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

November 3, 2009

Chairman Lynch and Members of the Subcommittee, my name is Greg Long and I am the Executive Director of the Federal Retirement Thrift Investment Board. The five members of the Board and I serve as the fiduciaries of the Thrift Savings Plan (TSP) for Federal employees and members of the uniformed services.

The TSP is the largest defined contribution retirement plan in the world. Individual accounts are maintained for more than 4.2 million Federal and Postal employees, members of the uniformed services, and retirees. As of September 30, 2009, the TSP held approximately $234 billion in retirement savings.

Your letter of invitation explained that the purpose of this hearing is to examine a host of issues, including upgrades to the TSP's Information Technology (IT) infrastructure and security capabilities, multiple legislative initiatives, regulatory proposals, and a changed financial landscape. I am pleased to discuss each of these matters and respond to questions from the Subcommittee.

Before I do, however, I would like to note that I am surrounded by individuals representing organizations whose knowledge and commitment to the TSP goes back twenty-six years. In 1983, the Congress extended Social Security coverage to Federal civilian employees for the first time, and undertook the task of devising a new retirement system for new Federal hires. Most of the groups represented at this table were key participants in that process, which ultimately led to the enactment of the Federal Employees' Retirement System Act of 1986 and the creation of the Thrift Savings Plan for Federal employees.

The individuals I am sitting with represent Federal and Postal employees, supervisors, managers, postmasters, senior executives, retirees, and members of the uniformed services; most serve on the statutory Employee Thrift Advisory Council, which is chaired by my fellow panelist, Jim Sauber. Their knowledge and support have been essential in making the TSP the success it is today.

Upgrades in TSP IT Infrastructure and Security

It is appropriate that IT infrastructure and security are the first items cited in your letter. The FY 2010 TSP budget approved by the Board just last month demonstrates our commitment to infrastructure, security, and other vital record keeping activities; $99.1 million (or approximately 76%) of our total FY 2010 budget of $130.3 million is dedicated to these areas. We are putting the resources where the need is.

As I told the Board when we discussed the budget, I am an Executive Director who leans forward. We have an ambitious agenda to improve the TSP. The Thrift Savings Plan Enhancement Act of 2009 provides substantial new benefits which we must implement. Further, the Agency must spend money in order to implement other improvements, like updating the TSP website and implementing e-messaging for our participants, which demand agency resources.

TSP expenses are borne not by the taxpayers, but by Plan participants. During 2008, the TSP expense ratio (expenses as a percentage of funds on account) was 2 basis points, or 20 cents for each $1,000 in an individual participant's account. This compares very favorably to the average expense ratio of 63 basis points in a recent survey of expenses in other similar plans. (401(k) Benchmarking Survey, 2008 Edition, Deloitte Consulting LLP.)

Despite our low administrative costs (which our enabling legislation requires), we nevertheless must maintain a robust IT infrastructure to support Plan activities. Attached to this statement is a status report presented by the Agency's Director of Automated Systems to the Board and ETAC members at their joint October 19, 2009, meeting. As you will note, this report covers the recently completed capital investments for our systems modernization program, as well as a status report on Data Center operations and software applications. I would be pleased to further discuss the major items identified in this document during the question and answer session. I would also be pleased to discuss any security matters the Subcommittee would like to pursue, but recommend that we do so in a closed session so we do not disclose key information regarding how we protect participants' funds and personal information.

Multiple Legislative Initiatives

On April 29, 2008, I appeared before this Subcommittee -- which was then chaired by Congressman Danny Davis -- to express the Board's support for automatically enrolling newly-hired employees in the TSP. As the Congress developed its legislation on that issue, it added provisions which bring the TSP up-to-date with comparable private sector 401(k) plans in a number of areas. Together, these legislative changes make the TSP an even more flexible and valuable program for participants. I come before you today to say "thank you," and to describe our plan for implementing the multiple legislative initiatives authorized by the Thrift Savings Plan Enhancement Act of 2009.

- **Immediate agency contributions**. As soon as the new law was signed on June 22, 2009, the waiting period for Federal Employees' Retirement System (FERS) employees to receive agency contributions was eliminated. But changes like this don't implement themselves. Agency staff had already been working with Federal employing agencies to speed the delivery of this valuable new benefit to participants. All FERS employees should now be receiving Agency Automatic (1%) Contributions -- and, if they are also contributing their own money, Agency Matching Contributions as well -- regardless of when they were hired or rehired. I would like to recognize the hundreds of payroll professionals and personnelists in the employing agencies who implemented this new benefit so quickly.

- **Accounts for spouse beneficiaries**. Beginning in Spring 2010, if a participant dies and the spouse is the beneficiary of the participant's TSP account, the spouse will have the option of leaving the death benefit payment in a TSP account in his or her own name. Currently, a spouse beneficiary may only transfer a TSP death benefit payment to an Individual Retirement Account (IRA) or eligible employer plan or receive a lump sum payment in cash.

  Although we cannot fully implement the new spouse beneficiary account program (which was the initiative of a member of the Employee Thrift Advisory Council) until 2010, we do not want to force surviving spouses of recently deceased participants to withdraw their inherited funds if they would prefer to keep them in the TSP until the beneficiary accounts become available. Consequently, I recently approved a policy to establish an interim procedure under which surviving spouses can have the TSP funds they inherit invested in the Government Securities Investment (G) Fund until spouse beneficiary accounts are established next year. At that time, the funds will be transferred to the new spouse beneficiary account under the complete control of the spouse beneficiary as anticipated by the new law.

- **Automatic enrollment**. Starting next spring, new Federal civilian employees will automatically make payroll contributions of 3% to the TSP. Their agencies will send these contributions to the TSP along with an additional amount equaling 4% of basic pay (Agency

Automatic (1%) and 3% Matching Contributions) each pay period, unless the employee opts out of contributing or elects to contribute more or less. This will give new employees a chance to start saving early, receive agency contributions (if FERS), and achieve potentially greater retirement savings.

- **Roth feature**. In 2011, we plan to offer a Roth feature. (This will not be a Roth IRA, and you will not be able to transfer a Roth IRA into the Roth TSP.) It will be the equivalent of a private sector Roth 401(k), which is subject to different tax rules from a Roth IRA and open to people of all income levels. Employee contributions to the Roth TSP will be made on an after-tax basis, and participants will not have to pay Federal income tax on any money they withdraw from it. (However, participants may still be subject to the early withdrawal penalty tax if they don't meet the age requirement for withdrawing.)

  The TSP estimates it will take about 2 years to implement this benefit. It will require substantial modifications to agency and uniformed service human resources and payroll systems as well as to the TSP's own record keeping, accounting and other associated systems. The TSP will provide participants with educational materials as the implementation date approaches.

- **Mutual fund window.** The legislation also allows the TSP to offer a mutual fund window in the future. A mutual fund window would allow participants to invest some of their TSP savings in mutual funds outside the TSP. Expenses related to the mutual fund window would be borne solely by those participants who use it. The TSP has not set an implementation target, and will further consider this option in cooperation with the unions and associations of the Employee Thrift Advisory Council.

Regulatory Proposals

In preparing for this hearing, the Subcommittee staff requested a discussion of recent Internal Revenue Service rulings regarding contributions of unused leave to retirement plans and TSP regulations issued last year limiting the number of interfund transfers. I am pleased to discuss both these matters.

- **Contributions of Unused Leave.** During his Labor Day weekend radio address on September 5, 2009, President Obama announced his intention to encourage employees to put payments for unused vacation and sick days into their retirement plans. This announcement followed the Internal Revenue Service's (IRS) issuance of two Revenue Rulings on this subject. IRS Revenue Ruling 2009-31 sanctions contributions to section 401(k) plans of the dollar value of unused paid time off that is in excess of the employer's carryover limit and would otherwise be forfeited or cashed out at year-end. Revenue Ruling 2009-32 sanctions contributions to section 401(k) plans of the dollar value of unused paid time off that would otherwise be distributed to an employee as a lump-sum at the time of termination of employment. For purposes of both rulings, a "paid time off" plan refers to "a sick and vacation leave plan under which a participant may take paid leave without regard to whether leave is due to illness or incapacity."

  Annual leave offered by the Government to Federal employees is the type of benefit described in Revenue Rulings 2009-31 and 2009-32. It falls within the purview of the fact scenarios described in Revenue Ruling 2009-31 because section 6304, Title 5, United States Code, establishes limitations on the amount of annual leave a Federal employee may carry over from one leave year to the next and the employee forfeits the excess over the carryover limit. It also falls within the purview of the fact scenarios described in Revenue Ruling 2009-

32 because, under sections 5551 and 5552, Title 5, United States Code, Federal agencies must make a lump-sum payment for accumulated and accrued annual leave when an employee separates from Federal service.

With respect to sick leave, Revenue Rulings 2009-31 and 2009-32 are not directly applicable because such leave is not subject to forfeiture at year-end, may not be cashed out, and cannot be taken without regard to illness or incapacity.

Revenue Rulings 2009-31 and 2009-32 are premised on the assumption that the plan's governing document permits participants to contribute the dollar value of unused paid time off to their retirement plan accounts. The Federal Employees' Retirement System Act of 1986 (FERSA) functions as the TSP's governing plan document. FERSA does not currently permit participants to contribute the dollar value of unused paid time off to their TSP accounts.

Pursuant to sections 8351(b)(2)(A) and 8432(a)(1), Title 5, United States Code, a civilian employee's "basic pay" is the only allowable source of TSP contributions. Unused paid time off is not included in the definition of basic pay. See U.S.C. § 8331(3). Moreover, section 8331(3), Title 5, United States Code, explicitly excludes "lump-sum leave payments under subchapter VI of chapter 55" from the definition of basic pay.

For the foregoing reasons, Federal employees now cannot contribute unused annual leave or unused sick leave to their TSP accounts unless Congress amends FERSA to specifically allow them to do so. This issue was discussed at the Joint Board/ETAC meeting on October 19, 2009. The Board would be pleased to implement a program of TSP contributions from unused leave if authorized by the Congress.

- **Limits on Interfund Transfers.** 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 three Thrift Savings Fund offerings—commonly known as the C, S, and I Funds—are invested to "replicate" the performance of selected market indexes at a low cost. We use this same approach for the F Fund. 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 Interfund Transfers (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, was challenged in 2007 by a noticeable increase in IFTs by a small group of participants. The Agency's analysis demonstrated that fewer than 1 percent of TSP participants were 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 became less random, which suggested coordination, led to fewer opportunities for cost savings due to offsets, and seemed to be concentrated on the International Stock Index Investment (I) Fund. The deleterious consequences of these activities in the TSP were the same as those which the Securities and Exchange Commission found were occurring in mutual funds -- and subsequently restricted. Importantly, the clear intent of this activity—to "beat" the market indexes—fundamentally conflicted with statutory mandates that the Board provide passive investments which replicate the performance of market indexes.

To overcome the problems caused by the small group seeking multiple interfund transfers, the Agency instituted a rule that the first two IFTs in a month were unlimited. After that, any IFTs made that month could only move money to the G Fund. The final regulation was published in the Federal Register on April 24, 2008, and continues in place to this day. The restriction has succeeded in providing more predictable cash flows and offsets, thereby reducing costs. For example, in 2007, the I Fund incurred trading costs of $16.5 million. For 2008, trading costs for the I Fund fell to $5.8 million, and are $2.1 million through September 2009.

Changed Financial Landscape

Events during the past year or so have indeed changed the financial landscape. Wall Street firms that were too big to fail, failed. Others survived only with large infusions of taxpayer dollars. Perhaps most importantly in the world of voluntary savings and investments for retirement, investor confidence was severely challenged while millions wondered if they could ever recoup their losses. In the TSP alone, funds on account fell from $234 billion to $191.5 billion in just nine months (May 2008 to February 2009). Those losses translated into sizable reductions in the average participant's account balance.

Because the situation was so difficult, I decided to post messages to participants on the TSP website during October and December of last year. Those messages, which are attached to this statement, convey a simple thought: Despite all of the carnage, fear, and heartache inflicted on regular people who are just hoping to set aside enough funds to retire with dignity, there is no better way to pursue the long-term security afforded by sound investments than the fundamental design offered by the TSP.

First of all, the TSP is one part of a 3-legged retirement stool which includes guaranteed income from Social Security and a defined benefit plan;

Second, the Agency Automatic (1%) and Matching Contributions are very advantageous for FERS employees;

Third, tax-deferred contributions provide immediate tax reductions for all participants;

Fourth, low administrative costs ensure that investors get to put their assets to work for them, rather than paying high fees;

Fifth, the diversification offered by broad-based index funds helps to reduce the participants' exposure to risk;

Sixth, the TSP Lifecycle (L) Funds offer professionally designed asset allocation models;

And finally, the ease of investing through regular payroll withholding, in good times and bad, helps secure the best average price via dollar cost averaging in building for future financial security.

The Congress wisely designed the TSP to focus on fundamentals like these. During difficult times in the markets, when investors flee the "investment du jour" and return to basics, they will rediscover the simple value offered by long-term, lost-cost, diversified investments such as those available in the Thrift Savings Plan for Federal employees.

Thank you Mr. Chairman. I will be pleased to respond to any questions.