulation. Section 1601.32(b) of title 5, Code of Federal Regulations does currently provide that there is no limit on the number of IFT requests that may be made by a participant. In 2003, the Executive Director published this regulation pursuant to his authority to prescribe such regulations as may be necessary to administer the Thrift Savings Plan. 5 U.S.C. 8474(b)(5). The Executive Director has determined that, in order to effectively administer the TSP, it is necessary to amend this regulation in order to address the impact of frequent transfers on the TSP.

Several participants stated that the TSP spent millions of dollars upgrading its systems to handle daily interfund transfers, and wasting that investment is inconsistent with the Board's fiduciary duty. The Agency did not move to a daily-valued record-keeping platform in order to facilitate frequent IFTs. This upgrade improved efficiency by spreading the volume of IFTs over the course of a full month, rather than requiring a one-time ''batch-process'' at month's end. This upgrade also eliminated the previous 15-day waiting period between IFT requests and execution. The daily-valued platform also enabled participants to have immediate account information access on the Web site and reduced paper statement costs (thus saving the participants over $3 million per year). Thus, the enhancement to the record-keeping system was not intended to facilitate frequent IFTs. In fact, the Agency's Executive Director and Board have expressed concern over the potential for misuse of the daily-valued platform both before and since its implementation.

In 2004, Agency staff reviewed the TSP's IFT records to determine if the newly enhanced system was being misused. The level of frequent IFT activity was de minimus at the time and there was no need to put restrictions in place.

Since fielding the daily-valued platform, the Agency has added toll-free telephone service, reduced processing and transaction timing, added dual/simultaneous call centers with extended hours, enhanced participant education materials, added a back-up state-of-the-art data center, and implemented the lifecycle funds. During this four-year period, the Agency's budget actually decreased on an annual basis.

In short, the Board takes its fiduciary duty very seriously. It has improved service while decreasing costs. It has adopted this IFT policy because the costs associated with frequent transfers have harmed TSP participants. By law, the Board must adopt investment policies that provide for low administrative costs. 5 U.S.C. 8475. The Board's IFT policy decision is completely consistent with this duty.

One participant wrote that the frequent transferors must be making money or else Congress would have stepped in to prevent these people from harming their retirement accounts. The Board, not Congress, has the statutory authority and duty to act solely in the interest of the Plan's participants and beneficiaries. 5 U.S.C. 8477(b)(1). Although the Agency advised the Congress of its plan to limit IFTs, Agency fiduciaries were solely responsible for this decision.

A participant asked if rebalancing a portfolio which may include adjusting the balances of 10 funds constitutes a single IFT. The answer is yes.

A participant suggested that the TSP ''should buy the EFA index which can be bought and sold with a low fee.'' The Agency believes this participant meant the exchange-traded fund (ETF) which tracks the Europe, Australia and Far East (EAFE) Index and has a stock symbol ''EFA.'' EFA is actually not a low cost alternative as it has an expense ratio of 34 basis points versus the TSP's expense ratio of 1.5 basis points.

A participant noted that comparison to other funds is ''meaningless'' as the TSP had unlimited transfers. Other funds also had unlimited transfers prior to 73 percent of them implementing curbs to reduce market timing activity.

A participant noted that Barclay's should make more use of EAFE futures to offset I Fund transactions. Barclays does make use of EAFE and country futures to offset a portion of I Fund transactions. The same participant noted that the Agency should balance out IFT requests to a single order to buy or sell. The Agency does that. That same participant noted that the Agency needs to evaluate whether total I Fund transactions in 2007 produced net positive or net negative trading costs, on what days and in what amounts. The Agency has that information for each day. The total cost for 2007 was $16,513,454.

Several participants commented they thought the G Fund should not be favored because it is not a good investment and does not keep up with inflation. The Agency is allowing unlimited redemptions to the G Fund to provide a safe harbor for participants who may wish to exit the stock market during times of financial distress. The Agency would also like to note that, by virtue of the fact that the G Fund rate adjusts every month and is based on longer-term Treasury rates, the G Fund is an inflation hedge because interest rates generally rise when inflation rises.

Several participants commented that the TSP should have more investment options. In 2006, the TSP hired an investment consultant to review the TSP's investment choices. The conclusion of that study was that participants were well served by the current fund lineup. The TSP will conduct similar reviews periodically in the future.

Some participants suggested that Agency comparisons to Fidelity, T. Rowe Price, and Vanguard (among others) are imperfect because these plans offer more diverse investment vehicles and that they are for-profit organizations. It is true that those fund families do offer more choices than the TSP, but defined contribution plans do not offer all available Fidelity, Vanguard, or T. Rowe Price funds. In 2006, the Board hired an investment consultant, Ennis Knupp and Associates, to review the plan. The consultant noted that 70 percent of defined contribution plans with more than 5,000 participants offer 15 or fewer investment options. Additionally, as cited before, over 73 percent of defined contribution plans have some type of trading restrictions. Mutual fund families are for-profit organizations, but all redemption fees are credited back to the funds, not to the profits of the companies. Additionally, why would a profit-oriented company, such as Vanguard, prohibit shareholders from repurchasing funds for 60 days unless it truly believed that market timing was detrimental to fund performance? It does so because the company is attempting to maximize performance of the funds by minimizing costs due to market timing activity.

Based on several comments, there seems to be a misconception that when a participant requests an IFT that his or her entire account is sold and repurchased to reflect the new percentages. In fact only the difference between the original percentage and the new percentage is traded, and that is netted against all other participant activity. The investment manager is then given a single dollar amount for each fund each day.

Some participants commented that there is a problem with the contract with Barclays, the investment manager, or that the fund should be managed by a firm better able to control the fees. The Barclays contract is extremely competitive. All of the costs related to the administration of that contract are included in the TSP's 1.5 basis point net administrative expense ratio. Every manager, who participated in the request for proposal process to manage the Funds of the TSP, charges trading costs back to their clients' funds, just as Barclays does for the TSP Funds.

A participant noted that he could not find information on the Vanguard Web site that Vanguard funds could not be repurchased within 60 days of redemption. On the site, in the search function, typing ''frequent trading policy'' will display that information.

The Agency appreciated the opportunity to review and respond to comments from participants who take an active interest in the TSP and wish to offer suggestions. The comment process allowed the Agency to address any misunderstandings about the proposed interfund transfer change, to learn if there are unanticipated legal or policy impediments to the proposed change, and to hear suggestions about how better to implement the proposed change. Although the comments received did not cause the Executive Director to make any changes to the proposed interfund transfer rule, he did carefully consider all comments received. Therefore, the Agency is publishing the proposed rule as final without change.

Regulatory Flexibility Act

I certify that this regulation will not have a significant economic impact on a substantial number of small entities. It will affect only Thrift Savings Plan participants and beneficiaries. To the extent that limiting interfund transfers is necessary to curb excessive trading, very few, if any, ''small entities,'' as defined in 5 U.S.C. 601(6), will be affected by the final rule. This is because the Thrift Savings Plan is sponsored by the U.S. Government and because the interfund transfer limitations are likely to affect primarily Federal employees, members of the uniformed services, and an insubstantial number of financial advisors who may provide advice in connection with the TSP.

Paperwork Reduction Act

I certify that these regulations do not require additional reporting under the criteria of the Paperwork Reduction Act.

Unfunded Mandates Reform Act of 1995

Pursuant to the Unfunded Mandates Reform Act of 1995, 2 U.S.C. 602, 632, 653, 1501–1571, the effects of this regulation on state, local, and tribal governments and the private sector have been assessed. This regulation will not compel the expenditure in any one year of $100 million or more by state, local, and tribal governments, in the aggregate, or by the private sector. Therefore, a statement under § 1532 is not required.

Submission to Congress and the Government Accountability Office

Pursuant to 5 U.S.C. 810(a)(1)(A), the Agency submitted a report containing this rule and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States before publication of this rule in the **Federal Register**. This rule is not a major rule as defined at 5 U.S.C. 804(2).

List of Subjects in 5 CFR Part 1601

Government employees, Pensions, Retirement.

Gregory T. Long,

Executive Director, Federal Retirement Thrift Investment Board.

For the reasons set forth in the preamble, the Agency is amending 5 CFR chapter VI as follows:

PART 1601—PARTICIPANTS' CHOICES OF TSP FUNDS

■ 1. The authority citation for part 1601 continues to read as follows:

Authority: 5 U.S.C. 8351, 8438, 8474(b)(5) and (c)(1).

■ 2. Amend § 1601.32, by revising paragraph (b) to read as follows:

§ 1601.32 Timing and posting dates.

* * * * *

(b) *Limit.* There is no limit on the number of contribution allocation requests. A participant may make two unrestricted interfund transfers (account rebalancings) per account (e.g., civilian or uniformed services), per calendar month. An interfund transfer will count toward the monthly total on the date posted by the TSP and not on the date requested by a participant. After a participant has made two interfund transfers in a calendar month, the participant may make additional interfund transfers only into the G Fund until the first day of the next calendar month.

[FR Doc. E8–8957 Filed 4–23–08; 8:45 am]

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ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R08–OAR–2007–0367; FRL–8552–4]

Approval and Promulgation of Air Quality Implementation Plans; Montana; Whitefish PM_{10} Nonattainment Area Control Plan

AGENCY: Environmental Protection Agency (EPA).

ACTION: Direct final rule.

SUMMARY: EPA is taking direct final action approving State Implementation Plan (SIP) revisions submitted by the Governor of Montana on June 26, 1997, and June 13, 2000. (Portions of the June 26, 1997 submittal were withdrawn by the Governor of Montana on February 8, 1999). These revisions contain an inventory of emissions for Whitefish and establish and require continuation of all control measures adopted and implemented for reductions of particulate aerodynamic diameter less than or equal to 10 micrometers (PM_{10}) in order to attain the PM_{10} National Ambient Air Quality Standards (NAAQS) in Whitefish. Using the PM_{10} clean data areas approach, we are approving the control measures and the emissions inventory that were submitted as part of the PM_{10} nonattainment area SIP for Whitefish. This action is being taken under section 110 of the Clean Air Act (CAA or Act).

DATES: This rule is effective on June 23, 2008 without further notice, unless EPA receives adverse comment by May 27, 2008. If adverse comment is received, EPA will publish a timely withdrawal of the direct final rule in the **Federal Register** informing the public that the rule will not take effect.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–R08–OAR–2007–0367, by one of the following methods:

- *http://www.regulations.gov.* Follow the on-line instructions for submitting comments.
- *E-mail: dygowski.laurel@epa.gov* and *ostrand.laurie@epa.gov.*
- *Fax:* (303) 312–6064 (please alert the individual listed in the **FOR FURTHER**

Last year, it became clear that a few thousand of the 3.9 million Thrift Savings Plan (TSP) participants were making frequent interfund transfer (IFT) requests. Because this activity was clearly accelerating, and in light of the detrimental effect on fund performance and transaction costs, the Agency is implementing limits on interfund transfers effective May 1, 2008.

In February 2008, the Agency notified all participants of the proposed change and the reasons for it when the Agency mailed the new annual participant statements. On March 10, the Agency published the proposed final regulation in the Federal Register and allowed a 30-day comment period. After considering all of the comments received, the Agency decided upon the limits that provide for a broader, system-wide solution.

The final regulation limits the number of unrestricted interfund transfer requests to two per calendar month. These first two IFTs can redistribute your account among any or all of the TSP funds. After that, for the remainder of the month, the participant may make additional interfund transfers only into the Government Securities Investment (G) Fund until the first day of the next month.

The following questions and answers describe the structural interfund transfer changes and the reasons why these limits are necessary. Additional details are provided in the Frequent Trading memorandum of November 6, 2007, and the FRTIB Frequent Trading presentation dated November 19, 2007.

Q1. Why is the TSP placing limits on the number of interfund transfers a participant may make each month?

The TSP is a retirement savings and investment plan. Investment choices should be made with a long-term objective based on a participant's time horizon. Although the TSP recognized that once it moved to the new daily valued system, some participants might engage in market timing activities, the practice was minimal at first. Although less than one percent of participants averaged more than one interfund transfer per month in 2007, and nearly 85% of participants did not make any IFTs in 2007, a very small number of TSP participants were requesting IFTs to such an extent that the activity began to adversely affect other participants.

For example, in September and October of 2007, the average International Stock Index Investment (I) Fund daily trade amount given to the Investment Manager was $224 million. This compares to average daily I Fund trade amounts of $49 million in 2006 and $27 million in 2005. In September and October 2007, 63% (or $142 million) of the $224 million traded was attributable to participants who had traded the I Fund eight or more times in the prior 60 days. Trade volume is up significantly, and the majority of this increased volume is attributable to a small number of TSP participants who are making frequent IFT requests.

Q2. What are the new limits on interfund transfers?

For each calendar month, the **first two** IFTs can redistribute a participant's account among any or all of the TSP funds. After that, for the remainder of the month, participants may ***only*** move money into the Government Securities Investment (G) Fund (in which case the participant will increase the percentage of the account held in the G Fund by reducing the percentage held in one or more of the other TSP funds).

We will count the interfund transfer based on its process date, not the date the interfund transfer is requested.

If the first or second interfund transfer in a month moves money only to the G Fund, it still counts toward the two (2) unrestricted interfund transfers per month limit.

Q3. How will these limits affect me?

Based on current behavior, 99% of TSP participants are not affected by this change.

Q4. When will the limits be implemented?

The Agency published a proposed regulation on March 10, 2008. The opportunity for comment on the proposed regulation ended on April 9, 2008. The Agency has considered the comments that were received and has made the decision to implement the limits on May 1, 2008.

Q5. Do these new interfund transfer limits also apply to contribution allocation requests?

The interfund transfer limits do *not* apply to contribution allocation requests.

Q6. What has been the impact of frequent interfund transfer activity on the TSP Funds?

Frequent trading activity has (1) increased fund transaction costs and (2) increased the likelihood that a fund's performance will deviate from its benchmark.

(1) Transaction costs, which are in addition to the TSP administrative expense for each fund, can be double or triple the cost of administering the fund. Transaction costs are not fees paid to Barclays Global Investors (BGI, the investment manager for the F, C, S, and I Funds). They are costs comprising commissions paid to brokers, transfer taxes, and market impact (the difference between where the stock is bought or sold versus the stock price used to value the fund). Before BGI places an order to buy or sell shares in the market, it trades shares internally among other public and corporate tax-exempt employee benefit plans that are invested in the same index funds as the TSP. There is no cost to the TSP for this service. However, the larger the trade, the lower the percent

that can be internally moved between plans. Thus, an increase in the size of the daily trade leads to a disproportionate increase in the transaction costs which are paid by all TSP participants invested in these funds.

(2) Further, because of the very large dollar amounts being traded, particularly in the I Fund, BGI has had to increase its cash/futures pool to ensure that the funds can meet their daily redemption requirements. As a result, the possibility that the funds' performance will differ from the performance of the benchmark index that each fund tracks has increased.

Q7. Why does it matter if a TSP fund's performance differs from the performance of the benchmark index for the fund?

The performance difference (tracking error) between a TSP fund and its benchmark index can be positive or negative, but the TSP is charged by statute to keep this tracking error as low as possible since the funds must, by law, "replicate" their respective indexes. See 5 U.S.C. § 8438. Reducing the dollar amount of interfund transfers will lower the amount of cash the investment manager must hold and will therefore reduce tracking error.

Q8. What are the costs to TSP participants invested in the funds affected by frequent trading activity?

Frequent trading activity results in additional fund trading expenses that are borne by *all* participants in the fund (not just those who are making interfund transfers), and can negatively impact returns. For example, in 2007, the transaction cost for the I Fund was 6 basis points (or 60 cents per $1,000). The cost of administering the TSP funds (expense ratio) was 1.5 basis points (or 15 cents per $1,000). This means that the impact of transaction expenses in the I Fund was four times the impact of the cost of administering the TSP funds. These costs affect everyone who is invested in the I Fund. High levels of trading also impacted the other funds. In addition, there is the possibility of foregone interest in those situations where BGI cannot settle our large trades on a next-day basis.

Thus, the limits on IFTs are designed to protect the interests of all participants in response to the frequent interfund transfers in the F, C, S, I, and L Funds made by a small number of TSP participants.

Q9. Why are the transaction costs high?

As explained in Question 6, transaction costs are not fees charged by the investment manager, but are comprised of brokerage commissions, transfer taxes, and market impact. Brokerage commissions are very low, but in some foreign countries, transfer taxes are very high. For example, Ireland charges a one percent tax on all purchases of securities. Market impact is by far the largest transaction cost, particularly in the I Fund, where we give our investment manager the order to buy or sell when the overseas markets are closed. The manager then executes the trades when the markets reopen. Any price difference is market impact, and there are always price differences. In 2007, transaction costs for all of the funds were nearly $14 million.

Q10. The TSP's expense ratio was only 1.5 basis point (.015%) in 2007. Why does the TSP need to limit trading when expenses are already low?

Transaction costs are investment expenses that reduce investment income before deductions for administrative expenses and **are not** included in the administrative expense ratio. (See the Thrift Savings Plan Statement of Changes in Net Assets Available for Plan Benefits portion of the Plan's financial statement.) Transaction costs of $16.5 million reduced the I Fund return by 6 basis points (or .06%) in 2007; net administrative expenses only reduced participants' returns by 1.5 basis point (.015%) in 2007.

Frequent IFT requests also increase the cash the investment manager must hold to meet redemptions, which leads to a greater chance of differences in performance from the indexes tracked by the funds. It is the goal of the TSP to keep this "tracking error" as low as possible since the funds are designed to mimic their respective indexes.

Q11. The TSP is a huge plan with $216 billion in assets. Why are transaction costs of $16.5 million a problem?

As indicated in Question 10, transfer costs affect the returns of the funds. For example, the I Fund's transaction costs in 2007 decreased the I Fund's return by 6 basis points or .06%. The cost of administering the TSP program was only 1.5 basis point (.015%) in 2007. The Board is charged with keeping TSP expenses low for all participants. See 5 U.S.C. § 8475. We have determined that IFT limits will result in a significant expense reduction for TSP participants.

Q12. Does rebalancing the L (lifecycle) Funds every day cause the amount traded to increase?

The dollar amount of trading activity attributable to the L Funds, especially compared to the dollar amount of trading activity attributable to participants making frequent IFT requests, is very small. For example, in the I Fund, for September and October 2007, the average daily dollar amount attributable to the L Funds' rebalancing accounted for just seven percent of the total daily trade, while the average daily dollar amount attributable to those making frequent IFTs (defined in this instance as participants who have traded in the I Fund eight or more times in the prior 60 days) was 63 percent. The impact of the L Funds' rebalancing is demonstrably minimal. The Agency monitors the L Funds, as it does all of its funds; and, in the unlikely event that dollar volume of the L Funds' rebalancing becomes costly, the Agency can take steps to reduce the frequency or amount of the rebalancings.

Q13. Why hasn't the TSP already placed limits on the number of interfund transfers that a participant can make each month?

Before the TSP moved to the daily-valued record keeping system, participants were limited to 12 interfund transfers a year — one per month. We decided not to limit the interfund transfers unless a problem developed. In 2007, however, the adverse effects of frequent IFT requests became more pronounced. Because the Federal Retirement Thrift Investment Board has a fiduciary responsibility to all of its participants to keep costs low, the decision was made to put limits in place.

Q14. Do other plans and mutual funds place trading restrictions on their participants?

The financial industry has responded in a variety of ways to the challenge of frequent trading in its mutual funds. Consequently, most large mutual fund families have adopted some type of trading restrictions or they have implemented a fee structure. The TSP reviewed the restrictions in place for many of these mutual funds and determined that allowing participants two interfund transfers per month, with subsequent interfund transfers only to the G Fund was both reasonable and prudent. (The TSP limits are not as onerous as the restrictions of other institutions. For example, one institution restricts transfers to once every 60 days; another provides for one round trip— an investment into and out of a fund — per year.)

Although the Securities and Exchange Commission (SEC) does not have direct oversight authority with respect to the TSP, its views on frequent trading and its directive to mutual fund boards of directors is instructive. The SEC provides that, under rule 22c-2(a)(1), "the board of directors must either (i) approve a fee of up to 2% of the value of shares redeemed, or (ii) determine that the imposition of a fee is not necessary or appropriate. *Id*. A board, on behalf of a fund, may determine that the imposition of a redemption fee is unnecessary or inappropriate because, for example, the fund is not vulnerable to frequent trading or the nature of the fund makes it unlikely that the fund would be harmed by frequent trading. Indeed, a redemption fee is not the only method available to a fund to address frequent trading in its shares. As we have stated in previous releases, funds have adopted different methods to address frequent trading, including: (i) restricting exchange privileges; (ii) limiting the number of trades with a specified period; (iii) delaying the payment of proceeds from redemptions for up to seven days (the maximum delay permitted under section 22(e) of the [Investment Company] Act); (iv) satisfying redemption requests in-kind; and (v) identifying market timers and restricting their trading or barring them from the fund." See 71 Fed. Reg. 58258 (Oct 3, 2006).

The TSP concluded that its interfund transfer policy is consistent with best practices in the financial industry and with the guidance provided by the SEC.

Q15. Why doesn't the TSP allow a higher number of unrestricted IFTs per month, such as four per month?

TSP studies showed that allowing four IFTs per month would not result in any meaningful reduction in the dollar amount of the daily trades. Allowing three per month would result in a 31% reduction and two per month would result in a 53% reduction.

TSP research has shown that less than 1% of participants make more than 12 IFTs per year. Therefore, the regulation will not affect 99% of participants. It will allow participants to rebalance their accounts twice per month, which the Plan's two investment consultants, Mercer and Ennis Knupp, view as more than adequate.

Q16. Why doesn't the TSP impose redemption fees instead of trading restrictions?

In deciding what action to take, the TSP conducted a study of the **best practices** of large mutual fund families, which revealed that two methods are used to control frequent trading: (1) fees and (2) trading restrictions. **T. Rowe Price** imposes fees on redemptions; it manages an international index fund similar to the TSP's I Fund and charges investors a fee of two percent for any redemptions made within 90 days of purchase. **Fidelity** limits international fund activity to one round trip (a purchase and sale) within 30 days, with a maximum of two round trips in any 90-day period. **Vanguard**, the largest manager of index funds, does not allow any of its funds to be repurchased within 60 days after a sale.

In developing its recommendation, the TSP chose not to pursue redemption fees because it is impossible to correctly assign the exact costs to those who are making interfund transfers. Additionally, imposing a percentage fee would deny our participants the ability to go to the safe harbor of the G Fund at any time for no charge. The Board considers that capability to be of paramount importance. A fee-based system would especially punish an infrequent trader who may wish to redeem within 30, 60, or 90 days (depending on the policy) because the market is declining. In this situation, the participant could face losing two percent of his/her investment in addition to the market decline, a worst case scenario.

Further, our approach is more liberal than most, if not all, of the restrictions reviewed. It allows participants to rebalance up to twice a month. Indeed, our two investment consultants, Mercer and Ennis Knupp, have conducted studies showing that rebalancing an account more than monthly or quarterly is ineffective. We therefore consider our approach to be more accommodating than necessary for optimal rebalancing frequency and demonstrably more liberal than the policies of 40 record keepers which use the same processing system as the TSP.

It is the TSP's intention that allowing participants to two unrestricted interfund transfers per month (with unlimited transfers into the G Fund **after** the first two interfund transfers) will eliminate the extra costs to the TSP that are generated by the transactions of a very small number of participants without affecting the 99% of participants who trade infrequently. It is a policy that is much more liberal than the policies of many large, well regarded mutual fund families.

Q17. Why doesn't the TSP limit interfund transfers to 24 per year instead of two per month?

The purpose of the regulation is to reduce costs to plan participants. Transaction costs are highest when the markets are the most volatile. The Agency is seeking to minimize the dollar volume of trades, especially during those times. With an annual limit, it is likely that a "bunching" of trades would occur during volatile times, precisely the opposite of the intention of the interfund transfer limits.

Q18. Don't the IFT limits prevent me from engaging in dollar cost averaging?

Dollar cost averaging is spending a fixed amount at regular intervals (e.g., monthly) on a particular investment *regardless of share price.* Dollar cost averaging is, by definition, not driven by the level of the market. A participant can most certainly employ a systematic investment plan, making IFTs every two weeks regardless of the performance of the market, just as dollar cost averaging is intended. In fact, this would essentially be the same frequency of dollar cost averaging into the TSP via deductions from biweekly paychecks.