

**OVERSIGHT OF THE THRIFT SAVINGS PLAN:
ENSURING THE INTEGRITY OF FEDERAL
EMPLOYEE RETIREMENT SAVINGS**

HEARING

BEFORE THE

FINANCIAL MANAGEMENT, THE BUDGET, AND
INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

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MONDAY, MARCH 1, 2004

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MANAGEMENT,
THE BUDGET, AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 11:06 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Peter G. Fitzgerald, Chairman of the Subcommittee, presiding.

Present: Senators Fitzgerald and Pryor.

OPENING STATEMENT OF SENATOR FITZGERALD

Senator FITZGERALD. Good morning. This meeting will come to order.

Today, we are conducting an oversight hearing of the Federal Government's Thrift Savings Plan, the \$131 billion government equivalent of a private sector 401(k) plan. This Subcommittee has jurisdiction over Federal retirement benefits, of which the Thrift Savings Plan, or TSP for short, plays an integral role.

The TSP was established by the Federal Employees Retirement System Act of 1986. The TSP currently provides virtually all Federal employees, including members of the military, the uniformed services, and Members of Congress and their staffs, with a tax-deferred defined contribution plan. TSP participants can invest their retirement savings in any or all of five TSP funds, each of which is either an equity or debt security index fund.

I would like to first welcome the witnesses we have with us today and thank them for taking time out of their busy schedules to discuss their involvement with the TSP and its operations.

It is important that Congress ensure the financial integrity of the TSP, in which 3.2 million participants have invested their retirement savings. Congressional oversight is especially important now in light of a growing list of trading abuses in the private sector mutual fund industry. I look forward to hearing from our witnesses regarding the TSP's oversight mechanisms, its audits, and its daily investment and management activities, as well as its management expenses and costs.

The TSP is the largest defined contribution plan in the world. Since its first full year of operation in 1988, the TSP has grown from \$2.7 billion in investments held by 1.3 million participants to

its current \$131 billion in investments held by 3.2 million participants. Despite its size, the TSP has been successful in providing plan participants with high quality service while keeping administrative fees and transaction costs to a minimum.

This Subcommittee recently held hearings to examine abuses in the mutual fund industry, including market timing, late trading, and hidden fees charged to investors. Last fall, Senator Akaka and I looked into the management of TSP investments, and based on the information provided to us and to the best of our knowledge, the TSP does not suffer from, nor is it vulnerable to, these types of abuses that contribute to high management fees and transaction costs in private index funds.

During our last hearing on January 27, I referenced the expense ratios of the TSP—which measure administrative expenses, management and advisory fees, and transaction costs as a percentage of total assets—and compared them with comparable private sector funds to illustrate the low cost of fund management and governance at the TSP. Last year, the expense ratio of the average government TSP fund was only 11 basis points, or 11 cents per \$100 invested, and in previous years it has been as low as 7 or 8 basis points.

Now, for those of you who can see these charts,¹ either that chart over there or the chart right here, the expense ratio of the TSP C Fund, which is the large cap equity fund for the TSP, is shown on the left as of the end of last year. The 2003 expense ratio was 11 basis points, 11 cents per \$100 invested.

Over on the right is the average expense ratio for the average private sector comparable mutual fund. The Lipper S&P 500 Index average, the average expense ratio for the average private sector equity stock index fund, is 63 basis points. That is about six times the expense ratio for the Thrift Savings Plan.

In the middle there is the Vanguard 500 Index Fund, which is the lowest-cost private sector index fund. Its expense ratio last year was 18 basis points. So the expense ratio for the TSP fund last year was quite a bit lower than Vanguard's expense ratio—the lowest private sector fund—and it was six times lower than the average private sector fund's expense ratio.

I would point out as well that the TSP's expense ratio includes transaction costs, while the expense ratio for the private sector funds does not include the transaction costs. It just includes their management fees and so forth.

So as I said, this is extremely low when compared to the most recent data for private sector index funds, particularly since the TSP's expense ratio includes transaction costs whereas expense ratios of private sector mutual funds do not. According to the Lipper Services, comparable index funds in the private sector have an average expense ratio of 63 basis points, or 63 cents per \$100 invested.

Contributing to the minimal costs and fees charged to each TSP account holder is the competitive bidding of contracts, such as the contract with Barclays Global Investors. Since 1988, Barclays has been selected to manage four of the five funds—the F, C, S, and

¹The chart referred to appears in the Appendix on page 124.

I funds. The competition is conducted separately for each fund every 5 years. Each year, Barclays or its predecessor has been selected to act as fiduciary and has established a record of good governance and strong management.

I have long been a proponent of competitive bidding and encourage the TSP to consider opening its nearly \$52 million contract with the National Finance Center to competition. The National Finance Center is a division of the USDA, the U.S. Department of Agriculture, that handles the TSP's processing and recordkeeping in Louisiana. As of January 31, 2004, there were 433 USDA employees assigned to the TSP, compared to 100 employees here in Washington. It is my view that the TSP could save significant funds if this contract were opened to competition, which would directly benefit the plan's 3.2 million participants. I look forward to hearing from our witnesses regarding this proposal.

Based on the information known to me, TSP participants do not need to worry about many of the problems plaguing the mutual fund industry, such as excessive fees, directed brokerage, revenue sharing arrangements, or soft dollar payments. Nor do participants need to worry about an incestuous board of directors that is beset with conflicts of interest. TSP board members are completely independent and required by law to act solely in the interest of plan participants and beneficiaries.

The Federal Employees Retirement System Act of 1986 also protects TSP participants from poor management by authorizing the Department of Labor to conduct investigations and annual audits of TSP activities. The Employee Benefit Security Administration, or EBSA for short, within the U.S. Department of Labor conducts audits on all aspects of the TSP, including its Board and other fiduciaries. EBSA has made over 800 recommendations under its audit program, 95 percent of which the Board has adopted. EBSA programs include an audit on fiduciary compliance which tests for compliance with the 1986 Act. This year, EBSA plans to review customer service at the TSP as well as the TSP's loan program to address participants' concerns about access to the TSP website.

In addition to its strong management and oversight protections against abuses, the TSP also strives to continually improve the services it offers to participants. Last year, the TSP switched from a paper-based system with quarterly valuing of accounts to a daily automated system that provides participants with 24-hour online access to their account balances, as well as the opportunity to transfer investments between funds and submit loan applications.

Initially, the system had some web access problems due to a computer glitch. Therefore, we would like to hear from our witnesses how these problems have been addressed and the extent to which participants are now benefitting from the new system's capabilities.

This year, the TSP is considering several changes to improve and expand its services to participants. One change to the TSP's loan program is scheduled to begin on July 1 which will better allocate the costs of loan processing among the applicants to the loan program. Another initiative under consideration is the addition of one or two new funds, lifecycle and lifestyle funds, that participants may select. While the addition of these funds is still being reviewed, they would provide a more tailored investment option for

participants based on their preferred investment style—conservative, moderate, or aggressive—or on their proximity to retirement.

Today, we will hear from witnesses with a variety of oversight roles and perspectives on the TSP. They are knowledgeable about the day-to-day activities of the TSP and they possess a strong understanding of the fiduciary duties and the investment policies regarding the TSP.

I would like to welcome Senator Pryor. I appreciate your being here, and before I turn it over to Senator Pryor, I would like to note that the Subcommittee's Ranking Member, Senator Akaka, very much wanted to be here today. His schedule, however, required him to be in Hawaii this weekend. As you know, Hawaii is a long way away, so when he goes back to Hawaii for the weekend, it is hard for him to be back by Monday morning and he was not able to return to Washington in time for this hearing.

In his absence, though, I would like to thank him for the record for his valuable contributions that he and his staff made in preparing for this hearing. Of course, we will include for the record any statements or questions the Senator may wish to submit for this hearing. Senator Akaka long has had an interest in the TSP and has worked to ensure the TSP operates as efficiently as possible on behalf of Federal employees. I look forward to continuing to work with Senator Akaka on any legislative initiatives that we might pursue regarding the TSP.

With that, I would like to again welcome Senator Pryor and invite you to make some opening remarks. Thank you.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Mr. Chairman. If you would entertain a motion, I would love for the next time we have this meeting, we accommodate Senator Akaka's schedule and just hold the meeting in Hawaii. Could we do that? [Laughter.]

Is that possible? [Laughter.]

I want to thank you, Senator Fitzgerald, for your great leadership on this issue. I know that this is something that you are very concerned about and have spent a lot of time on. We truly appreciate all the work that you have done.

Considering the significant abuses in the mutual fund industry which have recently come to light and have cost people millions of dollars, it is important for us to know that the Thrift Savings Plan has a lot of integrity. It is important for Federal employees all across the country to understand that their savings are secure and that the fund is being managed appropriately. I really have no doubt about that, but I look forward to hearing from the panel today about the changes in the Thrift Savings Plan and positive things that are happening to increase the efficiency in the operations, but at the same time still maintaining sound investment options and benefit selections at very low cost.

Mr. Chairman, thank you for holding this hearing today and thank you for your leadership on this issue.

Senator FITZGERALD. Senator Pryor, thank you very much for that.

One thing I want to say before I introduce our panel of witnesses is that it is my hope that someday we can create private sector mu-

tual funds that would give every American investor the same kind of low-cost mutual fund opportunities that are now available to Federal employees. The fact of the matter is that only Federal employees can get such low-cost mutual funds. These are not available to ordinary people who are non-Federal employees.

As shown by those charts over there, a non-Federal employee is probably going to have to pay six times as much in costs over years of investing as Federal employees. And those costs may not seem like a lot, but it is estimated that one basis point in additional costs over 30 years of investment can cut someone's retirement nest egg by 35 to 40 percent.

So what it means when a Federal employee can have a mutual fund that charges them 11 basis points—in fact, that is abnormally high this year because of the costs of charging off a computer contract, it may go back down to 6 or 7 basis points in the next couple of years—a Federal employee who invests the same amount for the same number of years as a non-Federal employee who is investing in a private sector mutual fund, the Federal employee will have much more money at retirement, and I don't think that is fair. My hope would be that we could have some reforms that would promote greater disclosure and liberate free market forces so that there could be greater competition amongst private sector mutual funds.

So I would now like to proceed to introducing our panel of witnesses. Our first witness is the Hon. Andrew M. Saul, who serves as Chairman of the Federal Retirement Thrift Investment Board that administers the TSP. Mr. Saul has been general partner in Saul Partners, LLP, in New York City since 1986. He has served as Chairman of the Board for Cache, Inc., and is a trustee for the Metropolitan Museum of Art and other organizations. He is Commissioner for the Metropolitan Transportation Authority for New York City and also sits on the Board of Overseers for the Wharton School of Finance at the University of Pennsylvania.

Our second witness is Gary A. Amelio, who has served as Executive Director of the TSP since June 2003. Mr. Amelio has extensive experience in pension plan management and investments, having served as Senior Vice President and Managing Director of the Retirement and Investment Services Department of PCN Bank in Pittsburgh, Pennsylvania. In addition, Mr. Amelio has over 20 years of banking experience, specifically in the areas of employee benefits, executive compensation, tax, and fiduciary duties.

Third on our panel today is Alan Lebowitz, the Deputy Assistant Secretary for Program Operations at the Department of Labor's Employee Benefits Security Administration, or EBSA. Mr. Lebowitz has served in this capacity since 1984 and has overseen the Department's annual audit program of the TSP and its fiduciaries since the TSP's first full year of operation in 1988. Mr. Lebowitz has extensive experience with employee benefit plans and fiduciary duties, having previously served as Assistant Administrator for Fiduciary Standards at the Office of Pension and Welfare Benefit Programs at the Department of Labor.

Our fourth witness is James W. Sauber, who serves as Chairman of the Employee Thrift Advisory Council that advises the Federal Retirement Thrift Investment Board on matters pertaining to the

administration and investment of TSP funds. Mr. Sauber is Director of Research for the National Association of Letter Carriers, which is one of the 15 employee organizations identified by statute to participate in the Council. He has over 16 years of experience with the Council and has served as the Council's Chairman since September 2003.

Our fifth and final witness is Blake R. Grossman, who is Global Chief Executive and Managing Director of Barclays Global Investors. Since 1988, Barclays or its predecessor, which was Wells Fargo, I believe—Barclays bought Wells Fargo's Global Investment subsidiary?

Mr. GROSSMAN. Exactly.

Senator FITZGERALD. Since 1988, Barclays or its predecessor has won the competitive bid to manage the investments of four of the five TSP funds. Mr. Grossman has primary responsibilities for Barclays' investment strategies globally, as well as the institutional businesses based in the United States. In this capacity, he oversees the team managing TSP and its assets. And, for full disclosure purposes, I would like to state that I know personally the Chairman of Barclays Bank in London, Matthew Barrett, from the time that he was Chairman of Bank of Montreal, with which my family is affiliated. I have no authority over awarding the contract to Barclays, but I did want to disclose that. [Laughter.]

Again, I would like to thank our witnesses for being here today to testify. In the interest of time, your full statements will be included in the record and we ask that you limit your opening remarks to 5 minutes.

Mr. Saul, you may begin. Thank you.

**TESTIMONY OF ANDREW M. SAUL,¹ CHAIRMAN, FEDERAL
RETIREMENT THRIFT INVESTMENT BOARD**

Mr. SAUL. Good morning, Senator Fitzgerald and Senator Pryor. My name is Andrew Saul and I am the Chairman of the Federal Retirement Thrift Investment Board. The Board administers the Thrift Savings Plan for Federal employees and members of the uniformed services. I am accompanied today by Gary Amelio, the Board's Executive Director.

My four fellow Board members and I serve in a part-time capacity. I might also say, Senator, that Gordon Whiting, one of our other Board members, is here and sitting behind Mr. Amelio.

By statute, the Board members are responsible for policy decisions affecting the investment and management of the TSP. The Executive Director carries out our decisions and directs the plan's day-to-day operations. The five Board members and the Executive Director are fiduciaries and, as such, are required to act solely in the interest of the Thrift Savings Plan's participants and beneficiaries.

When I and two of my fellow Board members last appeared before this Subcommittee in November 2002 at our confirmation hearing, then-Chairman Akaka graciously yet firmly made us aware of the difficult situation that we faced in assuming our new

¹The prepared statement of Mr. Saul appears in the Appendix on page 33.

roles as Board members. This warning proved to be an understatement as we entered an embattled agency.

The outgoing Executive Director took a number of actions just before his abrupt departure that demoralized the staff, many of whom had built the program from the beginning. Expensive lawsuits and investigations were sprouting up. Rancorous battles were underway with other agencies. The costs of the failed record-keeping system project had not been charged to participants. And decisions had to be made immediately on whether to go forward with the new recordkeeping system project at all.

I and my fellow Board members entered this environment, and working with the seasoned career staff, methodically sorted through these matters, keeping the new system and other projects on track and moving forward as we restored essential relationships.

Our first order of business was to address the agency leadership issue. We conducted an open and orderly nationwide search for an Executive Director that resulted in the selection of Gary Amelio, a private sector pension and investment expert. The Board was confident that Mr. Amelio's 22 years of private sector experience would result in the betterment of the Thrift Plan for the participants and we have not been disappointed.

He immediately dealt with the implementation of the new recordkeeping system, settled the lawsuits to the benefit of the plan participants, and working with the Board members, reestablished professional, respectful relationships with other agencies without diminishing independent fiduciary leadership.

Mr. Amelio has proven his leadership of the agency's career staff, established productive cooperation with the various employing agencies of government, and developed an outstanding rapport with the unions and associations that comprise the Employee Thrift Advisory Council. As a result of his efforts, Mr. Amelio has received favorable recognition for the plan in the pension industry and has already received two national awards in recognition of his performance. This achievement signals the turnabout originally sought by this Subcommittee.

When the TSP was first conceived in the early 1980s by Senator Ted Stevens, it was designed to be an efficient, low-cost vehicle securing retirements for a large and diverse group of Federal employees. Congress established the TSP using a diversified, passively managed index fund approach with a reasonable limit on the number of investment choices.

The Board has developed investment policies and adopted sound administrative practices in furtherance of these Congressional goals. The results have been what we believe Senator Stevens and his colleagues intended when they undertook the reform of the Federal retirement system 20 years ago.

Over the years, Congress has carefully considered proposals to change the TSP, adopting improvements and extending coverage as appropriate to new employee groups. At the same time, it has set aside seemingly well-intentioned proposals that would have moved the TSP away from its fundamental strategy. This restraint has preserved the basic commitment to investment choices which are

well managed, inexpensive, and appropriate for a long-term investment strategy.

In view of Chairman Fitzgerald's recent efforts to emphasize the value to investors of low administrative costs, we are pleased that the Thrift Savings Plan offers participants a diversified selection of investment options and a competitive array of plan benefits at an extremely low cost. In 2002, total participant expenses were 10 basis points. An additional one basis point of expense was offset with forfeitures. Two-thousand-and-three charges were unusually high because we had to charge 3 basis points to account for the expense associated with the earlier failed recordkeeping project. For 2005, we project that the cost to participants could be as low as 6 basis points.

Legislative improvements to augment benefits, simplify plan administration, and provide new investment funds, have been beneficial for participants. An example is the extension of plan participation to members of the uniformed services 2 years ago. In only 2 years, nearly 400,000 members have become voluntarily contributing to the plan to supplement their retirement benefits. We are proud to have the opportunity to make this program available to them.

I would like to bring one potential legislative improvement to the attention of the Subcommittee today and that is the elimination of TSP open seasons. The Board supports eliminating open seasons because it would expand participant access to the TSP and simplify Plan administration. We also believe it would increase participation and contribution levels.

Open seasons were useful when the Plan was conceived because they provided a structure for initial implementation. They are no longer useful in a daily value plan environment. Indeed, they restrict the opportunity for employees to make contribution elections, and more damaging, delay eligibility for automatic 1 percent in matching contributions to newly-hired employees.

The Board has previously supported legislative proposals, including one introduced by Senators Akaka and Warner on December 13, 2001, that would have overcome the latter barrier by providing these benefits as soon as new employees join the TSP. We would support similar legislation again.

We are also reviewing a second potential legislative issue, a change in the current fiduciary insurance provision in our statute. Currently, the agency must purchase such insurance. Self-insurance, however, is not allowed. We are in the process of examining whether it makes better economic sense for the Plan to cover its own risks rather than to pay premiums to private insurers. The staff analysis is expected to be completed this summer. Depending on the findings, the Board may subsequently seek legislative authority allowing us the option to either purchase insurance or self-insure as the fiduciaries would determine.

In this first 9 months as executive director, Mr. Amelio has dealt decisively with the major challenges facing the TSP. He has initiated necessary changes to the TSP loan program and is preparing a proposal to provide new investment allocation strategies based upon the existing Plan fund options. Mr. Amelio will also be initi-

ating a major revision of our communication materials with an emphasis on participant education.

With your permission, I would like to introduce Gary Amelio to the Subcommittee for his remarks.

Senator FITZGERALD. Mr. Amelio.

**TESTIMONY OF GARY A. AMELIO,¹ EXECUTIVE DIRECTOR,
FEDERAL RETIREMENT THRIFT INVESTMENT BOARD**

Mr. AMELIO. Good morning, Chairman Fitzgerald and Senator Pryor. My name is Gary Amelio and I have served as Executive Director of the Federal Retirement Thrift Investment Board since June 2003. I came to the agency with 22 years of banking, pension, and investment experience. I am pleased to appear today to discuss the challenges the agency has addressed over the past 9 months and to outline our future agenda. The challenges that face the TSP today offer opportunities to improve service for the plan's participants tomorrow.

First, however, I would like to compliment this Subcommittee and its predecessors on the design of the TSP. Since arriving, I have told everyone who will listen that this plan has an excellent combination of investment options, benefit selections, and low costs. Any retirement professional would reference the TSP as the optimum retirement plan. That reflects positively on the vision of its Congressional designers as well as the fortitude of those who have kept it true to its original principles over the past 18 years.

With 3.2 million participants and \$130 billion in assets, the TSP is the largest plan of its kind in the world. The participation rate is very high, the contribution levels well above average, and support among participants for the program is strong. Our roll-out of the state-of-the-art recordkeeping system last year ensures that we will be able to continue the efficient delivery of investment products and benefits to participants well into the future.

Although a variety of new features were introduced with the new system, improvement is still needed. For example, the roll-out of the new system last year, we experienced difficulty in promptly servicing the increased volume of participant calls to the service center. A request for proposals for a parallel call center to ensure uninterrupted service and improved overflow capacity has been issued. A selection is expected soon and the new call center will be operating later this year.

Based upon well-documented industry standards, I am concerned about the excessive use of the TSP loan program. At the end of 2003, the plan held over 934,000 loans. Almost 40 percent of these were issued in the last year. During implementation of the new system, a loan churning problem was uncovered. The administrative burden and cost to the plan and the inconvenience to the participants is significant. Three reforms that will reinforce to participants the importance of borrowing from their TSP accounts only as a last resort were recently announced and will be implemented in July. The changes make the system fairer for all participants and consistent with private sector loan practices.

¹The prepared statement of Mr. Amelio appears in the Appendix on page 37.

An important issue that required immediate attention when I arrived was the pending litigation between the agency and a contractor in an earlier failed effort to build a recordkeeping system. It was my decision to settle the lawsuits and to accept \$5 million, which was paid back into the accounts of TSP participants. A total of \$41 million had been spent on the unsuccessful project and the ultimate cost to each participant was 36 cents per \$1,000 of account balance. The settlement allowed us to move forward and refocus on providing investments and benefits for our participants.

Mutual fund trading and 401(k) plans has been a high profile subject recently and I am sure there are questions about the TSP's experience since it has become daily valued. The staff has reviewed participant trading practices and discovered no issues of concern. Indeed, only 146 participants, that is 0.0046 of 1 percent, have traded more frequently than twice a week. Interestingly, some of these traders held fewer shares at the end of the trading period. In other words, they lost money. The agency staff is currently reviewing guidelines just released by the Department of Labor which describe appropriate fiduciary actions in addressing such practices and will develop a recommendation for handling such accounts.

In regard to product enhancement, the agency staff is preparing a recommendation for the Board members that the TSP offer lifestyle or lifecycle investment options for TSP participants. The lifestyle approach is designed to reflect an investor's investment profile, for example, aggressive, moderate, or conservative. The lifecycle approach permits an investor to select the date upon which he or she would start withdrawing assets from the account, such as at retirement. In either case, the new life options would be invested solely in combinations of the five existing TSP investment funds using different allocations depending upon the investment objective.

Life investment options are professional asset allocation and rebalancing tools for participants who may not have the time or knowledge to manage account assets on their own. Professional research indicates that 80 to 90 percent of defined contribution plan participants fall into this category, as evidenced by their failure to rebalance their accounts. Indeed, the average age of a TSP FERS participant is 43.8 years and this group has 47 percent of its assets invested in stable value and fixed funds. By definition, this group has at least 20 years until retirement and will likely need portfolio diversification to achieve their retirement goals.

Agency research to date indicates that a life product is very inexpensive to implement. There is no doubt that the participants who embrace life professional asset allocation and rebalancing models will enhance the retirement values of their accounts over time.

Later this month, I expect to present to the Board and the Employee Thrift Advisory Council the result of months of research, including interviews with numerous investment providers who responded to our request for information on life options and our recommendation for this new investment product. My goal is to obtain insight from the Council and policy decisions from the Board that will allow us to have this option ready for implementation next year.

In the meantime, we are moving forward to substantially upgrade our web, print, and video communication materials. This is, of course, a long-term project. The Board members and I view the enhancement of communication materials as a priority. I am also aware that the Members of the Subcommittee have expressed concerns in this regard. A participant satisfaction and input survey will be part of the communication upgrade process, although such initiative is just now in the formative stage.

Other enhancements will be reviewed in the coming year as we, in Mr. Saul's words, take what has been an excellent plan to the next level. We will be pleased to take your questions. Thank you.
 Senator FITZGERALD. Mr. Lebowitz.

TESTIMONY OF ALAN D. LEBOWITZ,¹ DEPUTY ASSISTANT SECRETARY FOR PROGRAM OPERATIONS, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. LEBOWITZ. Good morning, Mr. Chairman and Senator Pryor. I appreciate the opportunity to appear before you today to address the Labor Department's activities with respect to the Federal Employee Retirement System and its Thrift Savings Plan. My name is Alan Lebowitz. I am the Deputy Assistant Secretary for Program Operations of the Employee Benefits Security Administration. Accompanying me and sitting immediately behind me is Ian Dingwall, our Chief Accountant.

EBSA oversees approximately 730,000 private sector pension plans and millions of private sector health and welfare plans that are subject to the Employee Retirement Income Security Act of 1974, known as ERISA. EBSA-covered pension plans hold over \$4 trillion in assets and cover more than 45 million workers.

Title I of ERISA establishes rigorous standards of fiduciary conduct for persons who are responsible for the administration and management of pension and other benefit plans, including the requirement to act solely in the interests of participants and beneficiaries, to act prudently, and to avoid transactions defined in the statute as prohibited. Under ERISA, fiduciaries are personally liable for losses resulting from their breach of these standards.

The Federal Employees Retirement System Act of 1986 charges the Department with administering and enforcing substantially similar provisions of law governing fiduciary conduct for the TSP.

As with private plans under ERISA, under FERS, the Secretary of Labor has broad investigative and auditing authority concerning the activities of the FERS Board and its Executive Director in the administration of the TSP. However, in contrast to ERISA, in 1988, Congress amended FERS to specifically exclude lawsuits by the Secretary against Board members or the Executive Director. While other fund fiduciaries and participants may still sue the Board and the Executive Director, the 1988 amendments do not permit any monetary recovery against these individuals. The Department and others may still bring actions for recovery of losses against other TSP fiduciaries, such as investment managers.

FERS specifically directs the Secretary of Labor to establish a program to carry out audits to determine the level of compliance

¹The prepared statement of Mr. Lebowitz appears in the Appendix on page 40.

with the Act's fiduciary standards and prohibitions on certain types of transactions. The statute specifies that the Secretary may contract with a qualified non-government organization. Currently, KPMG LLP conducts the audits under the supervision of EBSA's Chief Accountant.

To guide the auditors, the Department has developed a strategic fiduciary oversight program that uses detailed guides to test for compliance. Audits must cover all significant activities of the fund as well as the controls in place at the TSP investment manager, Barclays Global Investors, that ensure the accuracy of financial information, compliance with FERS, and operational efficiency and management effectiveness. The BGI management fee is reviewed for consistency with fees charged by other similar institutions in conformance with contractual agreements.

At the conclusion of each audit, the Department issues a report for formal response by the Executive Director on behalf of the Board. The Department's representative and auditor meet with the Board at least once a year to highlight significant issues from the audit, to present the Department's future audit schedule, and to answer Board members' questions.

The Department's audit recommendations range from compliance with FERS to economy and efficiency issues that may provide cost savings opportunities for the TSP. Most significantly, the Department communicated many recommendations over several years addressing TSP system and software control weaknesses which influenced the TSP Board's decision to replace the TSP recordkeeping system in June 2003.

Since the inception of the audit program, the Department has made more than 800 recommendations, 95 percent of which have been accepted. The remaining recommendations chiefly address controls for the TSP new recordkeeping system.

Certain abusive practices within the mutual fund industry, namely market timing and late trading, which have recently come to light, have raised concerns and prompted the Department to take certain steps. The Department recently performed a limited review of BGI's collective trust funds in which the TSP has equity investments to determine whether further investigation is warranted. Based upon this preliminary review, we do not believe that TSP participants are adversely exposed to costs and investment risks due to late trading and market timing.

The Department also recently announced that it is conducting reviews of mutual funds, similar pooled investment funds, and service providers to such funds to determine whether there have been any violations of ERISA. The results of these reviews will be used to later determine if any FERS issues require further investigation.

We are working very cooperatively with Chairman Saul and Executive Director Amelio and the members of the Board. We anticipate continuing a free and candid exchange of views that should benefit the TSP participants and beneficiaries and help us to fulfill our oversight responsibility.

This concludes my prepared remarks. Thank you for the opportunity to testify before you today regarding this important matter. We look forward to working with the Members of the Sub-

committee and the Thrift Savings Plan fiduciaries in this endeavor, and I will be happy to answer any questions you may have.

Senator FITZGERALD. Thank you, Mr. Lebowitz. Mr. Sauber.

**TESTIMONY OF JAMES M. SAUBER,¹ CHAIRMAN, THRIFT
ADVISORY COUNCIL**

Mr. SAUBER. Good morning, Chairman Fitzgerald and good morning, Senator Pryor. My name is James Sauber. Thank you for the invitation to participate in this hearing.

The Employee Thrift Advisory Council is a 15-member body established by the Federal Employees Retirement System Act of 1986 to advise the Thrift Investment Board on matters related to the TSP. The 15 members are nominated by organizations identified in the FERSA statute. These organizations represent Federal and postal employees, both active and retired, at all levels of the U.S. Government, from wage earners to senior executives. I was nominated to serve on the Council by my employer, the National Association of Letter Carriers, and was elected to serve as Chairman of the Council last fall.

As you know, the TSP is a very important and popular part of the Federal pension system. It has remained popular despite the poor performance of the stock market in recent years. The TSP's continued popularity reflects the wisdom of its designers from this Committee and on the good judgment of the Federal workforce, who have continued to invest and save for the long run in order to enjoy a more secure retirement.

The TSP is also popular because of the solid performance of the Thrift Investment Board over the years and because Congress has continued to give it strong backing. In practical terms, that means the Thrift Board has provided TSP participants good service while keeping expense ratios very low, and Congress has protected the TSP by insulating it from budgetary and political pressures. We are confident that these positive aspects of the Plan will be maintained.

ETAC has a constructive relationship with the Board. Lines of communication are wide open and the trust built up over many years has allowed us to work well together. That trust and communication has also helped us overcome difficulties that have occasionally arisen.

A recent example of such difficulties was the delayed launch of the new recordkeeping system last year. I can assure you that none of the organizations that make up ETAC were happy about the ill-fated contract with AMS to upgrade the recordkeeping system or the cost it imposed on TSP participants. At our first meeting last fall, we were given a comprehensive briefing on the Board's decision to reach a settlement to end the litigation with AMS and Executive Director Amelio answered all our questions.

In the context of the Board's long record of success, most ETAC members agree that the episode with the recordkeeping system should be finally seen as an aberration. We are pleased that the Board has finally successfully implemented the new system. Chairman

¹The prepared statement of Mr. Sauber appears in the Appendix on page 46.

Saul and Executive Director Amelio deserve great credit for managing the agency through a difficult period.

At the most recent ETAC meeting, we also covered two other important issues, possible changes to the TSP loan program and the Board's investigation of so-called lifecycle and lifestyle investment options. In general, there is a consensus among ETAC members that many TSP participants are making excessive use of the TSP loan program. Instead of using it as a last resort, some employees are using it as a short-term money management tool at the expense of their long-term financial interests.

Most of us agree that charging a nominal fee for the loans makes sense as a way to discourage excessive use of the loans and to more fairly allocate their administrative costs. However, not all organizations that make up ETAC favor the restrictions on second TSP loans. We look forward to discussing the proposed changes at our next ETAC meeting later this month.

There is also broad interest in the lifecycle investment options that the Board is investigating. Too many Federal employees fail to rebalance their investments as they age. A lifecycle fund that allowed the gradual reallocation of investments among the five TSP funds could be very useful. Although ETAC members are concerned about the added cost of offering a lifecycle fund, we look forward to reviewing the Board's research on the issue at our next meeting.

Finally, I would like to comment on two TSP-related legislative matters. First, ETAC fully supports the Board proposal to eliminate TSP open seasons, a concept that draws heavily on a bill sponsored by, or proposed by Senator Akaka in the 107th Congress. Open seasons made sense when the Thrift Board was a new agency with limited administrative capabilities. Today, with the new recordkeeping system and its capacity to value accounts daily and to implement investment allocations instantaneously, open seasons are no longer necessary. Eliminating them will save money and make participation in the TSP more flexible and attractive to all employees.

Second, the six ETAC members from Postal employee organizations wish to alert the Subcommittee to a proposal made by the President's Commission on the U.S. Postal Service that could adversely affect the TSP. The Commission recommended that Congress consider removing Postal employees from various pension, health insurance, and other benefit programs that currently cover all Federal employees. Among such programs are FERS and the TSP. All six organizations representing letter carriers, Postal workers, postmasters, and supervisors, strongly oppose this idea.

In the case of the TSP, removing 800,000 employees from the plan would raise the cost of retirement investing for Postal employees and Federal employees alike and unfairly deny Postal employees access to this excellent program. We urge the Subcommittee to oppose any proposal to exclude Postal employees from the TSP.

That concludes my oral testimony. I have submitted my full statement for the record. Thanks again for the opportunity to testify and I will be happy to answer your questions.

Senator FITZGERALD. Mr. Sauber, thank you very much. Mr. Grossman.

TESTIMONY OF BLAKE R. GROSSMAN,¹ GLOBAL CO-CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR, BARCLAYS GLOBAL INVESTORS

Mr. GROSSMAN. Thank you. Good morning, Chairman Fitzgerald and Senator Pryor. My name is Blake Grossman. I am the Co-Chief Executive Officer at Barclays Global Investors. Thank you for inviting me to discuss Barclays Global Investors in its role as the external asset manager for the Federal Thrift Savings Plan.

We appreciate the concerns of this Subcommittee in safeguarding the interests of all investors, including Federal employees, particularly in light of certain practices in the mutual fund industry that have recently come under close scrutiny. We are honored to have served as the investment manager for the TSP since 1988 and we take our responsibilities for the management of the retirement assets of the Federal workforce very seriously. We take great pride throughout BGI in maintaining the highest ethical and fiduciary standards and you have our commitment that no compromises to these standards are acceptable.

To understand why Federal employees should feel confident that BGI is managing their retirement assets responsibly, it is important to say a word about who we are, the service we provide for the TSP, and how we keep the costs associated with trading and investing as low as possible.

BGI was founded in 1971 as part of Wells Fargo Bank in California. Today, we are owned by Barclays PLC, one of the world's leading financial services providers. We remain headquartered in San Francisco with approximately 1,100 employees in California and elsewhere in the United States, and 1,000 more employees worldwide serving the needs of our global clients.

With more than \$1 trillion in assets under management, BGI is the world's largest index manager and, in fact, created the first index strategy in 1971, just one of many financial innovations that we have pioneered. Since our founding, BGI has been focused on a single global investment philosophy which we call total performance management. In brief, our objective is to deliver superior investment results by efficiently capturing the returns of market indexes while rigorously controlling all risks and minimizing trading and other implementation costs. This simple yet profound approach is rather unique in the industry. It helps us avoid investment fads or dependence on star managers or stock pickers. It has been the foundation of the way that we manage money for over 30 years and we believe it has served our clients very well.

As I noted, since 1988, one of those clients has been the TSP. BGI manages four of the five investment options, each an index fund that tracks a widely followed stock or fixed income benchmark available to TSP participants. It is important to note that we have successfully retained this relationship in regular highly competitive bidding processes. Also worthy of note is the fact that BGI's services to the TSP are completely focused on investment management. We don't provide any other services.

Mr. Chairman, as you know, the costs and expenses of investing to track from investment performance, and therefore from ultimate

¹The prepared statement of Mr. Grossman appears in the Appendix on page 51.

retirement benefits. There are three primary sources of cost and expense: The administrative cost, transaction costs, and investment management fees.

The majority of BGI's clients are large institutional investors, such as the TSP, and the average account size for our clients in the United States, in fact, is \$880 million. Because of our size and the ability to commingle the assets of our clients, we offer considerable economies of scale for our investors and, therefore, we are able to charge lower investment and administrative fees to these clients. Sophisticated trading strategies and large trading volume also enable us to minimize transaction costs in all of our investment activities, a key to both our long-term success in index management and the ability to keep the costs for the TSP at the very low expense levels that have been previously cited.

I also want to emphasize that our focus on transaction is completely on obtaining best execution. We don't use soft dollars or directed brokerage or anything else in connection with the TSP assets that would conflict with getting best execution.

Before concluding, allow me to comment on certain practices in the mutual fund industry that have recently come under scrutiny. We recently conducted a thorough review at BGI of these issues, including late trading, market timing, and personal trading by BGI personnel. I am pleased to report that we have found no issues at BGI of significant concern or any practices that compromise our fiduciary responsibilities to the TSP or any of our other clients.

Mr. Chairman, as a citizen, I appreciate the service that Federal employees provide for this country and every Federal employee should feel confident that we at BGI are managing his or her TSP retirement assets in a responsible fashion. We appreciate the trust that has been placed in BGI in this regard. We look forward to maintaining an open dialogue with the TSP and Members of this Subcommittee on these key issues in the future.

Thank you very much for the opportunity here today to share our views.

Senator FITZGERALD. Mr. Grossman, thank you very much and thank you for being here.

I would like to start with Mr. Amelio, and ask about the 11 basis points in expenses that the TSP C Fund had last year. Several of your other funds also seem to come in around 11 basis points in gross expenses, and the expense ratio tended to go down to 10 basis points after you netted out some forfeitures of people who start as Federal employees, start paying in, and then leave. Their money is forfeited and that goes back into the fund.

I know your management fee is confidential. It was the subject of competitive bidding, but Barclays has filed to keep that confidential under the FOIA so we won't go beyond where we can go, but I would like you to describe in general terms what is the breakdown of that 11 basis points in total expenses? How much, for instance, is administrative cost?

Mr. AMELIO. I would say roughly—and this is very much of a ballpark based upon the overall expenses—the budget that goes in is about \$110 million and virtually all of that, probably up over 90 percent, I would say, is administrative cost, which is far the re-

verse that you would find in the private sector where management fees are a lot higher than administrative costs.

Senator FITZGERALD. OK. So talking about the 11 basis points in expenses in dollars and cents terms, over the five funds, the costs in dollars and cents terms are about \$110 million, is that right?

Mr. AMELIO. That is the total cost charged to the plan, yes, sir.

Senator FITZGERALD. OK, and that works out to around 11 basis points of the total fund assets?

Mr. AMELIO. I am giving you a general number. The 11 basis points is an anomaly number. The 11 basis points includes that settlement, which is a one-time charge. Normally, we are talking about a little over 7 basis points is truly the cost to the participants.

Senator FITZGERALD. OK, so about 3 basis points last year, roughly, was for that anomalous charge for charging off that ill-fated computer contract, and this Subcommittee, by the way, is going to have a full Committee hearing on that issue probably sometime later this year, so we are not going to go deeply into that ill-fated computer contract at this hearing. But roughly last year, how much in dollars and cents was charged for the computer contract last year?

Mr. AMELIO. Forty-one million was the lawsuit. You have to net that against the \$5 million we recovered back, so about \$36 million.

Senator FITZGERALD. About \$36 million?

Mr. AMELIO. Yes, Senator.

Senator FITZGERALD. So you had \$110 million in total expenses. If we take out \$36 million for the computer contract, then let us describe your remaining expenses. I want to say that your administrative expenses approximate about \$54 million a year?

Mr. AMELIO. That is at the NFC, yes. There are other administrative costs. I have the fact sheet in front of me. About 3 percent of the entire number are administrative expenses. Everything else is a variety. The National Finance Center in New Orleans represents roughly 44 percent of overall expenses. The AMS write-off was 30 percent. Other various IT contracts and what not were about 9 percent. The Board here in Washington is about 8 percent of expenses. Investments are 3 percent. Printing for employee participant communications is 3 percent. Rent is 2 percent, and everything else is 3 percent.

Senator FITZGERALD. Printing is how much?

Mr. AMELIO. About three percent.

Senator FITZGERALD. OK. Now 44 percent is the National Finance Center. That is the backroom operation in Louisiana, I believe?

Mr. AMELIO. Yes.

Senator FITZGERALD. It has 433 Agriculture Department employees—

Mr. AMELIO. Yes.

Senator FITZGERALD [continuing]. That are providing the backroom services to run the day-to-day operations of the TSP. Has the Board ever competitively bid out the administrative services? How did we come to have the Agriculture Department doing this?

Mr. AMELIO. The National Finance Center, which is, I guess for the lack of a better term, a subsidiary of the Department of Agri-

culture, actually stepped in at the plan's creation back in the mid-to late-1980s, around 1986. It was always intended, and I am basically reading from the historical transcripts, that these services would be competitively bid out over time. There have been certain times when the services have been looked at up until very recently when we put out a request for proposal last year on the parallel call center. But there is certainly a history that it was understood that these services would be looked at to be competitively bid.

Senator FITZGERALD. But they have never been competitively bid.

Mr. AMELIO. That is correct.

Senator FITZGERALD. Does the statute not require you to competitively bid out your services?

Mr. AMELIO. The statute requires that we operate the plan at the lowest possible cost that we are able to.

Senator FITZGERALD. How do we know we are operating at the lowest possible cost with respect to administrative services if we haven't competitively bid those out?

Mr. AMELIO. That is a very good question, Senator. That is one reason why we have taken the first step in looking at the parallel call center. We will be able to judge the existing cost versus what the parallel call center costs.

Senator FITZGERALD. You are new. You just came in last year—

Mr. AMELIO. Yes.

Senator FITZGERALD [continuing]. And that is one of the things you identified that you wanted to work on.

Mr. SAUL. If I might just add something, I have been here actually over a year now and one of the things you have to realize, we could not really competitively bid out the work done by the National Finance Center prior to now because the old system wasn't properly documented. With the new system that we have installed in July that you have heard about, the automatic daily record-keeping system, it is much more transportable. It is transportable. The old system was a hodgepodge put together, as you can understand, from its inception and really was not—there was no ability to even have another vendor operate the system. So it wasn't even a question of whether you should have, could have, would have. It was not a system that could have been done.

And what we have done since we have come there, we have slowly—we have, as you heard in both of our testimonies, we had an awful lot of priorities that in the opinion of the Board were much more painstaking and had to be accomplished right away. We took things in order of priority.

As you see now, we have gone forward with taking some of the functions at the NFC and putting them out. We now have a parallel call center, as Gary Amelio has described. We are now in the process of bidding out a mainframe operation, which is the actual mainframe computer operation, to a third party, and we are also now having our software of our new system done by a third party vendor.

So the beginning phases are there of starting to competitively bid out the work that was done by the National Finance Center. But I think this is a very complex thing. We have just gone through a new system introduction and we have to be very careful that we

don't do anything at all to destabilize the system, as you can well appreciate, Senator. While costs are very important, and I don't mean to minimize costs at all, I think it is a question of priorities and I think we have taken the first steps, which were well thought out, and we will see how these steps work and then we will go from there.

Senator FITZGERALD. Just for the record, you all agree that this is the big expense. We had \$110 million in expenses last year. About 30 percent of that was for charging off that one-time hit for the computer contract, but we are talking something like \$54 million in administrative expenses, or 44 percent of the expenses of the funds are for administrative functions.

By comparison, you said only 3 percent of the expenses are the actual investment that Mr. Grossman's company is doing, and that is competitively bid out. The investment operations have been competitively bid out, but we haven't bid out the administrative back-room operations. Instead, we have the USDA National Finance Center in Louisiana doing it and that is the lion's share of the expenses for the fund.

Have you gotten any requests for proposals back yet? You said you put out an RFP?

Mr. AMELIO. Actually, we have completed the RFP process, received them, reviewed, them, and the recommendation is in the final stages. We will be prepared very shortly to sign a contract with one of the vendors and have the parallel call center up and running hopefully within a few months.

In addition to the parallel call center, Senator—

Senator FITZGERALD. This is just for the call center, though?

Mr. AMELIO. Yes, the parallel call center.

Senator FITZGERALD. OK.

Mr. AMELIO. There are two other pieces that were recently discussed and voted on at the last Board meeting, as well, and one is we will be moving the mainframe computer, and a separate function is the software support of that mainframe and we will also be moving those.

Senator FITZGERALD. How much will be left in the National Finance Center then?

Mr. AMELIO. A significant amount. Well, all of the jobs, but a significant portion—

Senator FITZGERALD. What will they be doing?

Mr. AMELIO. Still a significant portion of the call center as well as what we call data input. When the forms come in, they get processed into the system. All of the mailing of the statements, check processing, things of that nature.

Senator FITZGERALD. OK.

Mr. AMELIO. And the accounting.

Senator FITZGERALD. So you are a long way from—couldn't you bundle everything that the National Finance Center is doing and bid out that, or are there not firms out there that would do the full range of services?

Mr. AMELIO. We are not there yet. I don't know if there is any vendor out there that would be big enough that would be able to absorb everything. We haven't got that far down the pike yet.

Senator FITZGERALD. OK. Mr. Lebowitz, has the Department of Labor ever looked at the various services of the TSP and questioned whether the TSP Board was getting the lowest cost services?

Mr. LEBOWITZ. Many of the questions you asked were questions that we have asked over the years in the course of our audit program. My understanding is that the Board in the past had done a couple of feasibility studies as to the appropriateness, or in statutory terms, prudence of continuing the relationship with the National Finance Center.

But as Chairman Saul and Mr. Amelio have both said, it was not terribly feasible to consider moving outside of the National Finance Center when the underlying software was not portable. It was, as described, a hodgepodge of systems tied together. Documentation for that system was lacking in a number of respects, as our auditors pointed out many times over the years.

Now that the new system is completed and up and running, a whole range of options present themselves to the Board that, as a practical matter, were not available before.

Senator FITZGERALD. Now, here in Washington, we have 100 employees who are doing the management of the Government Bond Fund, in which we have the non-marketable government securities that are not traded publicly, but which the TSP Government Bond Fund—what fund is that, Mr. Amelio?

Mr. AMELIO. You are referring to the G Fund, which we refer to as the Stable Value Fund.

Senator FITZGERALD. The Stable Value Fund.

Mr. AMELIO. Yes.

Senator FITZGERALD. That is invested in government bonds—

Mr. AMELIO. Yes.

Senator FITZGERALD [continuing]. But non-marketable government bonds, is that not correct?

Mr. AMELIO. That is correct.

Senator FITZGERALD. And for those assets, the administrative work and the investment work, or just the investment work for that, is done here in Washington?

Mr. AMELIO. The Board's staff in Washington does handle the—I don't want to call it an investment piece because we are not actively managing, but they handle all of the work with respect to the G Fund, which is administrative processing, the movement of money back and forth, the accounting of it. In addition, we have a legal staff, a benefits policy staff, product development—

Senator FITZGERALD. Do you need 100 people to do that?

Mr. AMELIO. Well, no. I was just going through each of the offices. We do a lot of things other than just the G Fund, as well.

Senator FITZGERALD. How many people are dedicated to just the G Fund?

Mr. AMELIO. It would probably—I don't know, maybe a dozen.

Senator FITZGERALD. OK. So that is only a small portion of the 100 people that you mentioned.

Mr. AMELIO. Yes.

Senator FITZGERALD. OK. Now, Mr. Saul, in your written testimony you discussed, and in your oral testimony you discussed, two possible legislative changes regarding the TSP. One was that you would like the legislative authority for the TSP to self-insure, and

it is your impression that the current statute does not grant the TSP the authority to self-insure, is that correct?

Mr. SAUL. That is correct, Senator. The general counsel of our agency has issued a legal opinion that we do not have the ability to self-insure under the existing statutes as she reads them. We are not even 100 percent sure at this point, as I said in my testimony. We need to do some more research on this.

What has happened is because of the costs, as you are aware, of D&O insurance skyrocketing because of all the abuse that has been out there in the corporate sector, our rates for our insurance have skyrocketed and we are paying—

Senator FITZGERALD. Do you know how much you are paying?

Mr. SAUL. Yes. I was just going to say, we are paying—last year, I think it was approximately \$400,000 for \$5 million worth of liability insurance, and this insurance, by the way, does not cover the Board or the Executive Director because that is, as I think you said in your opening statement, it is statutory. We cannot be sued under the Federal statutes. What this policy does is provide insurance for the other employees of the agency.

The Board was very upset that we were paying \$400,000 or \$500,000. As a matter of fact, the year before, we were paying \$500,000 for this kind of coverage and, therefore, it became an issue as to whether we could use this \$5 million pool that we have that is actually paid—filled in by the other—

Senator FITZGERALD. Did your insurer suggest any steps that you could take to lower your—

Mr. SAUL. There is none. As a matter of fact, it was very difficult even to get some carrier to bid on this thing. We had quite a bit of problems when the RFP went out. There were very few insurance firms that even wanted to participate in this endeavor, so—

Senator FITZGERALD. You suggest it sounds very high risk—

Mr. SAUL. Well, it is—

Senator FITZGERALD [continuing]. And I wouldn't think it would be.

Mr. SAUL. Frankly, I don't think it is so high risk, but the industry assumes that it is high risk because of what has happened in the corporate sector. But at any rate, we are paying a lot of money for very little coverage at this point, Senator.

Senator FITZGERALD. Mr. Sauber, has your council looked into this issue?

Mr. SAUBER. No. This is a subject that has arisen only recently—the first time we discussed it was at our last meeting and I am sure we will continue to discuss it.

I would like to, if I could, just comment on an earlier subject, when you mentioned the National Finance Center. I think it, and this is just coming from my life representing workers, that it deserves to be said that the National Finance Center has served the Thrift Savings Plan quite well. One of the reasons the TSP's expense ratios are so low is that the Finance Center has done a very good job.

So I think it is worth stating that and I think a number of the organizations in the Thrift Savings Plan that represent public employees would be very concerned about decisions to contract out NFC work if it led to the creation of jobs that didn't have health

insurance, pensions and that sort of thing. So I think as a body, our ETAC Council would be concerned about any decision to look at outside vendors and would want these issues to be given a fair hearing.

Senator FITZGERALD. Even if it is lower cost and it would benefit the postal workers that you represent by lowering the cost?

Mr. SAUBER. We certainly are interested in having the lowest cost plan possible, but we also care that decent jobs be available to our members, as well. So I think there is an issue of balance for us. We are, of course, interested in the lowest possible cost and I think we have gotten a really good deal from the National Finance Center over the years.

Senator FITZGERALD. What about the printing costs? That was, did you say, 2 or 3 percent of the overall cost too, Mr. Amelio?

Mr. AMELIO. I did, Senator. That is right.

Senator FITZGERALD. And who does the printing for the TSP?

Mr. AMELIO. We have an outside service. UNICOR, the Federal Prison Industries does the printing.

Senator FITZGERALD. The Federal Prison Industries, OK. Is that competitively bid?

Mr. AMELIO. Not in the past.

Senator FITZGERALD. It hasn't been in the past?

Mr. AMELIO. I am advised that we were not able to in the past. Apparently, there was a rule that Federal agencies had to utilize this particular agency for their printing services in the past.

Senator FITZGERALD. So that could be contradictory to the statutory requirement that you use the lowest cost.

Mr. AMELIO. I would—I believe so.

Senator FITZGERALD. You might want to look at all these things in preparing legislative recommendations, such as with respect to self-insurance. You might want to catalog some of these discrepancies because I would like to help you keep this as low cost as possible.

Mr. Grossman, with respect to Barclays, you apparently commingle the TSP funds with the funds of hundreds, presumably, of other plan managers that you bring together. You have over \$1 trillion invested, or you manage and you have presumably hundreds of 401(k) plans and other types of plans with an average size of \$800 million, correct?

Mr. GROSSMAN. That is correct, yes. The TSP assets are commingled with other qualified investors in our collective funds, and qualified investors being primarily defined benefit and defined contribution plans, also foundations and endowments. However, it is important to note that the funds in which the TSP has invested are not open to hedge funds or individual investors. Individual investors can only invest, let us say, in a defined contribution plan in these funds.

Senator FITZGERALD. OK. So you have both defined contribution and defined benefit plans participating in your index funds, and you commingle all of those monies together.

Mr. GROSSMAN. That is correct.

Senator FITZGERALD. OK. And that allows you to achieve a lot of these economies that you are talking about?

Mr. GROSSMAN. Yes. And we have a series of different funds depending on the particular characteristics. So in the funds that we are managing for TSP, I could tell you that in terms of the assets, they are predominately defined benefit plans as opposed to defined contribution, but there are some defined contribution plans in there, as well.

Senator FITZGERALD. OK. And this all began as Wells Fargo years ago, you said 1971. Was it Wells Fargo that came up with what is now Barclays Global Investors?

Mr. GROSSMAN. That is right. It was operating at that time as a division of Wells Fargo Bank called Wells Fargo Investment Advisors that was the pioneer in developing index strategies, particularly for institutional clients in the United States.

Senator FITZGERALD. It sounds like you invented indexing before Vanguard, which claims to have invented indexing.

Mr. GROSSMAN. Technically, yes, we did. [Laughter.]

They get more publicity than we do, but they advertise more.

Senator FITZGERALD. OK. Now, you actually have some interesting strategies to keep the costs as low as possible. As I understand it, if—let us say that I buy, today, some of your C Fund, but Senator Pryor sells an equivalent amount of his C Fund shares. You will, in fact, try to net out our transaction before you go into the market and adjust your holdings of the S&P 500 Index, for example, is that correct? Could you explain how that works?

Mr. GROSSMAN. Yes, that is correct. What we do on the trading side is, first, look for any opportunities to cross or offset activity such as that, and it can happen at a couple different levels. The first level is at the fund level. So within a particular pool fund looking to offset contributions and redemptions to the full extent possible and therefore eliminating the need to trade completely at that level.

Senator FITZGERALD. And you want to eliminate the need to trade because trading drives up transaction costs, is that correct?

Mr. GROSSMAN. Exactly.

Senator FITZGERALD. And who do you use to execute your trades? Who does Barclays use? Do you have your own in-house trading firm?

Mr. GROSSMAN. For executing trades for the TSP plan, we use strictly outside broker dealers that we choose based on best execution.

Senator FITZGERALD. And you are not allowing—you said you don't use soft dollar arrangements, so in other words, you are not giving anybody permission to charge you an exorbitant brokerage commission in return for them providing you with research.

Mr. GROSSMAN. That is exactly right. We don't use soft dollars anywhere in the business. We don't believe in them. We think they present a conflict of interest.

Senator FITZGERALD. Do you do any directed brokerage?

Mr. GROSSMAN. We don't do any directed brokerage for the TSP assets or the funds in which they are invested. We do some directed brokerage in other parts of our business, where a client is hiring us to do something on a custom transition or restructuring basis, and there, we do have an affiliated broker that we use for that activity, but it is on a fully disclosed basis where the client

is hiring us to do that, or in the case of a mutual fund, where it is approved by the fund board.

Senator FITZGERALD. Do you do any revenue sharing?

Mr. GROSSMAN. Any revenue sharing? Certainly not in connection with the TSP assets in any way, no, we do not.

Senator FITZGERALD. When you say not in connection with the TSP assets, could you be more specific? You may do revenue sharing with another client's funds that may be commingled with the TSP funds, is that not correct?

Mr. GROSSMAN. I am not sure, Senator, exactly what the definition of revenue sharing is, because I don't know that there is a standard definition out there. In our mutual funds, for example, we do provide revenue, we do provide funds to intermediaries in exchange for shareholder servicing, services that they are providing on those funds and it is something that is part of the ongoing regular business relationship.

Senator FITZGERALD. Do you share part of your investment fee with brokerage firms in return for the brokerage firms distributing your funds?

Mr. GROSSMAN. We do not engage in any revenue sharing like that in exchange for shelf space. It is strictly where they are providing shareholder servicing for us. For example, they are providing aggregating account orders, they are putting together buy and sell activity which we get on an aggregate basis from those entities. They are providing recordkeeping. They are providing account servicing, covering telephone call centers and so on for the clients that they are servicing. There are costs associated with that, they get compensated by us for providing those services. But that is something that is quite different, as we look at it, than paying for shelf space, which we do not believe in.

Senator FITZGERALD. Does Barclays only have index funds or do you have actively managed funds that you offer?

Mr. GROSSMAN. We have actively managed funds, as well.

Senator FITZGERALD. That are open to retail investors? Can retail investors invest in your index funds?

Mr. GROSSMAN. In our index funds, they can. The primary avenue for retail investors to invest in our index funds is through our I shares, strategies which are exchange traded funds. So those trade on the exchanges. They are open and available to any investor. That is the primary avenue for retail investors or other mutual funds, that they can be obtained by retail investors, but generally, they are really targeted at defined contribution plans as opposed to the direct retail marketplace.

Senator FITZGERALD. Now, it is my understanding that you have some pretty sophisticated software that enables you to match the S&P 500 index. As one company in the index gets larger, you will make purchases to reflect the changes in composition of the S&P 500 index fund and the other indexes that you track. Can you describe your sophisticated software, or what I hear is sophisticated software?

Mr. GROSSMAN. Yes, certainly. I would be happy to. We do have a variety of analytics and software that we use for tracking not only the S&P 500 index but all of the indexes that we are tracking, including all of those that we are using on behalf of the Thrift Sav-

ings Plan. And the way the software works is it allows us to monitor with a very high degree of precision what is the composition of each of the indexes we are looking to track and to understand any changes in that index.

So, for example, if Standard and Poors makes a change in the index, if they remove a company and add a company, as they periodically do in rebalancing the S&P 500 index, we will then make the appropriate changes in the underlying portfolios, selling, if necessary, the company that is being removed from the index, buying the company being added, doing that in a way that looks to control the tracking error very precisely while also minimizing any trading cost, any frictional cost associated with that.

One other point to make with respect to index funds is that if you look at something like the S&P 500, it really does provide a good mirror of a buy and hold strategy, because if there are no constituent changes to the S&P 500, then one could track it quite well by an old approach, because if, for example, the weighting of a company goes up because its stock price has increased, that doesn't directly trigger any need for a trade to take place because the weight in the index and the weight in the fund will go up or down pretty much in lockstep with each other.

So the trading activity and the sophisticated software we use is primarily around facilitating client contributions and redemptions and dealing with changes to the index itself as opposed to the need to track it just because of market fluctuations.

Senator FITZGERALD. Mr. Saul.

Mr. SAUL. I am sorry, Senator. I would like to go back, if I might have permission, to this whole questioning of the National Finance Center, because I think it is important from the Board's perspective and my perspective as chairman of the agency to be very clear where we stand with this issue.

We have had a very successful historical relationship with the National Finance Center. The agency and the National Finance Center grew together from really ground zero. As you know, there was \$1 billion in here to \$131 billion, very few participants, there are now over 3.2 million participants that are availing themselves of the TSP.

So I think the Board has to be very careful, and the executive director, how we proceed with the National Finance Center because cost is very important and you know from our record where we have run one of the most competitive, as you stated, funds in the country, cost is certainly on our radar scope. I don't mean to minimize this and I respect your concern with cost, but we have to be very careful about the reliability and the service, also, because the last thing we need is any kind of a breakdown or any kind of questioning of the reliability and the accuracy of the numbers that our participants are getting.

So while in 1986 it was very clear that the NFC did not have a lockhold on this agency and that it was to be bid out, as I stated, the system that developed was an antiquated system. There was no way it could have been bid out until this summer when we put this new documented, automated system in.

Senator FITZGERALD. I want to ask you about that. I was in banking in the private sector and was general counsel for a bank

holding company that managed a number of small community banks. It was common for smaller banks to enter into a contract with the large money center bank to manage their backroom operations, and the computer operations of the small bank would not be compatible initially with the large money center bank's computer systems. As part of the contract to manage the computer records, the large money center bank would come in and do a conversion of the small bank's computer systems over to the new system.

Certainly, I appreciate the efforts of the people in the national call center, and I am very conscious about their jobs as well. But at the same time, you have a statutory obligation to provide this at the lowest cost and I am concerned that we have no evidence that we are getting the lowest possible cost here or even anything close to the lowest possible cost.

Mr. SAUL. But if you follow the histories, when this present Board and this executive director took over approximately 14 months ago, we had priorities here and the first thing we were faced with was a failed system. We were in the midst of developing a new system. So the most important thing to the Board was to be sure that we got our new computer system up and running, that it was running successfully. It was never a question of ignoring the cost. Now once the new system is up, if you take a look at what Gary Amelio and the Board—

Senator FITZGERALD. Now, is the new system compatible with that in which other backroom operations, such as that provided by, say, Hewitt and Associates—

Mr. AMELIO. Yes.

Senator FITZGERALD [continuing]. Could adapt and run?

Mr. AMELIO. Yes, sir.

Senator FITZGERALD. It is?

Mr. AMELIO. Yes. We have a state-of-the-art system now.

Senator FITZGERALD. OK, and it is used by other 401(k) managers, employers around the country, I presume?

Mr. AMELIO. It is very widely utilized. The vendors that have put our system in have put many systems in around the country.

Senator FITZGERALD. Who was the vendor who ultimately did it after they replaced AMS?

Mr. AMELIO. MATCOM was the primary vendor, but under them doing a lot of the specific work vis-a-vis the concept of daily defined contribution is SunGard, and you will find their name throughout the banking industry.

Senator FITZGERALD. It is very common.

Mr. SAUL. So if I just might go on, what happened was as the new system came up, it became evident to us that we would look into some of these other concerns, and in the last 6 months we have now established or are in the process of establishing a back-up call center. We have now taken the software maintenance of the new software away from the National Finance Center and given that to the vendor that has—

Senator FITZGERALD. Are you getting lower fees now from the National Finance Center as a result of taking—

Mr. SAUL. We are getting lower fees, yes.

Senator FITZGERALD. They charged you about \$54 million last year. What would they have been charging historically the year before and 10 years ago? Would you know those fees? What direction have those fees at the National Finance Center been going in dollars and cents terms?

Mr. AMELIO. The overall numbers have been going up, but obviously as the size of the plan goes up, the overall cost goes up every year. What has concerned me is the cost per participant has risen significantly.

Senator FITZGERALD. So instead of getting an economy of scale, we are getting the reverse with the National Finance Center?

Mr. AMELIO. That is correct. I have a chart in front of me that was provided¹ and the cost per participant started in 1991 at a little over \$6 per participant and it has now worked its way up to over \$18 per participant.

Senator FITZGERALD. So it has tripled?

Mr. AMELIO. Yes.

Senator FITZGERALD. Now, you weren't in a mutual fund before you came to the TSP, you were in pension management?

Mr. AMELIO. Yes. I was with a large bank—

Senator FITZGERALD. PNC Bank.

Mr. AMELIO [continuing]. The PNC, and we provided the services like the National Finance Center would do for private sector companies and State and local government—

Senator FITZGERALD. Well, in your experience, as a fund grew larger, weren't you trying to get an economy of scale so that the cost would go down per participant?

Mr. AMELIO. There is no question that costs needed to go down. The larger the plan, the larger the scale, the lower the cost per participant. That is undisputed.

Senator FITZGERALD. But that normal economy of scale is being turned on its head in this case with the fees from the National Finance Center tripling over the last 10 or 12 years.

Let me shift to just a few more issues I want to get into, and this does relate to costs, as well. A lot of people are taking loans from their TSP plans. It was mentioned by several of the panelists that loans are a bad idea unless you absolutely have to have them as a last resort. Do you think there may be evidence that some TSP participants are taking them not as a last resort, but just as available credit, and you want to take some steps to deter people from taking loans except as a last resort? One of your ideas is to charge a \$50 administrative fee.

Let us talk about the loans. How many people took loans last year? There are 3.2 million participants—

Mr. AMELIO. We have 934,000 loans. Forty percent of that number was issued last year.

Senator FITZGERALD. So a lot of the loans came last year?

Mr. AMELIO. They were reissued, yes.

Senator FITZGERALD. Reissued?

Mr. AMELIO. Some of them were new. We don't have the breakdown between what is new and what was a loan that existed and paid off—

¹The chart referred to appears in the Appendix on page 125.

Senator FITZGERALD. It sounds like about 25 percent of TSP participants have a loan outstanding?

Mr. AMELIO. That is correct, because many of the people that have a loan actually have two outstanding. So about a quarter of the plan's participants have outstanding loans. Three-quarters have no loans.

Senator FITZGERALD. Now, do the TSP fund make money or lose money on the loans they make?

Mr. AMELIO. I am sorry, Senator?

Senator FITZGERALD. Do we make money on the loans, are they done at cost, or do we lose money on the loans?

Mr. AMELIO. At this point, prior to the implementation of the new procedures, it does cost the plan's participants money because there is a cost involved with processing the loans. So we are—

Senator FITZGERALD. But we are charging an interest rate, right?

Mr. AMELIO. Yes, but that is paid back into the participant's account.

Senator FITZGERALD. So there is a cost that the other participants bear when somebody—and what was the cost? Can you quantify the cost for last year?

Mr. AMELIO. We can. It was about \$47 a loan, which is why we came up with the \$50 number, which actually is in line with industry standards.

Senator FITZGERALD. So we have at least a cost of \$47 per 900,000 employees that has been charged back to the rest of the fund. That is costing a lot of money.

Mr. AMELIO. Yes.

Senator FITZGERALD. Do you know system-wide how much it is costing per year, on average?

Mr. AMELIO. Without multiplying it out, and I don't want to make an inaccurate number—

Senator FITZGERALD. OK.

Mr. AMELIO [continuing]. But it is big. That was one of the reasons that we imposed the loan cost as a user fee so that participants who—

Senator FITZGERALD. Is the TSP providing sufficient education to participants that they shouldn't do this unless they are really in dire financial straits? Does anyone want to comment on that? Maybe Mr. Sauber?

Mr. SAUBER. I believe that the kinds of education programs available for TSP participants really varies across Federal agencies. Many agencies do a very good job of holding seminars on how to learn about the TSP, to learn about the TSP loan program, but I am not aware of a systemwide effort to educate TSP participants. I know that is an issue that Senator Akaka is very concerned about and something that the ETAC would like to talk about in the context of introducing new lifecycle or lifestyle funds.

Senator FITZGERALD. What is the reason for allowing the loans?

Mr. AMELIO. Loans are not a retirement plan feature. The reason that they are so popular in the industry is they are an inducement to get participants to participate in the plan. Participants are—

Senator FITZGERALD. Don't you have enough inducements here in that you have the lowest cost mutual fund in the world? Isn't that a sufficient inducement?

Mr. AMELIO. It was pointed out to me, the loan program is statutory, certainly, so it is mandated by statute. But to go on, it is just well known—

Senator FITZGERALD. Is it in the original statute?

Mr. AMELIO. Yes.

Senator FITZGERALD. It was?

Mr. AMELIO. Yes.

Senator FITZGERALD. OK. So that is one thing we could look at at the statutory level.

Mr. AMELIO. You could. I do think if you eliminated loans—I am an opponent of loans personally, professionally, but I would tell you that if you eliminated loans, your participation rates would decrease significantly, and that is not just true with the Federal workforce. That is true across the entire American workforce. I think every study bears that out.

Senator FITZGERALD. Do you think a \$50 fee will defray the cost to the other members of the TSP?

Mr. AMELIO. I definitely do. I believe it will cover costs, yes.

Senator FITZGERALD. OK. Mr. Sauber, did you want to comment?

Mr. SAUBER. I was just going to say, that it struck us as a very nice option that employees like to have because there is resistance when you first sign up: Employees ask themselves, “Well, what if I really need the money? What if I really get in a jam?” This loan program answers that issue. So I do think it is important, at least, for some participants, to overcome that first barrier to actually join the plan.

But I think our primary concern is to ensure that these costs be allocated fairly and I think applying a nominal fee like that would cover the cost would be fair to the rest of the participants. As Gary Amelio mentioned, three-quarters don’t have loans.

Senator FITZGERALD. I would think the cost per loan has got to be higher than \$50. There is loan documentation that goes along with this. You have a lot of involvement of your people at the Finance Center.

Mr. AMELIO. It is difficult to quantify these costs because many of the people and the systems that are doing the work of processing loans at other times do other things. But we believe that we are fairly close. And at \$47—somebody back here did the math without a calculator—the cost to the plan is about \$43 million. Now, that is over a period of time. That is not 1 year, because some of these loans extend out over 5 years, some 15 for residential. But for the existing loan base, it costs the participants \$43 million, all participants.

Senator FITZGERALD. When you say a residential loan, are you referring to something like a mortgage?

Mr. AMELIO. It would not be secured, but yes, the purpose of the loan would be to purchase a principal residence.

Senator FITZGERALD. Or provide the down payment before they get a mortgage from a commercial—

Mr. AMELIO. Yes.

Senator FITZGERALD [continuing.] So they are borrowing the down payment?

Mr. AMELIO. Yes. That is probably what is going on.

Senator FITZGERALD. Mr. Lebowitz.

Mr. LEBOWITZ. Mr. Sauber actually, I think, made most of the points I was going to make. We have certainly heard over the years in the private sector context of regulating plans under ERISA that the availability of loans is generally regarded as critical to inducing employees to participate and to participate at the higher levels permitted under the plan. Generally speaking, the surveys seem to show that employees are concerned about not having access to the money in circumstances when they might need it.

Senator FITZGERALD. What about the cost of the lifestyle fund that you may create? Mr. Amelio, would you care to comment on that? What do you think the likely cost of that would be? It sounds like a good idea, but if it winds up costing a lot of money, that may alter the calculation.

Mr. AMELIO. Obviously, I need to temper my remarks by the fact that we have completed the RFI process but have not yet gotten approval to go through the RFP process, so I want to be careful not to violate any Federal procurement laws.

I would tell you based upon the extensive research we have done with over 20 vendors already, we believe the cost will be extremely minimal. I just think it is—to use lay terms, dirt cheap, and I believe that this feature is the greatest thing to hit plans since sliced bread. I mean, it is just badly needed and it is very inexpensive. I don't think it will alter those numbers you have behind you on the chart in the least.

Senator FITZGERALD. What effort do you undertake to monitor customer satisfaction with the services of the TSP? Is there a survey that you ask people to fill out, or—

Mr. AMELIO. At this point, I don't believe historically any customer survey has ever been done by the TSP, but we do have one in the works now. It is just in the initial stages and will be rolled out with our new communications plan.

Senator FITZGERALD. Will you do that online as opposed to printing at great expense?

Mr. AMELIO. I believe we will limit it to online because that is the most cost effective way to do it.

Senator FITZGERALD. Are more TSP members declining to take their TSP prospectus in the mail annually and instead getting them to just look it up online?

Mr. AMELIO. I don't have those numbers, because actually, participants don't make requests of us. They make their requests through individual agencies, so it depends on what each agency is looking at. The figures I can give you are this. We recently went to what we will call the paperless statement route, since we have gone from two statements a year to quarterly, and what we have indicated to the participants are you can get your statements through the website online or you can call and get your balances over the thrift line. If you want a paper statement, you have got to request one.

Now, at this point, over 300,000 participants, or about 10 percent, have requested paper statements. That is very low. What I think is interesting is about a third of those made their requests online, so— [Laughter.]

The complaints that the folks who need paper statements because they don't have access to the Internet just doesn't hold water.

Senator FITZGERALD. So you are going to continue your efforts to try and go in a more paperless direction?

Mr. AMELIO. Absolutely. It saves us \$10 million a year. We will continue to make them available if somebody wants it, but we are going to continue to strive—

Senator FITZGERALD. Note to the Federal Prison Industries, right?

Mr. AMELIO. Yes.

Senator FITZGERALD. OK. That pretty much does it. I think this has been a good hearing. I want to compliment all those who are involved in the TSP, from the auditors at the Department of Labor to the Board members, to the outside vendors. I want to compliment you because I think despite a few bumps in the road, such as that computer contract in the last couple of years, I think it is a very well managed fund, and I think those numbers speak for themselves. It is much more low cost than any of the private sector funds that are out there, and, in fact, as I said at the beginning, I hope some day that we can give members of the general public the same kind of low cost investing options that we have given Members of Congress and other Federal employees.

So I want to thank you for coming here. I compliment you on the job you are doing, and we will look forward to staying in touch with you as new issues arise. Please give Senator Akaka and me a recommendation of legislative changes that you would like to see because we will try and help you with that.

Thank you very much. This hearing is adjourned.

[Whereupon, at 12:49 p.m., the Subcommittee was adjourned.]

APPENDIX

Statement of the Honorable Andrew M. Saul, Chairman
Federal Retirement Thrift Investment Board
Before the Senate Subcommittee on Financial Management,
The Budget, and International Security
March 1, 2004

Good morning Mr. Chairman and Members of the Subcommittee. My name is Andrew Saul, and I am the Chairman of the Federal Retirement Thrift Investment Board. The Board administers the Thrift Savings Plan for Federal employees and members of the uniformed services. I am accompanied today by Gary Amelio, the Board's Executive Director. My four fellow Board members and I serve in a part-time capacity. Gary serves as the full-time Chief Executive Officer of the Agency. By statute, the Board members are responsible for policy decisions affecting the investment and management of the TSP. The Executive Director carries out our decisions and directs the Plan's day-to-day operations. The five Board members and the Executive Director are fiduciaries and, as such, are required to act solely in the interest of the Thrift Savings Plan's participants and beneficiaries.

When I and two of my fellow Board members last appeared before this Subcommittee in November 2002, at our confirmation hearing, then Chairman Akaka graciously yet firmly made us aware of the difficult situation that we faced in assuming our new roles as Board members. This warning proved to be an understatement, as we entered an embattled agency. The outgoing Executive Director took a number of actions just before his abrupt departure that demoralized the staff, many of whom had built the program from the beginning. Expensive lawsuits and investigations were sprouting up, rancorous battles were underway with other agencies, the costs of the failed record keeping system project had not been charged to participants, and decisions had to be made immediately on whether to go forward with the new record keeping system project at all. I and my fellow Board members entered this environment and, working with the seasoned senior career staff, methodically sorted through these matters, keeping the new system and other projects on track and moving forward as we restored essential relationships.

Our first order of business was to address the Agency leadership issue. We conducted an open and orderly nationwide search for an Executive Director that resulted in the selection of Gary Amelio, a private sector pension and investment expert. The Board was confident that Gary's 22 years of private sector experience would result in the betterment of the Thrift Savings Plan for the participants and we have not been disappointed. He immediately dealt with the implementation of the new record keeping system, settled the lawsuits to the benefit of Plan participants, and, working with the Board members, reestablished professional and respectful relations with other agencies, without diminishing independent fiduciary leadership.

Gary has proven his leadership of the Agency's career staff, established productive cooperation with the various employing agencies of Government, and developed an outstanding rapport with the unions and associations that comprise the Employee Thrift Advisory Council. As a result of his efforts, Gary has received favorable recognition for the Plan in the pension industry, and has already received two national awards in recognition of his performance. This achievement signals the turnabout originally sought by this Subcommittee.

When the TSP was first conceived in the early 1980's by Senator Ted Stevens, it was designed to be an efficient, low-cost vehicle securing retirements for a large and diverse group of Federal employees to secure their retirement. Congress established the TSP using a diversified, passively-managed, index fund approach with a reasonable limit on the number of investment choices. The Board has developed investment policies, and adopted sound administrative practices in furtherance of these Congressional goals. The results have been what we believe Senator Stevens and his colleagues intended when they undertook the reform of the Federal retirement system twenty years ago.

Over the years, Congress has carefully considered proposals to change the TSP, adopting improvements and extending coverage as appropriate to new employee groups. At the same time, it has set aside seemingly well-intentioned proposals that would have moved the TSP away from its fundamental strategy. This restraint has preserved the basic commitment to investment choices which are well-managed, inexpensive, and appropriate for a long term investment strategy. In view of Chairman Fitzgerald's recent efforts

to emphasize the value to investors of low administrative costs, we are pleased that the Thrift Savings Plan offers participants a diversified selection of investment options and a competitive array of plan benefits, at an extremely low cost.

In 2003, total participant expenses were 10 basis points. An additional 1 basis point of expense was offset with forfeitures. 2003 charges were unusually high because we had to charge 3 basis points to account for the expense associated with the earlier failed record keeping project. For 2005, we project that the cost to participants could be as low as six basis points.

Legislated improvements to augment benefits, simplify Plan administration, and provide new investment funds have been beneficial for participants. An example is the extension of Plan participation to members of the uniformed services, two years ago. In only two years, nearly 400,000 members have begun voluntarily contributing to the plan, to supplement their retirement benefits. We are proud to have the opportunity to make this program available to them.

I would like to bring one potential legislative improvement to the attention of the Subcommittee today and that is the elimination of TSP open seasons. The Board supports eliminating open seasons because it would expand participant access to the TSP and simplify Plan administration. We also believe it would increase participation and contribution levels. Open seasons were useful when the Plan was conceived because they provided a structure for the initial implementation. They are no longer useful in a "daily-valued" plan environment; indeed, they restrict the opportunity for employees to make contribution elections, and more damaging, delay eligibility for Agency Automatic (1%) and Matching Contributions for newly hired employees. The Board has previously supported legislative proposals (including one introduced by Senators Akaka and Warner on December 13, 2001) that would have overcome the latter barrier by providing these benefits as soon as new employees join the TSP. We would support similar legislation again.

We are also reviewing a second potential legislative issue -- a change in the current fiduciary insurance provision in our statute. Currently the Agency must purchase such insurance. Self-insurance, however, is not allowed. We are in the process of examining whether it makes better

economic sense for the Plan to cover its own risks rather than to pay premiums to private insurers. The staff analysis is expected to be completed this summer. Depending on the findings, the Board may subsequently seek legislative authority allowing us the option to either purchase insurance or self-insure, as the fiduciaries would determine.

In his first nine months as Executive Director, Gary has dealt decisively with the major challenges facing the TSP. He has initiated necessary changes to the TSP loan program and is preparing a proposal to provide new investment allocation strategies, based upon the existing Plan fund options. Gary will also be initiating a major revision of our communication materials with an emphasis on participant education. With your permission, I would like to introduce Gary Amelio to the Subcommittee for his remarks.

Statement of Gary A. Amelio, Executive Director
Federal Retirement Thrift Investment Board
Before the Senate Subcommittee on Financial Management,
The Budget, and International Security
March 1, 2004

Good morning Chairman Fitzgerald, Senator Akaka, and Members of the Subcommittee. My name is Gary Amelio and I have served as Executive Director of the Federal Retirement Thrift Investment Board since June 2003. I came to the Agency with 22 years of banking, pension and investment experience.

I am pleased to appear today to discuss the challenges the Agency has addressed over the past nine months, and to outline our future agenda. The challenges that face the Thrift Savings Plan today offer opportunities to improve service for the Plan's participants tomorrow.

First, however, I would like to compliment this Committee and its predecessors on its design of the Thrift Savings Plan. Since arriving, I have told everyone who will listen that this Plan has an excellent combination of investment options, benefit selections, and low costs. Any retirement professional would reference the TSP as the optimum retirement plan. That reflects positively on the vision of its Congressional designers, as well as the fortitude of those who have kept it true to its original principles over the past eighteen years.

With 3.2 million participants and \$130 billion in assets, the TSP is the largest plan of its kind in the world. The participation rate is very high, the contribution levels well above average, and support among participants for the program is strong. Our rollout of a state-of-the-art record keeping system last year ensures that we will be able to continue the efficient delivery of investment products and benefits to participants well into the future.

Although a variety of new features were introduced with the new system, improvement is still needed. For example, since the rollout of the new system last year, we have experienced difficulty in promptly servicing the in-

creased volume of participant calls to the service center. A request for proposals for a parallel call center to ensure uninterrupted service and improve overflow capacity has been issued. A selection is expected soon and the new call center will be operating later this year.

Based upon well documented industry standards, I am concerned about the excessive use of the TSP loan program. At the end of 2003, the plan held over 934,000 loans. Almost 40% of these were issued in the last year. During implementation of the new system, a loan-churning problem was uncovered. The administrative burden and cost to the plan and the inconvenience to the participants is significant. Three reforms that will reinforce to participants the importance of borrowing from their TSP accounts only as a last resort were recently announced and will be implemented in July. The changes make the system fairer for all participants and consistent with private-sector loan practices.

An important issue that required immediate attention when I arrived was the pending litigation between the Agency and a contractor in an earlier failed effort to build a record keeping system. It was my decision to settle the lawsuits and to accept five million dollars, which was paid back into the accounts of TSP participants. A total of \$41 million had been spent on the unsuccessful project and the ultimate cost to each participant was 36 cents per thousand dollars of account balance. The settlement allowed us to move forward and refocus on providing investments and benefits for our participants.

Mutual fund trading in 401k plans has been a high profile subject recently, and I'm sure there are questions about the TSP's experience since it has become daily-valued. The staff has reviewed participant trading practices and discovered no issues of concern. Indeed, only 146 participants (.0046%) have traded more frequently than twice a week. Interestingly, some of these traders held fewer shares at the end of the trading period; i.e. they lost money. The Agency staff is currently reviewing guidelines just released by the Department of Labor, which describe appropriate fiduciary actions in addressing such practices, and will develop a recommendation for handling such accounts.

In regard to product enhancement, the Agency staff is preparing a recommendation for the Board members that the TSP offer lifestyle or lifecycle investment options for TSP participants. The lifestyle approach is designed to reflect an investor's investment profile; for example, aggressive, moderate, or conservative. The lifecycle approach permits an investor to select the date upon which he or she would start withdrawing assets from the account, such as at retirement. In either case, the new life options would be invested solely in combinations of the five existing TSP investment funds, using different allocations depending upon the investment objective. "Life" investment options are professional asset allocation and rebalancing tools for participants who may not have the time or knowledge to manage account assets on their own. Professional research indicates that 80-90% of defined contribution plan participants fall into this category, as evidenced by a failure to rebalance their accounts. Indeed, the average age of a TSP FERS participant is 43.8 years, and this group has 47% of its assets invested in stable value and fixed funds. By definition, this group has at least 20 years until retirement, and will likely need portfolio diversification to achieve their retirement goals. Agency research, to date, indicates that a "life" product is very inexpensive to implement. There is no doubt that the participants who embrace "life" professional asset allocation and rebalancing models will enhance the retirement values of their accounts over time.

Later this month I expect to present to the Board and the Employee Thrift Advisory Council the results of months of research, including interviews with numerous investment providers who responded to our request for information on "life" options, and our recommendation for this new investment product. My goal is to obtain insight from the Council and policy decisions from the Board that will allow us to have this option ready for implementation next year.

In the meantime, we are moving forward to substantially upgrade our web, print, and video communication materials. This is, of course, a long-term project. The Board members and I view the enhancement of communications materials as a priority. I am also aware that the members of the Subcommittee have expressed concerns in this regard. A participant satisfaction and input survey will be part of the communication upgrade process, although such initiative is in the formative stage. Other enhancements will be reviewed in the coming year as we, in Mr. Saul's words, take what has been an excellent plan "to the next level".

We would be pleased to respond to your questions.

STATEMENT OF ALAN D. LEBOWITZ
DEPUTY ASSISTANT SECRETARY FOR PROGRAM OPERATIONS
EMPLOYEE BENEFITS SECURITY ADMINISTRATION
U.S. DEPARTMENT OF LABOR
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET, AND
INTERNATIONAL SECURITY
UNITED STATES SENATE

March 1, 2004

Chairman Fitzgerald, Ranking Member Akaka, and distinguished Members of the Committee:

I appreciate the opportunity to appear before you today to present information about the Federal Employee Retirement System (FERS), the Thrift Savings Plan (TSP), and the Labor Department's activities in this area. My name is Alan Lebowitz. I am the Deputy Assistant Secretary for Program Operations, of the Employee Benefits Security Administration, U.S. Department of Labor. Accompanying me is Ian Dingwall, EBSA's Chief Accountant.

THE EMPLOYEE BENEFITS SECURITY ADMINISTRATION

Before describing the Labor Department's activities with the TSP, I would like to provide you with some background information specifically about the Employee Benefits Security Administration and our responsibilities.

EBSA currently oversees approximately 730,000 private pension plans and millions of private health and welfare plans that are subject to the Employee Retirement Income Security Act of 1974 (ERISA). The pension plans under our jurisdiction hold over \$4 trillion in assets and cover more than 45 million workers. EBSA employs a comprehensive, integrated approach encompassing programs for enforcement, compliance assistance, interpretive guidance, legislation, and research to protect and advance the retirement security of our nation's workers and retirees.

Title I of ERISA consists of provisions that establish standards of fiduciary conduct for persons who are responsible for the administration and management of pension and other benefit plans (including group health plans, life insurance, disability, dental plans, etc.). In addition, it establishes standards for the reporting of plan related financial and benefit information to the Department, and the disclosure of essential plan related information to participants and beneficiaries.

Under ERISA, fiduciaries are required to discharge their duties solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their

duties, fiduciaries must act prudently and in accordance with the documents governing the plan. Certain transactions between an employee benefit plan and “parties in interest,” including fiduciaries and others who may be in a position to exercise improper influence over the plan, are prohibited by ERISA. If a fiduciary’s conduct fails to meet ERISA’s standards, the fiduciary is personally liable for plan losses attributable to such failure.

Because of the Department of Labor’s experience and expertise in the administration and enforcement of Title I of ERISA as it relates to private sector employee benefit plans, Congress charged the Department with administering substantially similar provisions of law governing fiduciary conduct for the TSP under the Federal Employees’ Retirement System Act of 1986 (FERSA).

THE FEDERAL EMPLOYEES RETIREMENT SYSTEM

In FERSA, Congress created a retirement program for federal employees that generally follows the private sector model of large employers in providing retirement benefits through a combination of Social Security, a defined benefit plan, and a 401(k)-like tax advantaged savings plan, the TSP. For Federal workers hired after January 1, 1984 FERS takes the place of the old Civil Service Retirement System. Within FERS, the Labor Department’s formal responsibilities are limited to the TSP.

THE THRIFT SAVINGS PLAN

Employing agencies contribute one percent of pay to an individual account for each worker covered by FERS. In addition, covered workers can choose to make pre-tax employee contributions to the TSP that are matched by employer contributions up to certain limits. CSRS employees and uniformed service members may also make pre-tax contributions to the TSP, though there is no employer match for these contributions. Each contributing employee directs the investment of contributions to their individual account in four separate index funds and a U.S. government securities fund, known collectively as the Thrift Savings Fund.

The TSP is available to federal and postal workers, Members of Congress, Congressional employees, members of the Judicial Branch, and uniformed service members. Since its inception 17 years ago, the TSP has grown into a large, complex system. For example:

- o There are currently more than 3.25 million participants in the Thrift Savings Plan. The fund balances total over \$131 billion.
- o The number of participant loans and withdrawal disbursements has increased from approximately 50,000 in 1988 to 873,000 in 2003.

- o Total participant inquiries have increased from approximately 150,000 in 1989 to 2,631,000 in 2003.

In enacting FERSA, Congress established the Federal Retirement Thrift Investment Board (the Board) to administer the TSP. The Board is an independent agency of the Executive Branch. It has five members appointed by the President with the advice and consent of the Senate, and an Executive Director, appointed by the Board. The Board's principal statutory duties are to set policies for investment of the Thrift Savings Fund's assets and for administration of the TSP within the requirements of the Act. The Board selects appropriate indexes for the four index investment funds, but does not select specific investments. The Executive Director then carries out the policies established by the Board.

The Board contracts with Barclays Global Investors, N.A. (BGI) to provide investment management operations for the TSP's four index funds: (1) the Fixed Income Investment Fund ("F" Fund), (2) the Common Stock Index Investment Fund ("C" Fund), (3) the Small Capitalization Stock Index Investment Fund ("S" Fund), and the International Stock Index Investment Fund ("I" Fund). As investment manager, BGI is responsible for safeguarding F, C, S and I Fund investments, for ensuring that these funds closely track the performance of the investment indices selected by the Board, and for ensuring that these investments and related operations comply with FERSA and the provisions of the contract between the Board and BGI.

To ensure the integrity of the TSP, FERSA established rules concerning fiduciary responsibility, prohibited transactions, and bonding requirements. These standards are substantially similar to rules governing private sector pension plans under ERISA. The statute specifies that the Board members and the Executive Director are fiduciaries of the Savings Fund. They and other fund fiduciaries must discharge their responsibilities prudently and solely in the interest of the participants and beneficiaries. Certain types of transactions that may create potential for abuse are prohibited unless they fall within an exemption provided in the statute or specifically granted by the Secretary of Labor.

As in ERISA, the Secretary of Labor has broad investigative and auditing authority concerning the activities of the Board and other fiduciaries of the fund. When FERSA was originally enacted in 1986, the Secretary also had authority similar to that which she has under ERISA; to bring civil actions against the Fund's fiduciaries for breaches of their fiduciary responsibilities and to seek injunctive relief as well as recovery of losses suffered by the fund.

In 1988, in response to the lack of available fiduciary liability insurance, Congress amended the Act to specifically exclude suits by the Secretary against the Board members or the Executive Director. Participants and other fund fiduciaries may still sue the Board and the Executive Director, but the 1988 amendments do not permit any monetary recovery against these individuals. In addition, the 1988 amendments treat actions for recovery of losses to the Fund brought by participants and beneficiaries against Board members and the Executive Director as tort actions against the United States, which are defended by the Attorney General. The Department may, however,

still bring actions for recovery of losses against other TSP fiduciaries, such as investment managers.

THE THRIFT SAVINGS PLAN AUDIT PROGRAM

Section 8477(g) of FERSA specifically directs the Secretary of Labor to establish a program to carry out audits to determine the level of compliance with the Act's fiduciary standards and prohibitions on certain types of transactions. Under the statute, the Secretary may either contract with a qualified non-government organization, or may conduct the audit in cooperation with the Comptroller General of the United States. The Department has always elected to contract with a reputable accounting firm. Currently, KPMG LLP conducts the audits under supervision of the EBSA Chief Accountant.

The Labor Department's program for fiduciary compliance audits of the TSP is designed to determine: (1) whether the plan's fiduciaries are acquiring, protecting, and using plan resources prudently, efficiently, and solely in the interest of participants and beneficiaries; (2) whether the fiduciaries have complied with FERSA and applicable laws and regulations; (3) whether the desired results or benefits established by FERSA are being achieved; (4) whether the plan program activities, functions, and organization are cost effective and efficient; and (5) whether the Department's previous plan compliance and control audit recommendations have been adequately addressed.

To guide the auditors, the Department has developed a strategic Fiduciary Oversight Program that uses detailed guides to test for compliance. These audit program guides cover all significant activities of the Fund, including the Board's policy formulation and administration; record keeping functions handled by the Agriculture Department's National Finance Center; functions of Federal agencies related to contributions and employee participation programs; and the CIA's separate system for its employees. The audits include on-site reviews of the Fund's principal service providers.

The Fiduciary Oversight Program includes provisions for testing and commenting on the controls in place at the TSP Investment Manager, BGI, that ensure the accuracy of financial information, compliance with FERSA, and operational efficiency and management effectiveness. The Department also examines whether BGI complied with provisions of the contract under which it was retained. The BGI management fee is reviewed for consistency with fees charged by other similar institutions and that such fees conform to contractual agreements.¹

At the conclusion of each audit, the Department issues a report for formal response by the Executive Director on behalf of the Board. The Department's representative and the contract auditor meet with the Board members at least once a

¹ Our FY 03 TSP compliance audit report, the scope of which was June 1, 2001, through January 31, 2003, noted that TSP investment activities satisfactorily comply with the related contract between the Board and BGI.

year to highlight significant issues from the audit, to present the Department's future compliance audit schedule, and to answer Board members' questions.

The Department's audit recommendations range from statutory matters related to FERSA fiduciary compliance to economy and efficiency issues that may provide cost-saving opportunities for the TSP. Most significantly, the Department communicated many recommendations over several years addressing TSP system and software control weaknesses, which influenced the TSP Board's decision to replace the TSP record keeping system in June 2003.

At the June 2003 implementation of the new TSP record keeping system, the Department provided on site audit oversight of the data conversion and reconciliation processes from the "legacy" to the new system, where we noted no significant deficiencies in the data conversion. The Department's TSP audit plan through fiscal year 2007 calls for a comprehensive audit of the new system within 3 years, including an examination of participants' concerns surrounding the responsiveness of the new online system.

Although FERSA does not require the Board and Executive Director to adopt the Department's recommendations, disagreements are rare and generally are due to the timing or the form of implementation rather than to outright refusal. Since the inception of the audit program, the Department has made more than 800 recommendations, 95 percent of which have been accepted. The remaining recommendations chiefly address controls for the TSP's new record keeping system. This high rate of acceptance is due in large part to the longstanding and positive working relationship between the Department and the TSP service providers and fiduciaries throughout all phases of the FERSA compliance audit program.

LATE TRADING AND MARKET TIMING

Certain abusive practices within the mutual fund industry, namely "market timing" and "late trading," which have recently come to light, have raised concerns and prompted the Department to take certain steps. The Department recently performed a limited review of BGI's collective trust funds in which the TSP has equity investments to determine whether further investigation is warranted. This review included an examination of documents provided by the Board and BGI and discussions with key personnel at the Board and at BGI. We also communicated with the Office of the Comptroller of the Currency (OCC), which is the primary regulator of BGI. Based upon this preliminary review, we do not believe that TSP participants are adversely exposed to the costs and investment risks due to "late trading" and "market timing."

The Department recently announced that it is conducting reviews of mutual funds, similar pooled investment funds, and service providers to such funds to determine whether there have been any violations of ERISA. The results of these reviews will be used to later determine if any FERSA issues require further investigation.

We are working very cooperatively with Chairman Saul, and Executive Director Amelio and the members of the Board. We anticipate continuing a free and candid exchange of views that should benefit the TSP participants and beneficiaries, and help us to fulfill our oversight responsibility.

CONCLUSION

This concludes my prepared remarks. Thank you for the opportunity to testify before you today regarding this important matter. We look forward to working with the members of this Committee and the Thrift Savings Plan fiduciaries in this endeavor, and I will be happy to answer any questions you may have.

**TESTIMONY OF
JAMES SAUBER
CHAIRMAN OF THE EMPLOYEE THRIFT ADVISORY COUNCIL
before the
SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET AND
INTERNATIONAL SECURITY of the
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
March 1, 2004**

Good morning Mr. Chairman and Members of the Sub-Committee. My name is James Sauber. Thank you for your invitation to participate in this important oversight hearing and for the opportunity to share the views of the Employee Thrift Advisory Council with you. ETAC, as it is known, is a 15-member body established by the Federal Employees' Retirement System Act of 1986 (FERSA) to advise the Federal Retirement Thrift Investment Board on matters related to the Thrift Savings Plan. The 15 members are nominated by organizations identified in the FERSA statute. These organizations represent federal and postal employees, both active and retired, at all levels of the U.S government, from wage earners to senior executives. I was nominated to serve on the Council by my employer, the National Association of Letter Carriers, a union that represents 300,000 active and retired employees of the U.S. Postal Service, and was elected to serve as chairman of the Council last fall.

As you know, the Thrift Savings Plan is an extremely important part of the federal retirement system and is very popular among the 3.2 million federal employees and retirees who maintain TSP accounts. The TSP's popularity is traceable in part to its good fortune of having been created at the start of one of the greatest bull markets in history. But it has remained popular despite the poor performance of the stock market in recent years. I think that shows the wisdom of its Congressional designers on this

Committee and the good judgment of the federal workforce, who have continued to invest and save for the long run in order to enjoy a more secure retirement as a result.

The TSP is also popular because of the solid performance of the Federal Retirement Thrift Investment Board over the years and because Congress has continued to give it strong backing. In practical terms, that means the Thrift Board has provided TSP participants good service while keeping expense ratios very low and Congress has protected the TSP by insulating it from political and budgetary pressures. We are confident that these positive aspects of the Plan will be maintained.

ETAC has developed a constructive relationship with the Board over the years. Lines of communication are free and open and the trust built up over many years has allowed us to work well together. For example, ETAC worked with the Board to establish a way for participants to recover lost earnings resulting from agency errors related to TSP contributions. And the organizations that make up ETAC have used materials prepared by the Board in their publications to promote participation in the TSP. That trust and communication has also helped us overcome difficulties that have occasionally arisen, such as dealing with the impact of government shut-downs in the 1990s or resolving the unfortunate problems the Board experienced with the launch of the new record keeping system last year

I can assure you that none of the organizations that make up ETAC were happy about the ill-fated contract with AMS to upgrade the record keeping system or the cost it imposed on TSP participants. At our first meeting last fall, we were given a comprehensive briefing on the Board's decision to reach a settlement to end the litigation with AMS and Executive Director Amelio answered all our questions. I believe

most members of the Council agree that, in the context of the Board's long record of success, the episode with the record keeping system should be seen as an aberration. We are pleased that the Board has finally completed the new system and has worked out the normal implementation glitches. Chairman Saul and Executive Director Amelio deserve credit for managing the agency through a difficult period.

At that first meeting of the newly appointed ETAC, we also discussed a number of other important issues. We discussed possible changes to the TSP loan program and the Board's plan to investigate so-called lifecycle investment options. I would like to convey the views of the Council on both issues.

In general, there seemed to be a consensus among ETAC members that many TSP participants are making excessive use of the TSP loan program. There was general support for the thrust of the Board's proposals, though there was a diversity of opinions on the specific ideas. Most of us agree that charging a fee for the loans makes sense as a way of discouraging excessive use of the program and for more fairly allocating the administrative costs of the loan program. However, not all the organizations that make up ETAC favor the restrictions on second TSP loans. We look forward to discussing proposed revisions to the regulations governing the loan program at our next ETAC meeting later this month.

There is also broad interest in the lifecycle investment options under investigation by the Board. Though few if any ETAC organizations provide investment advice to their members – despite unremitting demand for such advice – it is widely understood that too many federal and postal employees fail to rebalance their investment allocations over time to better reflect their circumstances. Workers who are decades away from

retirement can afford to take more risk than those within years or months of retirement. Investment allocations should be adjusted over time. A lifecycle fund that allowed for the gradual reallocation of investments among the five TSP funds could be very helpful to employees who need help in managing their TSP accounts. Although ETAC members are concerned about the added cost of offering a "lifecycle fund," we look forward to reviewing the Board's research on the issue at our next meeting.

Finally, I would like to comment on two legislative matters related to the Thrift Savings Plan.

First, ETAC fully supports the Board proposal to eliminate TSP Open Seasons – a concept that draws heavily on a bill proposed by Senator Akaka in the 107th Congress. Open seasons made sense when the FRTIB was a new agency just getting started and lacked the administrative capability to quickly enroll participants and to implement investment elections on a real-time basis. Today, with the new record keeping system and its capacity to value accounts daily and to implement investment allocations instantly, Open Seasons are no longer necessary. Eliminating them will save money and make participation in the TSP more flexible and attractive to all employees. And new employees would be more likely to participate in the TSP if they could get automatic agency contributions as well as matching contributions right away, just like all other federal employees. Eliminating the TSP Open Season is perhaps the single best way to reach that 13% of FERS employees who still do not make contributions to the TSP.

Second, the postal employee organizations that are represented on the Employee Thrift Advisory Council wish to alert the Subcommittee to a proposal made by the President's Commission on the United States Postal Service that could adversely affect the Thrift

Savings Plan. We note that the President's postal commission recommended that Congress consider removing postal employees from various pension, health insurance and other benefit programs that currently cover all federal employees. Among such programs are the Federal Employees' Retirement System and the Thrift Savings Plan. All six organizations – the NALC, the American Postal Workers Union, the National Rural Letter Carriers Association, the National League of Postmasters, the National Association of Postmasters and the National Association of Postal Supervisors – strongly oppose separate postal employee benefit plans. In the case of the TSP, removing 800,000 employees from the TSP would raise the cost of retirement investing for postal and federal employees alike, and unfairly deny postal employees access to an excellent program. We urge the members of this Subcommittee to oppose any proposal to exclude postal employees from FERS and the TSP. Given that the recommendations of the President's Commission are before the full Committee on Governmental Affairs, I thought it appropriate to raise this specific proposal here today.

Thank you once again for the opportunity to testify and I will be happy to answer any of your questions.

Statement of Barclays Global Investors

Blake R. Grossman
Global Co-Chief Executive Officer

**Before the Senate Subcommittee on Financial Management, The Budget and
International Security, Committee on Governmental Affairs**

Thank you for inviting me to testify today about Barclays Global Investors (“BGI”) and its role as the external asset manager for the Federal Thrift Savings Plan (“TSP”). We appreciate the concerns of this committee in looking out for the best interests of all investors, including Federal employees, especially in the context of certain practices in the mutual fund industry that have recently come under close scrutiny. We are honored to have served as an investment manager for the TSP since 1988, and we take our responsibilities very seriously for the management of the retirement assets of the Federal workforce. We at BGI take great pride throughout our organization in maintaining the highest ethical and fiduciary standards. You have our commitment that no compromises to these standards are acceptable at BGI.

To understand why federal employees should feel confident that BGI is managing their retirement assets responsibly, it is important to first discuss our investment philosophy and our structure, both of which are focused on delivering highly reliable, low cost investment results to institutional investors like the TSP. By ‘institutional’ I refer to defined benefit and defined contribution pension plans sponsored by corporations or public agencies, and to endowments, foundations and other similar pools of capital. I will then say a few words about the service we provide for TSP, elaborate on how we keep the costs associated with trading and investing as low as possible, and briefly

describe how BGI is organized and regulated. Before concluding, I will comment on the issues concerning mutual fund managers that have received so much attention lately, and how BGI has addressed these in our business.

Barclays Global Investors was founded in 1971 as part of Wells Fargo Bank in San Francisco, California. Today, we are owned by Barclays PLC, one of the world's leading financial service providers. We remain headquartered in San Francisco with approximately 1100 employees in California and elsewhere in the U.S. and 1000 more employees worldwide serving the needs of our global clients. With more than \$1 trillion in assets under management, BGI, together with its affiliates, is the world's largest index manager. BGI created the first index strategy in 1971, just one of many financial innovations we have pioneered.

Since our founding, BGI has remained true to a single global investment philosophy, which we call *Total Performance Management*. BGI manages *performance* through the core disciplines of *risk*, *return* and *cost* management. The success of our indexing methodology results from our focus on delivering superior investment returns over time while minimizing trading and other implementation costs and rigorously controlling investment and operational risks. This simple, yet profound approach is rather unique in our industry, and helps us avoid investment "fads" or a dependence on "star managers" or "stock pickers." It has been the foundation for the way we've managed money for over 30 years and we believe it has served our clients very well.

As I noted earlier, since 1988 one of those clients has been the TSP. BGI is honored to manage four of the five investment options available for participants—the TSP C Fund (based on large-capitalization US equities), the S Fund (based on mid- and small-capitalization US equities), the F Fund (based on the Lehman Aggregate Long-term Bond index) and the I Fund (based on the MSCI Europe Australia Far East (EAFE) index of non-US equities). It is important to note that we have successfully retained this relationship in regular, highly competitive bidding processes since 1988.

BGI's services to the TSP are completely focused on investment management; we do not provide any other services. Management of payroll contributions, record keeping (e.g., changes made by participants in investment elections), distributions and communications to participants are handled directly by the TSP or its other vendors.

BGI understands that the costs and expenses of investing detract from investment performance and investment returns, and therefore we seek to minimize transaction costs in all our investment activities. In fact, the key to our success in index management has been our ability to minimize implementation and trading costs. Let me say a few words about how we do this.

The majority of BGI's clients are large institutional investors, such as defined benefit and defined contribution plans, foundations, and endowments. Because of BGI's size as an investment manager and the ability to commingle the assets of our clients, we offer

considerable economies of scale for investors and, therefore, we can achieve lower implementation and trading costs for our institutional clients, such as the TSP.

To expand on this point, each of our index funds is structured to match the performance of a specific index. These indexes (such as the S&P 500 or the MSCI EAFE) are designed, however, as ‘paper portfolios’ and do not include any of the trading costs that real-world investors experience. Thus to successfully achieve the performance target—that is, to track the index as closely as possible—BGI strives to minimize the “real world” costs through a variety of highly efficient trading approaches.

The size and diversity of our client base enable us, for example to match or offset a significant percentage of our clients’ buy and sell orders internally, thereby reducing or eliminating transaction costs. The internal matching of buy and sell orders is commonly referred to as “crossing,” and is conducted by BGI pursuant to the terms and conditions of an exemption issued by the Department of Labor. Compliance with the exemption’s conditions is actively monitored. All these transaction savings, which we estimate are in the hundreds of millions each year, are passed directly to our clients.

When we trade in the external markets, we utilize carefully developed and managed trading strategies and we access all possible sources of liquidity, including electronic marketplaces. Our trading activities are supported by a dedicated trading research team, whose sole job is to develop new trading techniques and strategies to minimize the impact of trading costs on BGI’s funds. We execute our trades through broker-dealers

who have been pre-screened for credit-worthiness, and we rigorously monitor the prices at which our trades are executed relative to a number of market-related benchmarks to ensure we are receiving superior execution. We also use our scale to negotiate low per share commission rates. In light of the current controversy regarding soft dollars, I should emphasize that BGI does not and has never used soft dollars in its trading activities on behalf of its funds.

The majority of our assets are managed for large institutional clients such as the TSP and the average account size for our US clients is \$880 million. BGI is able to charge lower investment management and administrative fees to its institutional clients than a mutual fund firm geared towards retail investors, where the average account size is comparatively small¹ and costs of administrative services (including shareholder communications and recordkeeping) are considerably higher. By way of example, the average fee for large capitalization US equity index portfolios of \$100 million in size that are managed for institutional clients is 0.05% versus retail-oriented equity index mutual funds where the fees average 0.73%.

Over the course of a long-term investment, lower management fees and expenses (including trading commissions) can translate into considerable savings for an investor. Indeed, index investing remains the most cost-efficient and diversified way to gain exposure to various segments of the capital markets. We believe index funds are the best

¹ According to the Investment Company Institute's Mutual Fund Fact Book 2003, the median household had mutual fund assets of \$40,000 as of December 2001.

core investment for most investors' portfolios – whether they are the largest pension fund in the world, or an individual investor.

Let me say a few words about the comprehensive regulatory oversight of BGI. Barclays Global Investors, N.A. is a national banking association organized under the laws of the United States. BGI operates as a limited purpose trust company, whose primary regulator is the Office of the Comptroller of the Currency (“OCC”), the agency of the US Treasury Department that regulates national banks. The OCC ensures that the fiduciary activities of national banks are conducted in a manner that promotes the safety and soundness of both the overall national banking system and the individual bank. The OCC conducts regular and frequent examinations of BGI to ensure that it is exercising its powers in accordance with these requirements. As part of the Barclays Group in the US, BGI is also subject to Federal Reserve Board oversight.

BGI is also subject to the jurisdiction of the US Department of Labor to the extent that its clients are subject to the Employee Retirement Income Security Act of 1974 (“ERISA”). As the manager of the assets of the TSP, BGI is also subject to the Federal Employees’ Retirement System Act of 1986, a statute modeled closely on ERISA.

BGI provides investment management services for separate accounts, common trust funds and group trusts and other investment vehicles. The TSP, along with many of our other institutional clients, is invested in bank collective funds (legally trusts), which are subject to OCC oversight. TSP assets are commingled with ERISA assets in BGI’s collective funds. In contrast, mutual funds are investment companies subject to SEC

oversight, and the activities of mutual funds are not subject to ERISA. Bank collective funds are only open to qualified institutional investors such as public and corporate pension funds, foundations and endowments—hedge funds and individual investors (except indirectly through their defined contribution plans) are not permitted to invest in them.

BGI's operating procedures and internal controls with respect to its fund management activities are examined annually by an independent accounting firm, currently PricewaterhouseCoopers LLP, and Barclays Internal Audit Group. BGI's procedures and controls are also reviewed by the Audit Committee of BGI's Board of Directors and the Audit Committee of Barclays Group. The purpose of these annual reviews is to ensure that adequate controls are in place to safeguard client assets.

Under OCC regulations, a bank, such as BGI, that administers collective funds must have an annual audit made of each fund by auditors responsible only to the bank's board of directors. Based on this audit, the bank must prepare an annual financial statement of each fund within 90 days of the end of the fund's fiscal year. Copies of the annual financial statements of the funds in which the TSP assets are invested are provided each year to the Thrift Investment Board and other participating clients.

Additionally, other regulators, including the Securities and Exchange Commission, the National Association of Securities Dealers, the Commodity Futures Trading Commission

and the National Futures Association provide regulatory oversight as to other parts of BGI's business, generally unrelated to the service provided to the TSP.

Before concluding, allow me to comment on certain practices in the mutual fund industry that have recently come under close scrutiny. We recently conducted a thorough review at BGI of these issues, including late trading, market timing and personal trading by BGI personnel. I am pleased to report that we have found no issues at BGI of significant concern, or any practices that compromise our fiduciary responsibilities to the TSP, or any other client. Our review also confirmed that BGI's choice of brokers is made only in regard to their ability to provide best execution for BGI's clients. As I said, we take our responsibilities as an investment manager for the retirement assets of federal employees very seriously.

Mr. Chairman, as a citizen and taxpayer, I appreciate the service that federal employees provide for this country, and every federal employee should feel confident that we at BGI are managing his or her TSP retirement assets responsibly. We appreciate the trust that has been placed with BGI.

As an organization, we take great pride in maintaining the highest ethical and fiduciary standards, and you have our commitment that no compromises to these standards are acceptable at BGI. We look forward to maintaining an open dialogue with the TSP and members of this Subcommittee on these key issues in the future. Thank you very much for the opportunity to share our views today with the Subcommittee.

ANSWERS TO QUESTIONS FOR THE RECORD FROM SENATOR DANIEL K. AKAKA
QUESTIONS FOR ANDREW SAUL, CHAIRMAN
OVERSIGHT OF THE THRIFT SAVINGS PLAN: ENSURING THE INTEGRITY OF
FEDERAL EMPLOYEE RETIREMENT SAVINGS
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET, AND
INTERNATIONAL SECURITY
MARCH 10, 2004

Participation in the Thrift Savings Plan (TSP) is an important tool to augment the retirement benefits of federal workers. In 1998 and 2000, the IRS issued rulings allowing private companies to automatically enroll their employees in 401(k) plans. A September 19, 2002, Congressional Research Service report notes that GS-4 federal workers under the Federal Employee's Retirement System with 30 years of government experience, who contribute 5 percent of their income, can reasonably plan on around 90 percent of their salary after retirement, including social security and their basic annuity.

Question 1. What are your views on automatic enrollment for 401(k) plans and how would this work with the TSP? What are your views on strategies to ensure higher participation rates among all federal workers, and what is TSP's strategy to increase participation among lower income workers?

Answer: Automatic enrollment is not permitted under the law governing the TSP and we have not recommended any change in that regard. Affirmative elections, which were established by the Congress and have been required since the TSP began in 1987, have worked very well as evidenced by voluntary participation rates which exceed those in similar private sector plans.

Nevertheless, we continue to encourage increased participation primarily through educational publications, web-based materials, and in-person trainings and briefings of eligible employees. These efforts are conducted in cooperation with Federal employing agencies, the employee unions and associations which comprise the statutory Employee Thrift Advisory Council, and the United States Office of Personnel Management.

We have endorsed legislation in the Senate to eliminate open seasons and believe this change could increase voluntary participation. We have also endorsed legislation in the House of Representatives that would eliminate open seasons and provide

immediate employer contributions for new employees. The latter would make the TSP like the government's health and life insurance programs for employees by providing the incentive of employer contributions from an employee's first day on the job. These employees are frequently lower-paid, and may be more inclined to contribute their own funds if they were provided the same employer matching contribution incentive given to their more senior (and generally higher-paid) colleagues.

Question 2. Strong financial literacy programs play a critical role in providing federal employees with the information they need to make sound decisions about their retirement savings. This includes making informed decisions about retirement savings before **and** after retirement.

Could you please explain, how the TSP is educating federal employees to make informed decisions on managing their retirement savings after they retire?

Answer: The agency, in close coordination with the Office of Personnel Management and the employing agencies, provides extensive education regarding the TSP to all participants. These coordinated efforts are detailed in a recent report to the Honorable Carl Levin entitled "Federal Retirement: Key Elements Are Included In Agencies' Education Programs. GAO/GGD-99-27.

In addition to understanding their investment choices like other participants, retirees need to fully appreciate the provisions of the U.S. Tax Code which require that they begin to withdraw funds from the TSP (as well as other tax-deferred retirement savings plans) when they reach age 70½. The agency has developed special educational materials that deal specifically with these complexities, and has instructed employing agencies to include these materials in the "withdrawal packages" they provide when their employees retire. We also maintain this material on our web site, and work closely with the National Association of Retired Federal Employees in preparing articles as well as Q's and A's on specific retiree-related issues for publication in that association's monthly magazine which goes to its nearly 500,000 (primarily retired) members.

Question 3. The TSP hopes to offer "lifestyle" and lifecycle" plans to federal workers by the beginning of 2005. These plans would be combinations of existing TSP funds and would be customized according to the investment needs of individual participants.

Question 3A. What criteria will be used to define aggressive, moderate, and conservative risk?

Answer: The Request for Proposals (RFP) to create the Lifecycle fund models and develop the communications program was issued on May 24, 2004. Proposals have been received from interested parties and are being evaluated. We expect that selections will occur in September and the Lifecycle funds will be available in mid-2005

Use of criteria involving definitions of aggressive, moderate, and conservative funds is generally associated with "Lifestyle" funds. Although we considered this approach, we decided instead to solicit proposals for "Lifecycle" funds. Under this approach, the vendor would design models that will adjust the investment mix over time leading up to the year in which the participant plans to withdraw the funds. Thus, rather than grapple with whether they consider themselves aggressive, moderate, or conservative investors, participants will simply identify the year they plan to withdraw and the model will adjust their investments as that time draws near.

Question 3B. How will the Federal Retirement Thrift Investment Board (FRTIB) ensure that participants have the financial literacy tools to determine if "lifestyle" and "lifecycle" funds are appropriate for their investment mix and preparation for retirement?

Answer: The RFP includes two "lots." Under the second lot, the contractor must recommend a comprehensive communications strategy for informing and educating the TSP participants about the new lifecycle funds. The strategy must identify any existing materials requiring revision and must recommend any new communication materials or vehicles. The strategy must address written and web-based products and participant statements as well as the use of other media (e.g., the ThriftLine, video clips) and must recommend the timing for dissemination of communication materials. The strategy should present at least two alternative design approaches for the communications.

Question 3C. What are the projected administrative costs of these funds per participant and how will participants be made aware of these costs?

Answer: The costs associated with the Lifecycle funds will be determined through the procurement process. Although we will not have an answer until that process is completed, we expect those expenses will be quite small.

Question 4. Mr. Amelio reports that TSP intends to place loan costs on borrowers rather than all plan participants. Mr. Amelio has said that FRTIB has proposed that borrowers be charged a \$50 fee per loan, but the actual administrative costs will be \$47 per loan. How does the FRTIB plan to use any excess funds collected?

Answer: The \$47 cost cited is an estimate. Some may be higher and some may be lower. As with all TSP activities, any excess would reduce the administrative expenses otherwise charged to participants.

Question 5. During the hearing it was suggested that the FRTIB should consider outsourcing the administration of the TSP. Could you please discuss the risks of outsourcing the administration of the TSP.

Answer: I have reviewed the earlier response to this question provided for the record by Executive Director Amelio and am in complete agreement with his comments.

ANSWERS TO QUESTIONS FOR THE RECORD FROM SENATOR DANIEL K. AKAKA
OVERSIGHT OF THE THRIFT SAVINGS PLAN: ENSURING THE INTEGRITY OF
FEDERAL EMPLOYEE RETIREMENT SAVINGS
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET, AND
INTERNATIONAL SECURITY
MARCH 10, 2004

Questions for Gary Amelio, Executive Director of the TSP

On March 8, 2004, the Federal Retirement Thrift Investment Board (FRTIB) announced the selection of Spherix Incorporated to run a parallel call center for the Thrift Savings Plan (TSP). Spherix Incorporated currently runs call centers in Maryland.

Question 1A. Would you please provide details on the cost of establishing and running an additional call center, the cost of the call center borne by each TSP participant, and the process you relied on to determine the cost of the call center?

Answer: Spherix Incorporated was selected through a competitive procurement issued on November 11, 2003. A total of 22 proposals were received. The successful contractor price is \$2,465,891.11. As with all Thrift Savings Plan administrative expenses, the cost will be shared by all 3.3 million TSP participants consistent with the provisions of 5 U.S.C. § 8439(a)(3).

Question 1B. Is there any provision in the contract with Spherix Incorporated requiring that the call center be located, and any subcontracting services be performed, in the United States?

Answer: Under section F.3 of the contract, the place of performance "must be within the United States."

Question 1C. Would you please describe the qualifications and training that will be required for employees staffing the new call center? What training and qualifications are required for employees in the existing TSP call center?

Answer: Because the Agency contracts with vendors for call center services, the qualifications of the participant service representatives whom they employ are determined by the respective vendors.

The Agency is currently working with the parallel call center vendor to develop the TSP training program for their call center representatives. The training will cover the various aspects of the TSP program and its operations, the computer system applications that support the representatives, and customer service techniques. For example, the training elements for the loan program will include the features of the TSP loan program, the mechanics of applying for and repaying a loan, and resources available to participants (e.g., the TSP web site). Customer service training includes the proper way to answer and conduct a call, how to interact with participants, how to resolve problems, etc. The training is a combination of lecture, hands-on exercises, role playing, and shadowing (working with an experienced representative).

The TSP Service Office at the National Finance Center has developed its own training program for its employees that includes the same components described above. In addition, Agency staff has conducted training on new benefits or processes as necessary for the current vendor, and will do so for the new vendor as well.

Question 2. What is being done to improve the financial literacy of TSP participants and how effective are these efforts?

Answer: Since its inception, the Agency has sustained a continuous effort to educate employees regarding the investment choices, benefits, and operations of the TSP. The Agency has issued a variety of communications to help participants understand the five TSP Funds and investment considerations. For example, the *Guide to TSP Investments* describes in detail investment considerations and approaches, fund management, and operations. Other publications, for example, the *Summary of the Thrift Savings Plan* and the *TSP At A Glance*, also provide information about investing in the TSP.

The Agency has also published in the *TSP Highlights* and on the Web site shorter articles addressing specific investment topics. These are issued in conjunction with TSP Participant Statements. Over the years, these topics have covered specific descriptions about the five TSP Funds, the change to daily valuation and the new share-based record keeping system, the importance of rebalancing accounts to maintain a desired asset allocation, the perils of market timing, etc. The April 2004 *TSP Highlights* includes two articles: one reminding participants to review

their contribution elections to be sure that they are contributing enough to reach their retirement goals and the other encouraging participants to "invest wisely." The latter article is the first in a series of Highlights articles that will address specific investment concerns such as determining the amount of money needed for retirement, risk tolerance, time horizons, asset allocation and rebalancing, and market timing. Every TSP Highlights includes information about the five investments funds.

In a March 1999 Report to the Honorable Carl Levin, U.S. Senate, entitled "Federal Retirement, Key Elements Are Included in Agencies' Education Program", the General Accounting Office affirmed that the responsibility for retirement counseling and education rested with the U.S. Office of Personnel Management and employing agencies. The Agency has concentrated its efforts on educating participants about the Thrift Savings Plan. These efforts cover the broad spectrum of TSP benefits, including the investment options offered by the TSP. Although the Agency does not provide investment advice to participants, it has developed numerous written and Web-based materials (such as the extensive *Guide to TSP Investments* and shorter articles in the *TSP Highlights*) that educate participants on various investment topics.

The effectiveness of efforts to date are reflected in the very high TSP participation rate and contribution levels, which significantly exceed performance in other similar plans. The Board intends to survey participants regarding materials that would help them in the future to better understand their investments and benefits under the plan.

Question 3. For the record, would you please provide the TSP participant and contribution rates among low, middle, and high federal employee wage earners. What are the general and residential loan borrowing rates and default rates of these employee groups?

Answer: Although the TSP does not maintain salary information in the participant database, demographic information on contribution and investment activity is developed annually, through a data match with information contained in the Central Personnel Data File maintained by the Office of Personnel Management. Attached is the most recent analysis. Participation and deferral rates by salary increments are discussed on pp. 2-4, and displayed in figures 1-10.

In the past loan data has not been included in the demographic analysis. Thus, we cannot provide loan utilization rates by salary level. We will attempt to capture this information in the next data match we conduct later this year.

Question 4. The Social Security Administration executes a series of procedures that ensure the accountability of employees and third parties (i.e.; representative payees) who oversee beneficiary funds. Its Office of the Inspector General is responsible for investigating and responding to reports of fraud, waste, and abuse of individual beneficiary accounts as well as completing random audits of individual accounts to promote high quality services. Does the TSP have similar procedures? How does the TSP ensure accountability for individual accounts?

Answer: By law, the Board is a unique independent Federal agency. Board members and the Executive Director have fiduciary responsibility. Decisions regarding Plan administration are made exclusively by these statutory fiduciaries under the Federal Employees' Retirement System Act (FERSA) of 1986, Pub. L. No. 99-335, 100 Stat. 514 (codified primarily at 5 U.S.C. §§ 8401-8479 (1994)).

The fiduciaries are subject to the extremely close scrutiny which FERSA provides. Like private sector 401(k) fiduciaries, the TSP fiduciaries must act solely in the interest of participants and beneficiaries. The Report on the legislation creating the TSP notes that they may be held civilly and criminally liable for not doing so. FERSA provides for audits, including the extensive activity conducted by the Department of Labor and its contract auditor, KPMG. 5 U.S.C. § 8477(g). Over 200 audits of the TSP have been performed under this program.

Attached is the most recent overview of the TSP fiduciary oversight program. The TSP record keeper reviews described on pp. 17-22, in particular those relating to account maintenance, participant support, interfund transfers, withdrawals, and loans, ensure the accountability for individual accounts.

Question 5. During the hearing it was suggested that the FRTIB should consider outsourcing the administration of the TSP. Could you please discuss the risks of outsourcing the administration of the TSP?

Answer: Regardless of how necessary services are obtained, the Executive Director, by law, remains responsible for TSP administration. 5 U.S.C. § 8474(b)(4). This explicit statutory responsibility invests the incumbent of that position with the duty to decide how to obtain and deliver Plan services (consistent with Board policy). Since the beginning of TSP operations in 1987, the Agency has obtained major services including record keeping, printing, asset management, and annuities from external governmental and private sources. To the extent possible, source selection has been competitive to help ensure high quality and low cost consistent with the statutory requirement that decisions be made solely in the interest of plan participants and beneficiaries who bear the costs of the program.

While there are performance risks associated with obtaining services (as opposed to developing and maintaining Agency capacity in-house), these can be mitigated through the application of sound business practices in the selection process and redundancy in operations. Indeed, even during the failed record keeping project of the late 1990s, TSP operations were never compromised because the Plan continued to operate using the old system until the replacement contractor successfully built and tested the new system.

Question 6. Could you please clarify the three reforms you would like to implement to encourage participants to borrow from their TSP accounts as a last resort and how these changes could affect federal workers?

Answer: A participant can gain temporary access to a portion of his or her TSP retirement savings through the TSP loan program. TSP loans are subject to the requirements of FERSA (5 U.S.C. 8433(g)), the Internal Revenue Code (26 U.S.C. 72(p)), and the TSP loan regulations (5 C.F.R. part 1655). These provisions require the TSP to charge interest on loans and to establish a repayment schedule.

The loan program offers an important benefit. It encourages participants to contribute more to the TSP because they know they will have access to some of the money in their accounts to help purchase a home or pay unexpected bills. However, the TSP is not a checking or savings account; it is a long-term investment intended for retirement. Removing money from a TSP account - even when it is paid back - may diminish the amount available to the participant for retirement.

Nevertheless, the number of TSP loans outstanding has been increasing rapidly in recent years. A review of loans issued shows that many participants are paying off a loan and immediately taking another loan. Also, a significant percentage of TSP participants maintain two loans outstanding. It is inappropriate for participants to maintain constant loan balances, thus treating the loan program as a source of ready cash, rather than a lender of last resort.

The administrative expenses of the TSP loan program are considerable and they are borne by all of the participants as a general administrative expense. It is appropriate for the participants who take advantage of the loan program to bear its cost, rather than 2.7 million participants who do not use the program.

Three TSP policy changes have been proposed in regulations to reinforce the importance of borrowing from the TSP only as a last resort, to ensure that the administrative expenses of the loan program are reasonable for a retirement savings plan, and to ensure that the costs of the TSP loan program are paid by the participants who use it. First, the Board proposes to establish a 60-day waiting period between paying off one loan and receiving another loan of the same type. Second, participants would be limited to having a single general purpose loan outstanding at any one time. Third, a \$50.00 loan fee would be charged to the borrower when a TSP loan is disbursed.

These changes will allow participants to still borrow up to the same amounts from their accounts as is currently allowed; however, there will be fewer small loans, loan program administration will be simplified, and the cost of the loan program will be borne by the borrowers rather than all plan participants.

Analysis of 2002 Thrift Savings Plan Civilian Participant Demographics

Federal Retirement Thrift Investment Board
1250 H Street, NW
Washington, DC 20005

Analysis of 2002 Thrift Savings Plan Civilian Participant Demographics

Introduction

This analysis of Thrift Savings Plan (TSP) civilian participant demographics prepared by the Federal Retirement Thrift Investment Board is based on participant data enhanced with information from the Office of Personnel Management (OPM) database of Executive Branch and Postal Service employees. The analysis of calendar year 2002 data is similar to previous analyses of data in calendar years 1987 through 2001.¹ Groups of Federal Employees' Retirement System (FERS) participants who entered the TSP during the July open seasons from 1988 through 2001 are reviewed after an additional year of eligibility, and FERS participants entering in the July 2002 open season are studied after their first opportunity to participate. These groups are also compared to each other, and the 2002 information is compared to data from selected previous analyses, where applicable.

In summary:

- Overall, the FERS participation rate (i.e., a measure of current FERS-covered employees making voluntary salary deferrals) increased slightly to 88.4% during 2002, from 88.1% in 2001. FERS participation has been near 88% since 1997, after rising steadily for ten years from the plan's inception in 1987, when 44.1% participated.
- The overall average deferral rate (i.e., the percentage of basic pay contributed to the TSP) for FERS contributors increased to approximately 7.7% in 2002, from 7.2% in 2001. The FERS average deferral rate has increased every year since 1988, the first full year of plan operation, when it was 4.9%. The average deferral rate in 2002 for Civil Service Retirement System (CSRS) contributors was approximately 5.6%, an increase from 4.6% in 2001. The significant increases in deferral rates are largely attributable to higher statutory maximum contribution limits in 2002; the maximum permitted deferral was 12% for FERS participants and 7% for CSRS participants, up from 2001 effective maximum annual rates of 10.4% and 5.4%, respectively.²
- The median age and salary of FERS contributors, 43.8 years and \$42,635, were higher than those of FERS noncontributors, which were 41.2 years and \$37,551. For CSRS contributors, the median age and salary were 52.2 years and \$56,387.
- Each year's FERS entrants showed increases in their participation rates in 2002 compared to 2001 and from their respective initial year participation rates, as summarized below. The substantially higher participation by the July 2002 class is likely because this group is the first to have been immediately eligible to begin making employee-only contributions upon hire, rather than being required to wait up to one year before being eligible to make contributions.

Date of Entry	Participation Rates			No. Of Years of Eligibility
	Initial Year	In 2001	In 2002	
July 1988	24.6%	92.0%	92.2%	14½
July 2000	58.5%	76.3%	82.2%	2½
July 2001	59.3%	59.3%	76.9%	1½
July 2002	74.6%	n/a	74.6%	new

- The average year-end allocation of investments by contributing participants was 49% in the U.S. Treasury securities fund, 11% in the bond index fund, 38% in the common stock index fund, and 1% each in the small capitalization and international index funds.

Background

The U.S. Department of Agriculture, National Finance Center, the TSP's record keeper, provided a computer tape containing extract data about the accounts of approximately 2.7 million TSP participants reported in TSP records as active civilian federal employees as of December 31, 2002. OPM enhanced these data with June 2002 annual salary rate, sex, and length of Federal service data. OPM returned data on approximately 2 million full-time employees. There are an additional 185,000 part-time or intermittent employees identified in the data, but they are not included in these analyses because their actual compensation is not known. OPM was not able to provide information about the remaining participants either because they were not reported to OPM (principally for employees of the Legislative and Judicial Branches) or the data OPM had were not complete.

The summary analysis provided is subject to the following limitations:

- Employees of the Legislative and Judicial Branches may participate in the TSP at different participation and/or deferral rates from the Executive Branch employees included in this study. However, because these groups are a relatively small part of the total population, the deviation is unlikely to affect significantly the statistics presented here.
- Employees' actual deferral rates are not included in TSP or OPM centralized data bases. Therefore, an approximation of an annualized deferral rate has been calculated by comparing the total amount of 2002 employee contributions to annual salary at June 2002. Thus, for example, assuming no salary change during the year, a FERS employee who deferred 10% for the first half of the year and terminated contributions in the second half would be considered to have contributed 5%.
- For purposes of this study, "FERS contributor" is defined as an employee who contributed his or her own money (i.e., an employee contribution) at any time during the year. An "active FERS participant" is one who received at least one employee or employer contribution during the year.
- Approximately 3% of the data appeared to have erroneous deferral rates (i.e., CSRS employees

in excess of 7% and FERS employees in excess of 12%). This can result either from the use of the annual salary at mid-year, which understates the actual compensation for persons receiving salary increases in the latter half of the year, or from faulty data. Where the calculated deferral rates exceed the statutory maximums, those employees have been included in the overall deferral rate calculations at their statutory maximum deferral rates.

Analysis

The following sections address Plan population characteristics. The exhibits following this narrative display, over time, relationships between participation rates and age and salary, and between deferral rates and age and salary.

Ages are broken down into 10-year increments (e.g., ages 20 through 29, 30 through 39). However, as the CSRS was closed to new entrants in 1983, there were insignificant numbers of CSRS participants younger than age 30 in 2000. Salaries are generally shown in \$10,000 brackets (e.g., annual salary between \$10,000 and \$19,999, and between \$20,000 and \$29,999). The appendix provides descriptive statistics with respect to participation and deferral rates.

Age, Salary, Participation Rates, and Deferral Rates of TSP Participants

Figures 1 and 2 show the FERS participation rates (the number of FERS participants who made voluntary employee contributions as a percent of the number of active FERS participants) by age and salary, respectively. In 2002, the FERS participation rates increased with age or salary increases, except in the case of participants over 70 years of age, who participated at a slightly lower rate than the age 60-69 category. The percentage of FERS contributors ranged from 77% in the youngest age group to 92% in the 60-69 age group, and from 51% in the lowest salary bracket to 97% in the highest salary bracket. The overall FERS participation rate was approximately 88%. These charts also display comparative data from the previous two years and from 1988, which was the first full year of operation of the TSP. As can be seen from Figure 1, FERS participation rates have been nearly constant

from 2000 through 2002 in all age groups except the youngest, in which there has been a slight variation. When arrayed by salary (Figure 2), the participation rate among participants with salaries between \$10,000 and \$19,999 increased significantly in 2002 over 2000 and 2001, but has declined slightly among participants with above \$20,000.

Figures 3 and 4 display deferral rates (the percentage of pay contributed to the TSP) of FERS contributors by age and salary. The average deferral rates showed a consistent pattern of increasing rates as age or salary increase. The average deferral in 2002 ranged from 6.8% in the youngest age group to 8.8% in the oldest age group, and from 5.6% in the lowest salary bracket to 9.0% in the highest salary bracket. Figures 3 and 4 show that deferral rates for FERS contributors increased in 2002 for all age and salary ranges. The average salary deferral among all FERS contributors was approximately 7.7%, an increase from 7.2% in 2001.

Participation rates of CSRS employees classified by age and salary are not shown because data is not available for non-participating CSRS employees. The overall CSRS participation rate in 2002 was approximately 67%, compared to 66% in 2001; the CSRS participation rate in 1988, the first full year of the TSP, was approximately 20%.

Deferral rates by age and salary for CSRS participants who are contributing to the TSP³ are shown in Figures 5 and 6. The CSRS average deferral rates for 2002 reflect consistently increasing rates of deferral as age or salary brackets increase, although the range of differences was smaller in the CSRS population than among FERS participants. The average deferral in 2002 ranged from 4.6% to 5.4% in the youngest and oldest age groups, respectively, and from 4.0% to 5.8% for the lowest and highest salary brackets, respectively. The average salary deferral among all CSRS contributors was approximately 5.2% compared to 4.6% in 2001.

In summary, these charts show that from 2001 to 2002, FERS and CSRS deferral rates increased markedly in all age and salary brackets. The increases in the average deferral rates are the result of some participants electing to contribute at the higher statutory maximum contribution rates of 12% for FERS participants and 7% for CSRS participants, as described below.

The distributions of FERS and CSRS contributors' deferral rates are shown in Figures 7 and 8, re-

spectively. Among FERS participants, the data show that, in 2002, 14% of contributing participants were deferring at rates of up to 3%, where the agency matching contribution is dollar-for-dollar, and 20% were deferring at 5%, the maximum contribution that is matched. Approximately 18% of the FERS contributors were contributing at 10%, which was the maximum allowable rate prior to the enactment of P.L. 106-557, approximately 10% of FERS contributors were deferring 11% of salary, the new maximum rate allowed during 2001; and approximately 18% of FERS contributors were deferring 12%, which was the increased maximum rate allowed in 2002. Among CSRS contributors, an aggregate of only 23% of contributors deferred at 1-4% of salary. Approximately 27% deferred 5%, the maximum rate allowed for CSRS employees prior to July 2001; 16% of CSRS contributors deferred at a 6% rate, the maximum permitted for the latter part of 2001; and 35% deferred at 7%, which was the maximum allowed for 2002.

The distributions of deferral rates in prior years are also shown in Figures 7 and 8. Although the proportions of participants deferring at rates below the pre-2001 maximums have been relatively consistent during 2000 through 2002, the proportion of participants deferring at the previous maximum rates are now split across the higher deferral rates up to the new maximums; however, the sums of the groups in 2002 deferring at or above the old limits (i.e., 10-12% for FERS and 5-7% for CSRS) are approximately equal to the proportions of participants deferring at the maximum rates in the immediately prior years. It cannot be determined from the data whether the FERS contributors at 11% or the CSRS contributors at 6% reflect participants holding their deferral rates at the maximum rates in effect in 2001, or belatedly making an election to the highest permitted rates in the second half of 2002. Note that because of lags in participant response to the changing maximum permissible deferral rates, the patterns of deferral rates in the upper ranges may not stabilize for several years after the percentage limitations are removed in 2006.

The distribution of deferral rates varies considerably at different salary levels. Four salary brackets were extracted from the 2002 data for comparative analysis: \$25,000-\$29,999; \$40,000-\$44,999; \$55,000-\$59,999; and \$70,000-\$74,999. Figures 9 and 10 illustrate the FERS and CSRS deferral rates within these selected salary brackets. Among contributing FERS participants in the lowest of the four selected salary brackets, 58% deferred 5% of salary or less, with half of this group contributing at a

less, with half of this group contributing at a rate of 3% or less, and less than one in ten contributing at the maximum rate. Among FERS contributors in the \$40,000–\$44,999 range, 42% deferred 5% of salary or less, including 15% deferring 3% of salary or less, while 14% deferred at the maximum rate. The trend towards higher deferral rates at higher salary levels continues in the \$55,000–\$59,999 group, with approximately 30% deferring 5% of salary or less, including only 10% contributing 3% or less, and 25% deferring at the maximum rate. In the highest salary range selected for this analysis, less than one-fourth deferred 5% or less, including only 6% contributing at a rate of 3% or less, while one-third deferred at the maximum rate. CSRS participants exhibited a similar trend of higher deferral rates among higher salary brackets. Among CSRS contributors in the lowest of the four selected salary brackets, less than 15% deferred at the maximum rate; however, nearly 45% of CSRS contributors in the \$70,000–\$74,999 group deferred at the maximum rate.

Figures 11 and 12 present the population distribution of FERS participants by age and salary, showing both contributors and noncontributors. As can be seen, contributors were somewhat older and more highly paid than noncontributors. Also, as shown in Tables 4 and 5 in the appendix, median ages were 43.8 years for FERS contributors and 41.2 years for FERS noncontributors. Median salaries were \$42,635 and \$37,511 respectively.

New FERS Participants

In previous analyses of participant data, FERS participants who joined the plan in the July open season of each of the respective years have been profiled after their first season of TSP eligibility and compared with their counterparts from earlier years. The FERS participants in the entering class of July 2002 have been added to this ongoing analysis of new participants. As indicated in Table 4 in the appendix, the mean and median ages of FERS participants in their first year of eligibility have been comparable for several years. However, as indicated in the endnotes, the level of salaries (as measured by the median and mean) was slightly higher in 2002 than in 2001, continuing the general trend of increases from previous years (after adjustment for inflation).⁴

As shown in Figure 13, the July 2002 class of new entrants had a participation rate of 74.6%, a significant increase from the 59.3% rate in 2001. The par-

ticipation rate among new entrants had been stable, at or near 60%, since 1997, but increased markedly in 2002. This is likely the result of P.L. 106-361, which changed the time of initial eligibility of FERS employees for making contributions to the TSP from the second semi-annual open season after hire (i.e., six to twelve months after hire) to immediate eligibility for making employee contributions (although employer matching contributions are still subject to the waiting period). Approximately three-fourths of employees in the July 2002 class of FERS employees newly eligible for employer contributions, and of them, approximately 85% were already making their own employee contributions without the advantage of matching contributions.

Figure 14 shows the overall average deferral rates among new FERS entrants. The initial average deferral rate of 7.1% for the July 2002 new entrants continues in the narrow range of 7.1%–7.3% exhibited since 1997.

Follow-up of FERS Participants Who Entered in Previous Years

Analyses are also conducted on each July class of FERS participants to observe any changes after subsequent years of eligibility for participation in the TSP. Comparative analysis of these groups presents a pattern of year-to-year progressions in participation and deferral rates. Figures 15 and 16 show the overall participation rates and average deferral rates for selected classes from their initial year through 2002 (e.g., 15 years for the July 1988 class, 14 years for the July 1989 class, etc.). For clarity of presentation, only the two oldest classes and five most recent classes are shown, but the progressions in the interim classes are similar. The changes in participation rates and average deferral rates over time for each selected group are remarkably similar. Figure 15 shows that participation rates have continued to increase each succeeding year, although the year-to-year rates of increase moderate over time. Noteworthy, however, is that the initial year participation rate of approximately 75% for the July 2002 class, as described above, is comparable to the participation rates in the second year in prior classes, as a result of the new, immediate participation rule.

Figure 16 shows that average deferral rates increase in the third and following years of eligibility after a decrease during the second year. (The second-year decline in the average deferral rate from the initial year reflects relatively large increases in the total num-

ber of new contributors in the second year, and these new contributors tend to contribute initially at relatively lower deferral rates.) However, the year-to-year increases in deferral rates also moderate over time, and the participation and deferral rates of the participant groups with the longest tenure may be reaching a plateau.

Substantially increasing participation rates during the first several years of eligibility has been a persistent pattern. Significant factors that may influence participants to begin contributions to the plan after an initial period of not contributing could be stability of employment, career advancement, and increasing awareness of TSP benefits. However, the opportunity for immediate participation may cause this historic pattern to change for the July 2002 and subsequent classes.

Participant Investments

In 2002, the TSP provided five investment choices for participants: the Government Securities Investment (G) Fund, which was invested in short term nonmarketable U.S. Treasury securities; the Fixed Income Index Investment (F) Fund, which was invested in a Lehman Brothers Aggregate bond index fund; the Common Stock Index Investment (C) Fund, which was invested in a Standard & Poor's 500 stock index fund; the Small Capitalization Stock Index Investment (S) Fund, which was invested in a Wilshire 4500 stock index fund; and the International Stock Index Investment (I) Fund, which was invested in a Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) stock index fund. The S and I Funds were new investment choices in 2001, accepting their first investments in May 2001.

Demographic analysis of the investment allocations of FERS and CSRS participants, as indicated by their year-end balances in the respective investment funds, is presented in Figures 17-19. FERS noncontributors (i.e., participants receiving only the agency automatic (1%) contributions) are excluded from the analysis.⁵

Figures 17 and 18 show the average allocations of TSP contributors among the five investment funds by age and salary. For 2002, the average allocation among the G, F, C, S, and I Funds, respectively, ranged from 52%:8%:36%:3%:1% to

62%:9%:28%:1%:0% for the youngest and oldest age groups, and from 84%:4%:11%:1%:0% to 39%:12%:47%:2%:0% for the lowest and highest salary brackets. These patterns of higher allocations to the G Fund as age increases and lower allocations to the G Fund as salary increases are displayed in the charts. Although not shown here, the same demographic pattern occurred in the 2000 and 2001 data.

The average 2002 investment allocation among all contributors was 50%:11%:38%:1%:1% to the G, F, C, S, and I Funds, respectively. Compared to 2001, when the overall average investment allocation among contributors was 42%:9%:48%:1%:0%, there was a marked reduction in 2002 in the proportions allocated to equities. This likely reflects a combination of participant reallocations to the G and F Funds and losses in 2002 in the equity markets.

To examine these patterns in a different way, contributors' investments are categorized as to low-risk (G Fund) vs. higher risk (the combined F, C, S, and/or I Funds) in 10% increments. As shown in Figure 19, the two most common investment combinations in 2002 were 90 to 100% investment in the low-risk G Fund, comprising 26% of all contributors (including 21% who were invested exclusively in the G Fund), and 90 to 100% investment in the higher risk market-based funds, comprising 24% of contributors (including 16% who were invested entirely in the market-based funds). The remaining half of contributors was fairly evenly distributed among the various other combinations.

Figure 19 also shows comparable information for 1998 through 2001. Although these same two investment combinations included approximately half of all contributors in all five years, the proportion of contributors with all or substantially all their assets in the G Fund decreased substantially between 1998 and 2000 during a period of a rising market, followed by a reversal of the trend during 2001 and 2002, a period of market decline. There was an opposite pattern for contributors with all or substantially all their assets in the market-based funds.

The demographic characteristics of these two largest groups were consistent with the findings displayed in figures 17 and 18. The risk-averse contributors tend to be older and/or lower paid, while risk-tolerant investors tend to be younger and/or higher paid.

Notes

¹ The Federal Retirement Thrift Investment Board has published an analysis of Thrift Savings Plan participant demographics annually since 1987, the first year of plan operation. Copies of previous publications are available from the Board upon request.

² Beginning in July 2001, P.L. 106-554 authorized one percentage point increases in the maximum employee deferral rates each year through 2005; the percentage of pay limits are removed in 2006. The 2002 maximum allowed rates were 12% for FERS and 7% for CSRS, compared to 11% and 6% after July 2001 (or 10.4% and 5.4% effective annual limits for 2001), and 10% and 5% before July 2001.

³ In 2002, approximately 96% of non-separated CSRS employees with TSP accounts made contributions to their accounts.

⁴ The following table provides median and mean salaries for the July 1988 - July 2001 groups, as adjusted for inflation (CPI-W), with the comparable actual figures for the July 2002 class:

	<u>Median</u>	<u>Mean</u>
July 1988 new entrants	\$28,028	\$30,265
July 1989 new entrants	\$27,583	\$30,147
July 1990 new entrants	\$27,787	\$31,677
July 1991 new entrants	\$28,090	\$32,672
July 1992 new entrants	\$28,435	\$33,598
July 1993 new entrants	\$29,995	\$34,812
July 1994 new entrants	\$27,180	\$33,439
July 1995 new entrants	\$28,699	\$33,994
July 1996 new entrants	\$29,494	\$34,538
July 1997 new entrants	\$28,839	\$33,832
July 1998 new entrants	\$31,238	\$36,407
July 1999 new entrants	\$31,244	\$37,019
July 2000 new entrants	\$31,860	\$37,627
July 2001 new entrants	\$32,284	\$38,437
July 2002 new entrants	\$33,990	\$40,785

⁵ FERS participants who did not make contributions from their salary during 2002 had, on average, 90% of their account balances in the G Fund; and 81% of them held their entire account balance in the G Fund. Unless a noncontributing participant directs otherwise, his or her FERS agency automatic (1%) contributions are invested in the G Fund.

FERS Participation Rates

Figure 1. - By Age

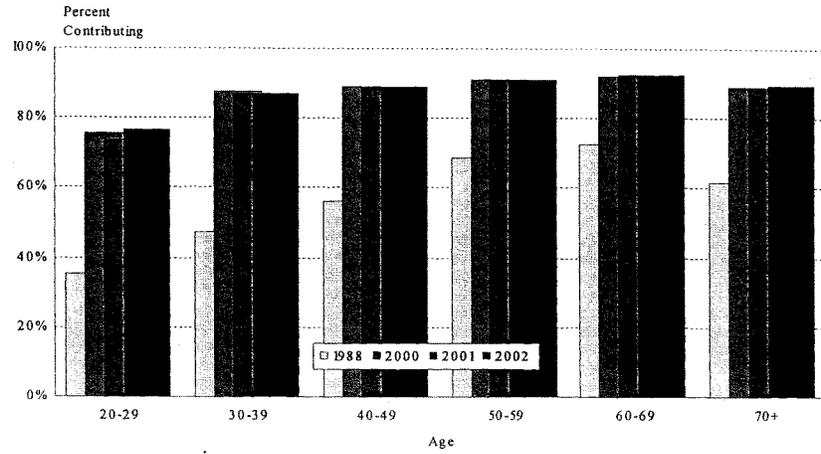
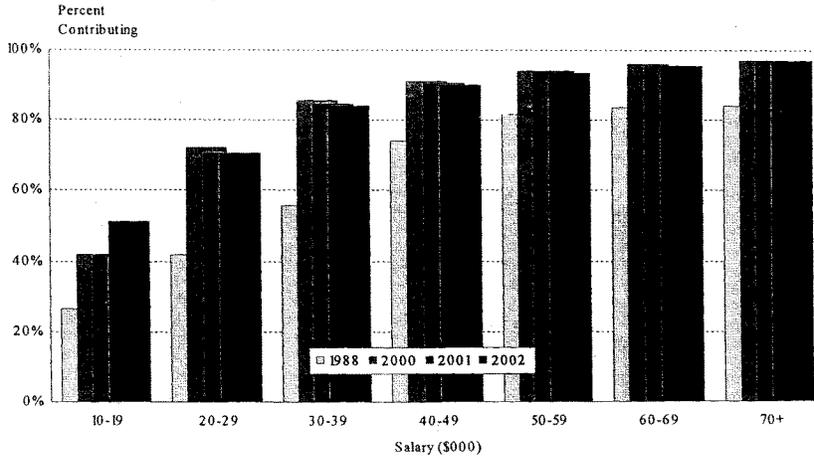


Figure 2. - By Salary



1988, 2000, 2001 salaries adjusted by 1.50, 1.04, and 1.01, respectively, for increases in CPI-W

FERS Average Percent of Pay Deferred

Figure 3. - By Age

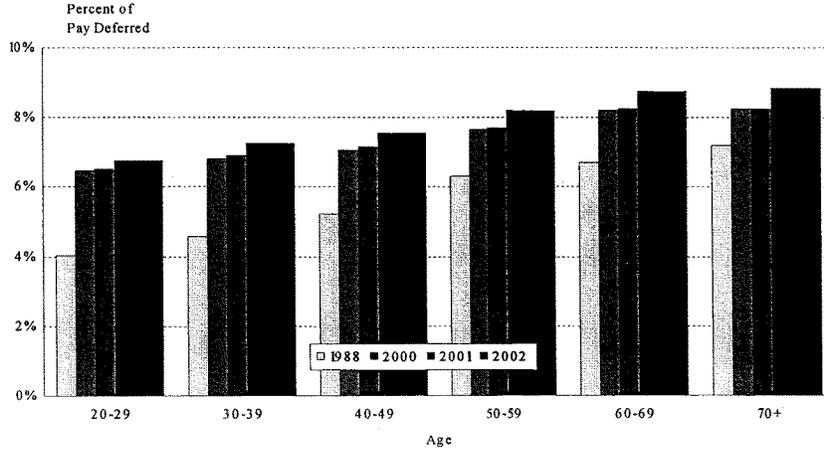
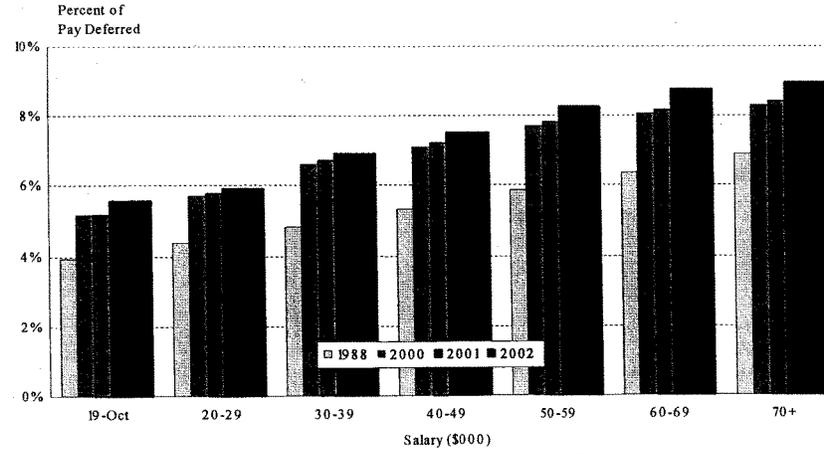


Figure 4. - By Salary



1988, 2000, 2001 salaries adjusted by 1.50, 1.04, and 1.01, respectively, for increases in CPI-W

CSRS Average Percent of Pay Deferred

Figure 5. - By Age

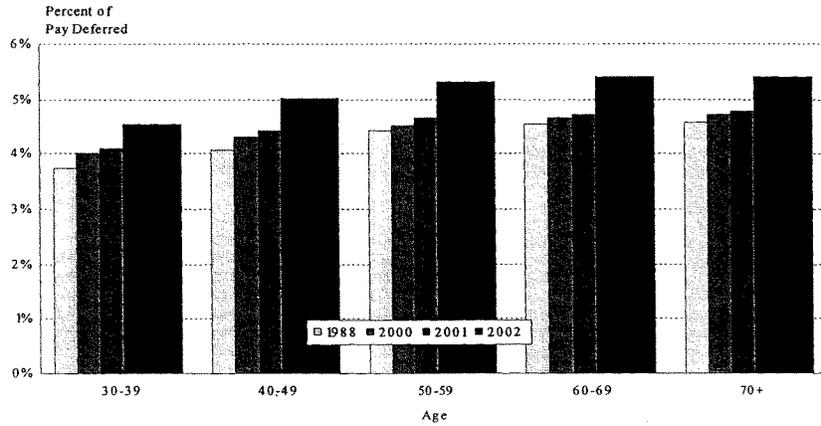
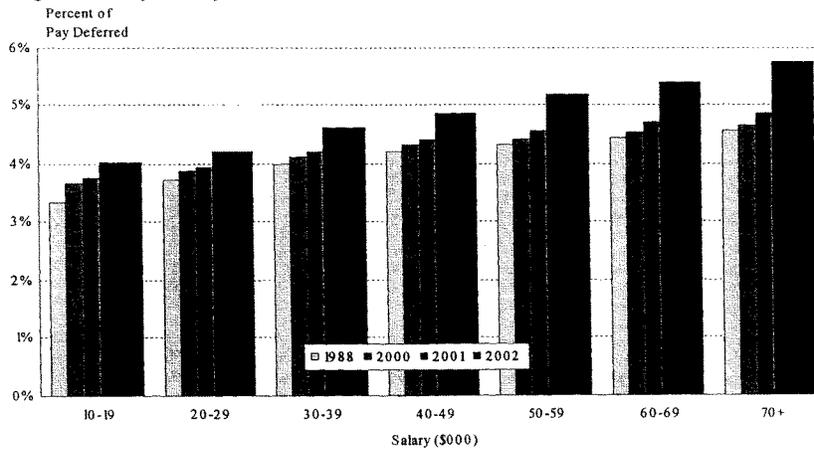


Figure 6. - By Salary



1988, 2000, 2001 salaries adjusted by 1.50, 1.04, and 1.01, respectively, for increases in CPI-W

Distribution of Deferral Rates

Figure 7. - FERS Deferral Rates

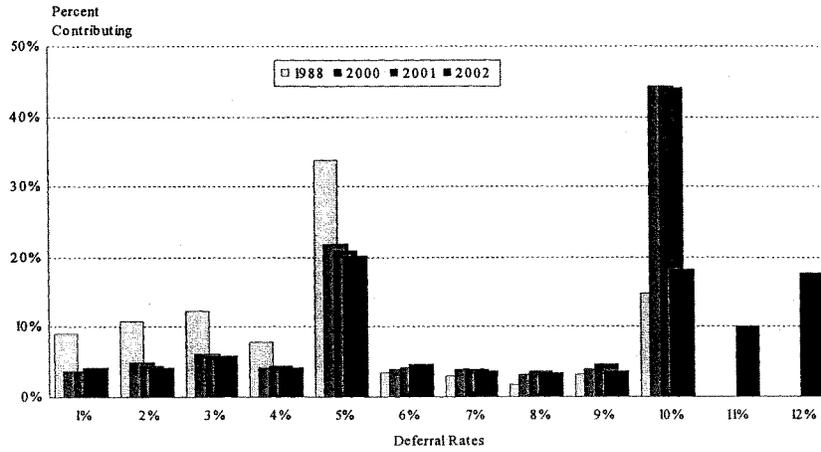
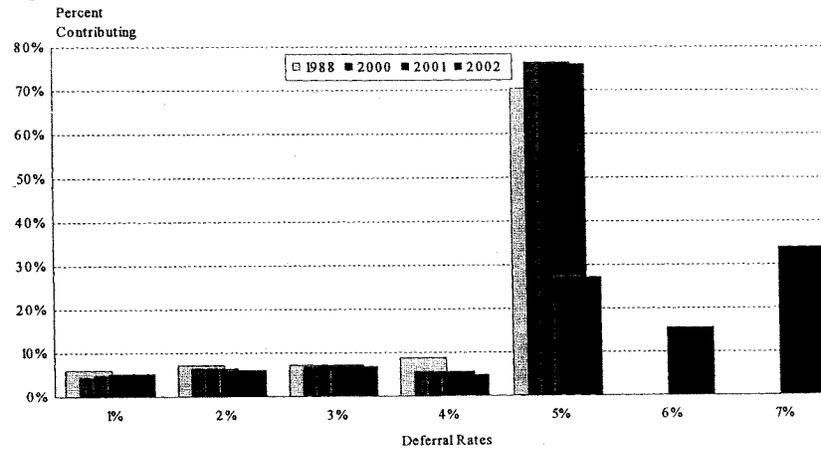


Figure 8. - CSRS Deferral Rates



Distribution of 2002 Deferral Rates For Selected Salary Ranges

Figure 9. - FERS

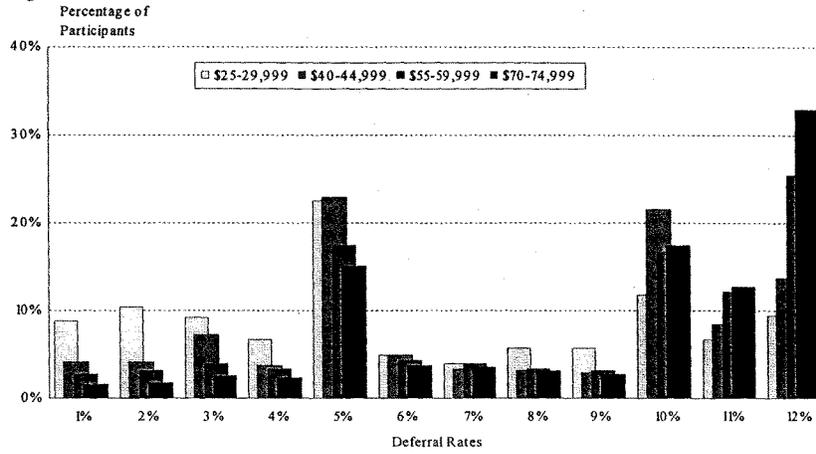
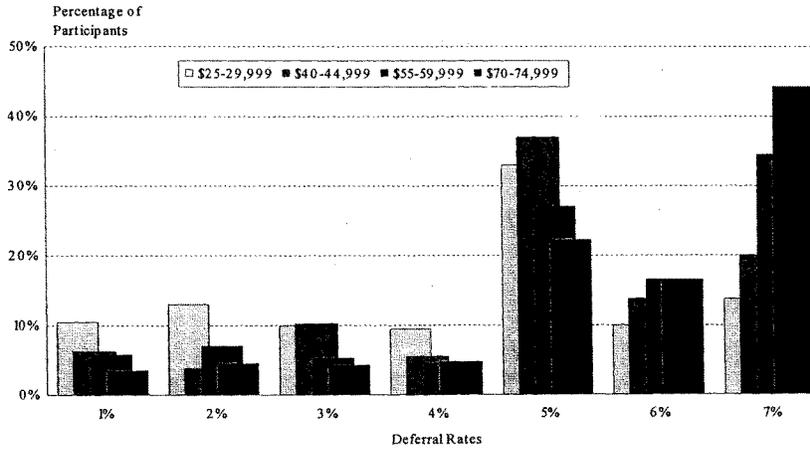


Figure 10. - CSRS



FERS 2002 Population Distribution

Figure 11. - By Age

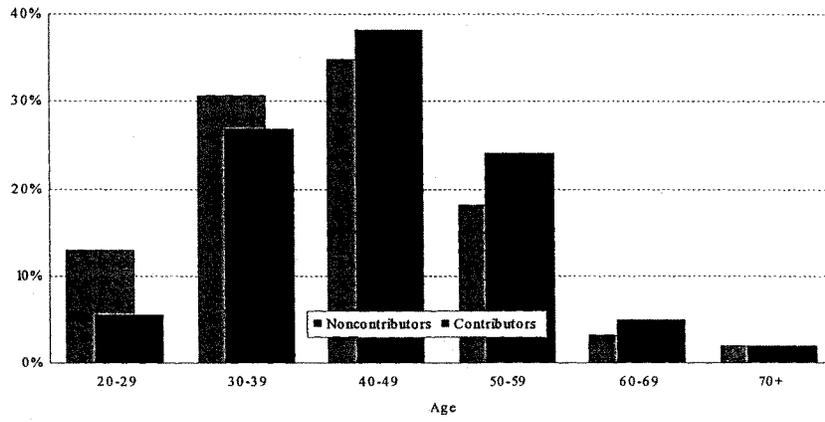
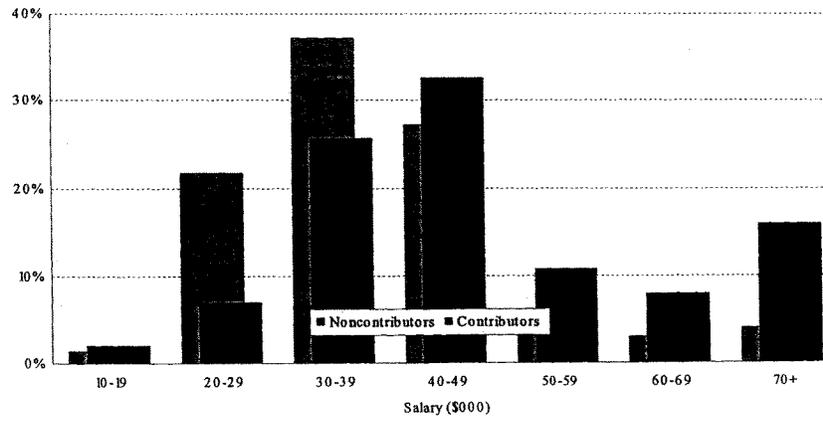


Figure 12. - By Salary



FERS Participants in Their First Season

Figure 13. - Overall Participation Rates

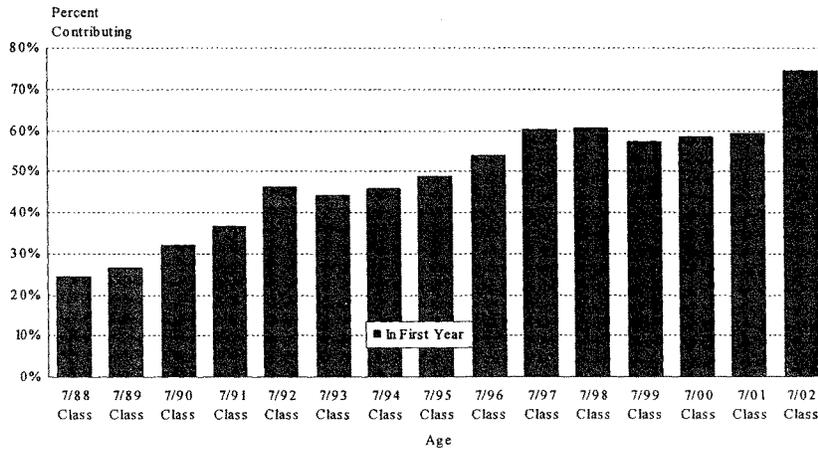
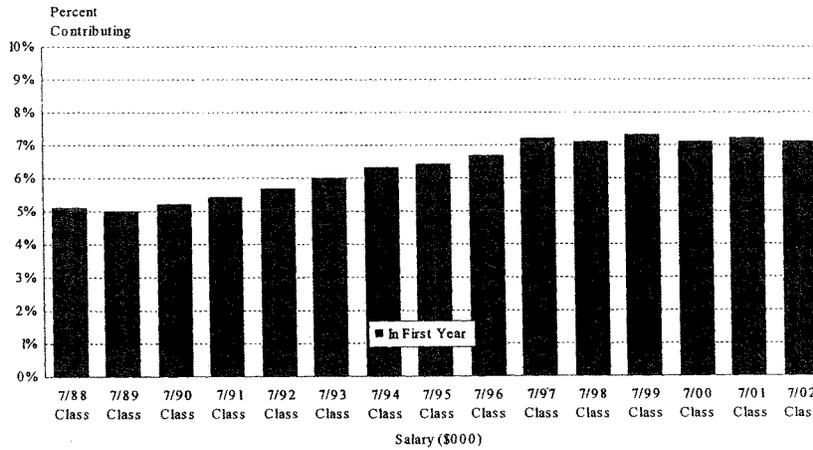


Figure 14. - Overall Percent of Pay Deferred



Comparative Followup of Selected New FERS Participants Groups

Figure 15. - Participation Rates

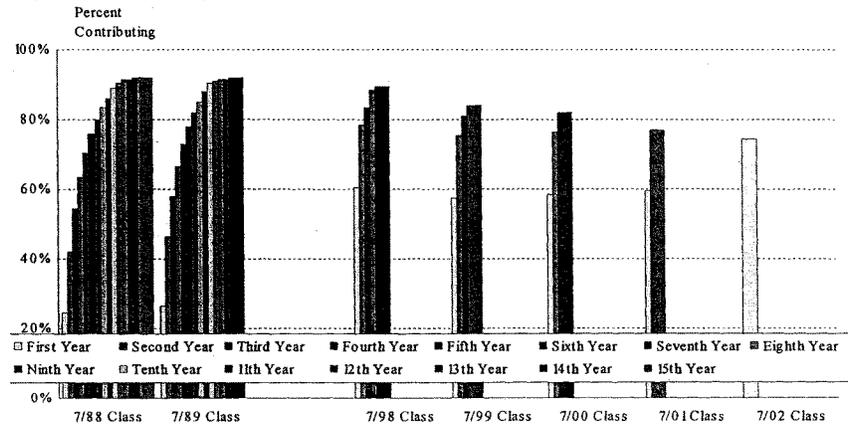
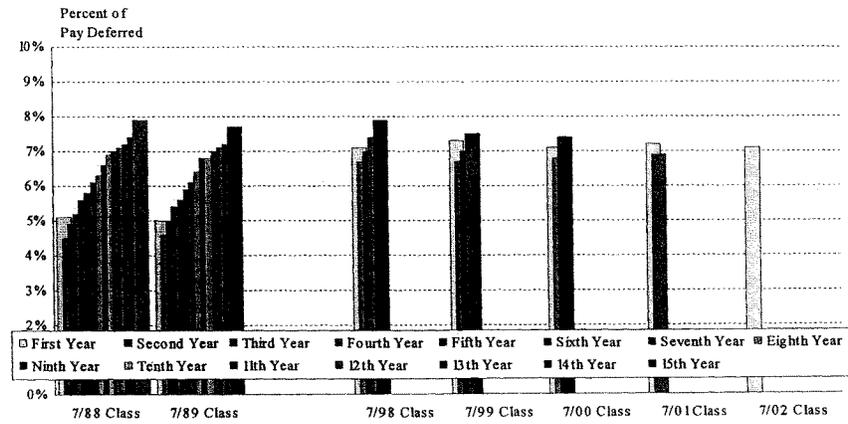


Figure 16. - Average Deferral Rates



2002 Investment Allocation

Figure 17. - By Age

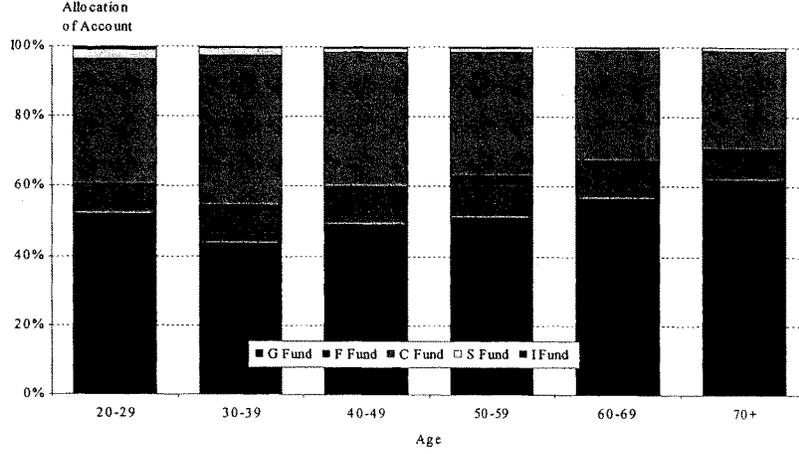
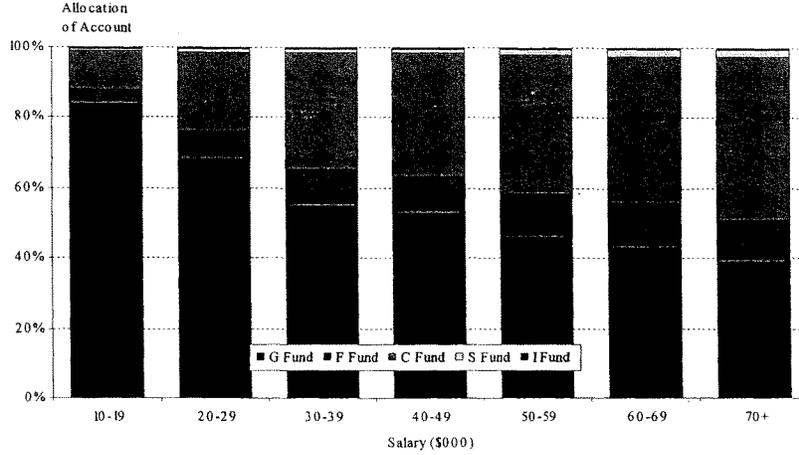
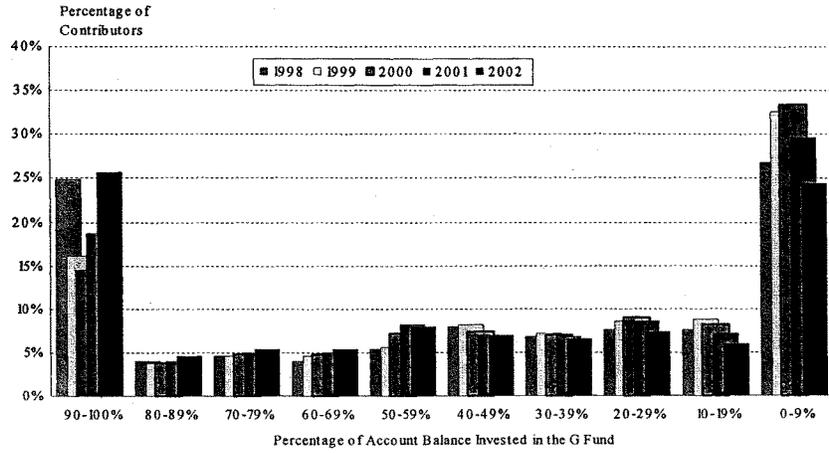


Figure 18. - By Salary



Distribution of G Fund vs. Other Investments

Figure 19.





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**U.S. Department of Labor
Employee Benefits Security Administration**

**Fiscal Year 2004 Thrift Savings Plan
Fiduciary Oversight Program**

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**Subsystem Entrance Conference
USDA National Finance Center
March 3, 2004**

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**Employee Benefits Security Administration
TSP Fiduciary Oversight Program
Key Contacts**

EBSA

- Alan D. Lebowitz, Deputy Assistant Secretary
- Timothy Hauser, Associate Solicitor
- Ian Dingwall, Chief Accountant
- Wm. H. Bailey, Senior Auditor, FERSA Compliance

Phone Number

- (202) 693-8316
- (202) 693-5590
- (202) 693-8361
- (202) 693-8372

KPMG LLP

- Diane Dudley, Client Service Partner
- Heather Flanagan, Engagement Partner
- Derek Thomas, Manager
- Felipe Alonso, EDP Partner
- Don Farneau, Computer Systems Analyst

- (202) 533-3002
- (202) 533-4012
- (202) 533-5402
- (202) 533-3022
- (202) 533-4320



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**Employee Benefits Security Administration
TSP Fiduciary Oversight Program**

**FY 2004 Subsystem Entrance Conference
USDA National Finance Center
March 3, 2004**

Agenda Item

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III. Summary of Open Recommendations	7

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C. Uses of TSP Information Obtained from Each Review	15
D. Review and Report Process of Each TSP Fiduciary Compliance Review	16
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I. Scope of TSP Reviews at the NFC

TSP Record Keeper Activities	Plan 2004	2003	2002	2001	2000
EDP-Related Audits					
1. System Enhancements and Software Change Controls	-	-	FS	-	R
2. IT Hardware Operations Management	-	-	-	R(1)	-
3. Computer Access Control and Security	-	-	-	FS	LTD
4. Data Security Vulnerability Study	-	-	-	-	R
5. Backup, Recovery, and Contingency Planning/ System Availability and Capacity Readiness/ TSP Capacity Planning	-	-	-	LTD	-
6. Pre-implementation Review of Selected Business Processes	-	-	-	LTD	-
7. - New System	-	-	SP	SP	SP
8. Post-implementation Review of New System	SP	-	-	-	-
9. System Infrastructure Controls Review - Legacy System	-	-	-	SP	-
10. Year 2000 Status Review	-	-	-	-	LTD
Subsystem Audits					
10. Account Maintenance	FS	-	(2)	-	-
11. Participant Support	FS (4)	-	(2)	-	-
12. Forfeitures	(3)	-	(2)	-	-
13. Interfund Transfers	(3)	-	(2)	-	-
14. Withdrawals	-	-	(2)	-	-
15. Loan Operations	FS	-	(2)	-	-
16. NFC Billings Relating to TSP Operations	-	-	-	FS	FS
17. Legacy System Subsystem Controls Review	-	-	SP	-	-

(1) Reported with the System Infrastructure controls review

(2) Included in the Legacy System Subsystem Controls Review

(3) Included in the Account Maintenance Review

(4) Includes call center review

FS = Full Scope LTD = Limited Scope SP = Special Project R = Review

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Subsystem Controls Review

- Review of Subsystem Controls for the new TSP System (from date of implementation through January 31, 2004)
- Subsystems include:
 - Account Maintenance (including Interfund Transfers and Forfeitures)
 - Participant Support (including the Call Center)
 - Loan Operations
- Follow Up to Prior Year Recommendations



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II. Schedule of Fiscal Year 2004 TSP Subsystem Reviews at the NFC

<u>TSP Record Keeper Activities</u>	<u>Work</u>		<u>NFC</u>		<u>TIB</u>	
	<u>Begin</u>	<u>Exit</u>	<u>Begin</u>	<u>Exit</u>	<u>Begin</u>	<u>Exit</u>
Participant Support Subsystem (including the call center)	1/12/04*	03/26/04	03/26/04	03/26/04	05/14/04	05/14/04
Loans Subsystem	01/12/04*	03/26/04	03/26/04	03/26/04	05/14/04	05/14/04
Account Maintenance Subsystems (including interfund transfers and forfeitures)	02/09/04*	03/26/04	03/26/04	03/26/04	05/14/04	05/14/04

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* Because of the implementation of the new TSP system and significant changes in the related processes, we scheduled our work in two phases – planning/walkthroughs and testing. The planning/walkthroughs phase began as noted above, and the testing phase began on 3/1/04.

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III. Summary of Open Recommendations

<u>TSP Record Keeper Reviews</u>	<u>Fundamental Controls</u>	<u>Less Critical Controls</u>	<u>Efficiency/ Effectiveness</u>	<u>Total</u>	<u>#Open Originating Prior to 2003</u>
1. System Enhancements and Software Change Controls (1)	3	1	--	4	4
2. IT Hardware Operations Management	--	--	--	--	--
3. Computer Access Controls and Security (2)	4	5	--	9	9
4. Data Security Vulnerability Study	--	--	--	--	--
5. Backup, Recovery, and Contingency Planning (2)	--	1	1	2	2
6. System Availability and Capacity Readiness/TSP Capacity Planning and Performance Management (2)	5	--	--	5	5

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III. Summary of Open Recommendations (continued)

<u>TSP Record Keeper Reviews</u>	<u>Fundamental Controls</u>	<u>Less Critical Controls</u>	<u>Efficiency/Effectiveness</u>	<u>Total</u>	<u># Open Originating Prior to 2003</u>
7. Pre-implementation Review of Selected Business Processes (1)	1	--	--	1	1
8. Post-implementation Review of the New System	TBD	TBD	TBD	TBD	--
9. System Infrastructure Controls Review -- Legacy System	--	--	--	--	--
10. Account Maintenance	--	--	--	--	--
11. Participant Support	--	--	--	--	--
12. Forfeitures	--	--	--	--	--
13. Interfund Transfers	--	--	--	--	--
14. Withdrawals	--	--	--	--	--
15. Loan Operations	--	--	--	--	--
16. NFC Billings Relating to TSP Operations (2)	3	2	--	5	5
17. Legacy System Subsystem Controls Review (1)	3	--	--	3	3

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Supplemental Information

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A. Overview of the EBSA TSP Fiduciary Oversight Program

1. EBSA's TSP Fiduciary Oversight Responsibility

The Thrift Saving Plan (TSP) was authorized by Congress under the Federal Employees' Retirement System Act (FERSA) of 1986 (Public Law 99-335).

The Employee Benefits Security Administration (EBSA), through the statutory reference to the Secretary of Labor [5 USC 8477(g)], is responsible for establishing a program to carry out audits to determine the level of compliance with the requirements of FERSA relating to fiduciary responsibilities and prohibited activities of fiduciaries.



Department of Labor

A. Overview of the EBSA TSP Fiduciary Oversight Program (continued)

2. EBSA's Approach to the Fiduciary Audit Oversight Program

EBSA's TSP review procedures are designed to comply with Government Auditing Standards, published by the General Accounting Office (GAO), for conducting the following audits:

- Financial audits, including reviews of contracts/memoranda of understanding, internal control systems, computer-based systems, and related TSP transaction processing; and
- Performance audits, including economy and efficiency and program reviews.



A. Overview of the EBSA TSP Fiduciary Oversight Program (continued)

3. EBSA's Fiduciary Audit Oversight Program

EBSA's program is designed to determine whether:

- The fiduciaries are acquiring, protecting, and using TSP resources economically, efficiently, and solely in the interest of TSP participants and beneficiaries;
- The fiduciaries have complied with FERSA and applicable laws and regulations;
- The desired results or benefits established by FERSA are being achieved;
- The TSP program activities, functions, and organization are cost effective and efficient; and
- EBSA's previous TSP recommendations have been adequately acted upon.



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A. Overview of the EBSA TSP Fiduciary Oversight Program (continued)

4. Other Benefits:

Besides discharging the Secretary of Labor's statutory responsibilities for a TSP audit program, the EBSA Fiduciary Oversight Program provides the following benefits to TSP participants and beneficiaries:

- Assurance that their retirement assets are properly protected; and
- Potential opportunities for greater future earnings through implementation of EBSA-identified enhancements to TSP system operations.



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B. Examples of TSP Information Obtained for Each Review

- Prior audit reports
- Organization charts
- Position descriptions
- Flowcharts
- Narratives describing work flows
- Descriptions of support systems
- Identification and evaluation of key TSP control points
- EBSA, Federal Retirement Thrift Investment Board (the Board) members and Staff, the U.S. Department of Agriculture (USDA), and the USDA National Finance Center (NFC) management concerns



Department of Labor

C. Uses of TSP Information Obtained from Each Review

- Test internal controls
- Test detail TSP processing transactions
- Conclude on the TSP fiduciaries' overall level of FERSA-related compliance
- Address EBSA, the Board Staff, and USDA management concerns, as practicable
- Provide input for Congressional testimony
- Update EBSA's TSP Fiduciary Oversight Program Manual



D. Review and Report Process of Each TSP Fiduciary Compliance Review

- Entrance conference
- Completion of field work
- Auditee and the Board Staff technical review of first draft
- Exit conference
- Auditee and the Board Staff review of second draft, as applicable
- Final report forwarded to the Board Executive Director for formal response
- Summary of final report forwarded to DOL Assistant Secretary, EBSA, for appropriate further action
- The Board Executive Director provides DOL a formal response, and presents reports and responses to Board at scheduled meetings
- DOL answers any Board Members' TSP audit report questions annually at a scheduled Board meeting.



E. Overview of TSP Review Objectives

TSP Record Keeper Reviews

1. System Enhancements and Software Change Controls
Determine the adequacy of controls over: (1) Project management practices, (2) Enhancements to industry and control standards, and (3) Changes to and deviations from authorized TSP software.
2. IT Hardware Operations Management
Determine the adequacy of operational efficiencies and management effectiveness in scheduling, hardware operations management, and physical access to IT equipment and information.
3. Computer Access Control and Security
Determine the adequacy of controls safeguarding computerized access to data and programs to prevent unauthorized use, modification, damage, or loss.



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E. Overview of TSP Review Objectives (continued)

TSP Record Keeper Reviews

4. Data Security Vulnerability Study Determine the adequacy of controls to prevent unauthorized access to NFC and TSP files through use of the modem and the Internet.
5. Backup, Recovery, and Contingency Planning Determine whether policies, procedures, and related controls are adequate to restore TSP operations effectively and timely in the event of a disaster at the NFC.
6. System Availability and Capacity Readiness/ TSP Capacity Planning Evaluate controls that manage system availability and reliability risks applicable to both the "legacy" and the new TSP system software, under development.



E. Overview of TSP Review Objectives (continued)

TSP Record Keeper Reviews

7. Review of Selected Business Processes Document, review and evaluate the TSP “business” process controls proposed for proper design, including both systems-based and manual controls.
8. Post-implementation Review of the New at TSP System Document the controls and operation of the new TSP System, and review the accuracy of the data conversion.
9. System Infrastructure Controls Assessment – Legacy System Perform a high-level assessment of the “legacy” system controls to determine if: (1) Controls provide reasonable assurance over the efficient and accurate scheduling of production jobs, (2) Maintenance scheduling is reliable, and (3) NFC complies with appropriate standards in making software changes.



E. Overview of TSP Review Objectives (continued)

TSP Record Keeper Reviews

10. Account Maintenance* Determine whether (1) participant account balances accurately record summary and detail contributions and earnings, (2) processing occurs timely, (3) control procedures have been established and are reliable for processing error corrections and lost earnings according to legal requirements, and (4) inactive accounts are properly identified and safeguarded.
11. Participant Support* Determine whether TSP information remitted to the participant is accurate and timely and whether participant inquiries are resolved properly and timely.
12. Forfeitures* Determine the adequacy of procedures and controls to ensure that participant forfeitures and forfeiture restorations are proper and accurate.



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E. Overview of TSP Review Objectives (continued)

TSP Record Keeper Reviews

13. Interfund Transfers* Determine whether participant account balances accurately record "G", "F", "C", "S" and "I" Fund balances as elected by participants.
14. Withdrawals* Determine whether procedures and controls are adequate to ensure proper, accurate, and timely processing, payment, and recording of participant withdrawals.
15. Loan Operations* Determine whether procedures adequately ensure the proper input, processing, and output of data for loans.

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E. Overview of TSP Review Objectives (continued)

TSP Record Keeper Reviews

16. NFC Billings Related to TSP Operations Identify costs applicable to the TSP at the NFC and appraise the reasonableness of such costs billed to the Board in accordance with applicable agreements.
17. "Legacy" System Sub-System Controls Review Determine the adequacy of procedures and controls in the "legacy" TSP system to process routine transfers, actions (e.g., contributions, loans, interfund transfers, and withdrawals), provide routine reporting to the Board, and manage participant support activities.

* These subsystem reviews include a review of the subsystem's related application controls. This non-statistical review determines whether the application controls over input, processing, and output are adequate, in place, and functioning at the subsystem level. Thus, conclusions on the operations at the subsystem level are based on both automated and manual controls.

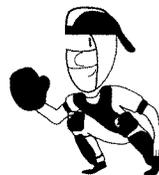
Thrift Savings Plan HIGHLIGHTS

May 2003

Open Season: April 15 – June 30

Inside	
Info for Ready Reserves	2
Beneficiary Designations	2
Feeling "Unbalanced"?	3
Investment Information	4

Catching Up on "Catch-Up" Contributions



PIN Points. When you started contributing to your account, the TSP sent you a Personal Identification Number (PIN).

You can use it to access your account on the TSP Web site (www.tsp.gov) or the ThriftLine (504-255-8777).

(Your TSP PIN will not work on other systems, such as PostalEASE, Employee Express, and MyPay.)

Using your Social Security number and your PIN, you can review your account balance, request an interfund transfer, change your contribution allocation, or review the status of your loan or withdrawal.

You can also change your assigned PIN to a PIN of your choice. The change will be effective immediately. If you lose or forget your PIN, you can request a replacement; however, you will not be able to access your account until you receive your replacement PIN in the mail.

TSP Fund Balances	
AS OF 4/30/2003	
G Fund	\$ 52.0 billion
F Fund	\$ 13.0 billion
C Fund	\$ 37.7 billion
S Fund	\$ 1.3 billion
I Fund	\$.5 billion
Total	\$104.5 billion
Participants	3.1 million

TSP Web site: www.tsp.gov

Beginning in July, Thrift Savings Plan participants age 50 and over will be eligible to make a new type of tax-deferred contribution to the TSP. These "catch-up" contributions are in addition to regular TSP contributions.

Am I eligible to make catch-up contributions? You are eligible if you are a Federal employee or a member of the uniformed services who will be age 50 or older during 2003, and you are already contributing the maximum amount of regular TSP contributions for which you are eligible. The maximum amount of regular contributions for 2003 is 13 percent of basic pay for FERS employees and 8 percent of basic pay for CSRS employees and members of the uniformed services, or, for highly paid employees, an amount which will result in reaching the IRS elective deferral limit (\$12,000 for 2003) by the end of the year.

How much can I invest in catch-up contributions? In 2003, eligible participants may invest up to \$2,000 in catch-up contributions. That amount will increase to \$3,000 for 2004, \$4,000 for 2005, and \$5,000 for 2006. Subsequent years will be indexed to inflation.

When can I start making catch-up contributions? You can submit your election to make catch-up contributions in July, or anytime thereafter. You don't have to wait for a TSP open season. Elections made in July will be effective in August; thereafter, elections will be effective the first pay period after your agency or service receives your request.

How do catch-up contributions work? Your catch-up contribution will be taken as a payroll deduction from your basic pay each pay period. Contributions will be invested in the TSP funds according to your most recent contribution allocation. You will be able to change, stop, or restart your catch-up contributions at any time. Your contributions will automatically stop when you reach the maximum dollar limit allowed for catch-up contributions for the year. You must make a new election each calendar year if you want catch-up contributions to continue. Your agency does not match catch-up contributions.

How do I sign up to make catch-up contributions? Complete Form TSP-1-C, Catch-Up Contribution Election (or Form TSP-U-1-C, if you have a uniformed services TSP account), and submit it to the personnel or payroll office responsible for processing your election. Beginning in July, you can obtain a copy of the form from the TSP Web site, www.tsp.gov, or from your agency or service. Some agencies may be using an electronic version of the form. Check with your agency or service for guidance.

(Continued on page 2)

Federal Retirement Thrift Investment Board

Participants Ask . . .**Q Do I need to designate a beneficiary for my TSP account?**

A It is only necessary to designate a beneficiary if you want your TSP account to be paid to someone **other than** those specified in the following "order of precedence":

- To your widow or widower.
- If none, to your child or children equally, and descendants of deceased children by representation.
- If none, to your parents equally or to the surviving parent.
- If none, to the appointed executor or administrator of your estate.
- If none, to your next of kin who is entitled to your estate under the laws of the state in which you resided at the time of your death.

A will is not valid for determining the disposition of your TSP account.

Q How do I designate a beneficiary?

A Complete a Designation of Beneficiary (Form TSP-3 for civilians; Form TSP-U-3 for members of the uniformed services), which is available from your agency or service or from the TSP Web site. Send your completed form directly to the TSP Service Office. Your participant statement should indicate whether you have submitted a Designation of Beneficiary and the date you signed it.

It is a good idea to review and update your Designation of Beneficiary whenever your personal situation changes (for example, as a result of marriage, birth or adoption of a child, or divorce).

"Catch-Up" Contributions (Continued from page 1)

Are there any special rules for members of the uniformed services who make catch-up contributions? Yes. Members of the uniformed services may contribute only from taxable basic pay. They may not contribute from tax-exempt basic pay (earned while serving in a combat zone), or from bonus pay, special pay, or incentive pay.

Are there circumstances when my catch-up contributions must stop? Yes. If you are in nonpay status or within the six-month period following a financial hardship in-service withdrawal, you are not eligible to make catch-up contributions. ¶

In the Ready Reserve?

(We've got you covered, coming and going.)



If you are a member of the Ready Reserve and your Reserve status changes to active duty, there are some things you need to know about your TSP account.

If you have a uniformed services TSP account:

- *Your contributions will continue in the percentage you elected when you were receiving Reserve pay.* This means, however, that when your uniformed services pay increases as a result of active duty, the amount you contribute to the TSP also increases. You may find that you need to adjust this amount, and you can do so during the first 60 days of active duty or during a TSP open season. (Of course, you can stop your contributions at any time, but you will have to wait for the second open season after you stop to reinstate them.)
- *Pay you receive while serving in a combat zone is tax-exempt, and your contributions to the TSP will also be tax-exempt.* Unlike the regular tax-deferred contributions you make to the TSP, tax-exempt contributions are not taxed — even when you withdraw them. Also, they are not subject to the elective deferral limit (\$12,000 in 2003). They do, however, count toward the Internal Revenue Code section 415 limit which allows you to contribute a maximum amount (\$40,000 in 2003) of combined tax-exempt and tax-deferred contributions into all eligible retirement plans for the year.
- *If you have taken a loan from your uniformed services account, you should ensure that loan payments continue to be deducted from your uniformed services pay when your status changes.*
- *Your loan payments will not increase when your pay increases. They will continue to be made according to your original loan agreement.* Although you may wish to reamortize your loan to increase your payment while you are on active duty and your pay is higher, remember that currently you can only reamortize your loan one time. You may find that you are unable to continue your higher loan payments when you return to Reserve status. This would cause you to default on your loan, resulting in a taxable distribution of the outstanding loan balance and an early withdrawal penalty tax if you are under age 59½.

If you have a civilian TSP account:

- *When you are placed in nonpay status, you cannot contribute to your civilian TSP account. However, when you return to Federal civilian employment, you can make up missed contributions from your future pay for the period of time you were on active duty.*

(Continued on page 3)

Ready Reserve (Continued from page 2)

- If you do not already have a uniformed services TSP account, you can open one (within 60 days of your change in duty status, or during a TSP open season) and continue making contributions to the TSP during your period of active duty.
- If you are a FERS employee and you were eligible for agency contributions during your civilian nonpay period, your agency must deposit retroactive Agency Automatic (1%) Contributions (based on what your civilian basic pay would have been) when you return to Federal civilian employment. If you also have a uniformed services TSP account and you contributed to it from active duty basic pay, you are also entitled to Agency Matching Contributions when you return. If you did not contribute to your uniformed services account while on active duty, your agency will contribute matching contributions based on the employee contributions you make up when you return.
- When you return to civilian service, make sure your agency restarts your TSP contributions to your civilian account. If you are still a member of the Ready Reserve, you can also continue to contribute to your uniformed services account from your Reserve pay, as long as you do not exceed total contribution limits.
- If you have taken a loan from your civilian TSP account, loan payments will be suspended for the period of time you are in approved nonpay status. However, interest will continue to accrue on your loan. The TSP will extend your loan repayment period by the amount of time you were on active duty, if it is indicated on one of the following that your civilian nonpay status is due to military service:
 - Form TSP-41, Notification to TSP of Nonpay Status; or
 - Standard Form 50, Notification of Personnel Action; or
 - a letter from your agency on agency letterhead; or
 - a copy of your orders.

When you return to Federal civilian service, you or your agency must submit documentation to the TSP that specifies the ending date of your active duty so that correct loan payments can resume.

If military service is **not** specified as the reason for your nonpay status, the TSP will suspend loan payments only up to one year, after which your remaining loan balance will be considered a taxable distribution and you will be liable for taxes on the outstanding amount, and possibly an early withdrawal penalty tax.

If you have an active private-sector retirement account and your Reserve status changes to active duty:

- You can make up contributions to your private-sector employee retirement plan when you return to your civilian job. Be sure to notify your employer as soon as you are aware of your orders for active duty so that your retirement savings and any loans you may have are handled appropriately before you leave for active duty.
- Whether or not you participate in an eligible employer plan through your civilian employer, you should consider taking advantage of this opportunity to save for retirement through the TSP.

For more information, see the TSP Fact Sheets "Effect of Nonpay Status on TSP Participation" and "TSP Benefits That Apply to Members of the Military Who Return to Federal Civilian Service," which are available on the TSP Web site (www.tsp.gov). If you have a TSP loan, refer to the booklet *TSP Loan Program*, also available on the TSP Web site. The Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) can be found in the E-Laws section of the Department of Labor's Web site (www.dol.gov).

Feeling**"Unbalanced?"**

Every now and then it's a good idea to check your fund balances to see if the distribution of your TSP investments reflects your goals and to make sure you're not exposed to more risk than you can tolerate. If what you find makes you feel a bit "unbalanced," here's what you can do:

You can make an interfund transfer to redistribute your existing account balance among the five TSP funds. You might want to use this option if market changes have significantly altered your fund balances and you want to restore your account to the proportions you prefer. Or you can make an interfund transfer to diversify (or consolidate) your investments. However, you may prefer to make a series of transfers over time, rather than making one large transfer on a single day. This strategy will limit your exposure to market risk; that is, the risk that if you make one large transfer, the entire amount would be subject to short-term market conditions.

You can change your contribution allocation to affect the distribution of new money coming into your account (payroll contributions, loan payments, and transfers from other plans) by designating the percentage you want invested in each of the five TSP funds. This approach to rebalancing takes greater advantage of "dollar-cost averaging" than a series of interfund transfers.

You can make an interfund transfer or change your contribution allocation on the TSP Web site, www.tsp.gov, the ThriftLine at (504) 255-8777, or Form TSP-50, Investment Allocation (Form TSP-U-50, if you are a member of the uniformed services).

For more information about rebalancing your account, read the *Guide to TSP Investments*, which is available from your agency or service, or the TSP Web site.

Thrift Savings Plan Investment Information

TSP participants may invest in any or all of five TSP funds — the G, F, C, S, and I Funds. The Federal Retirement Thrift Investment Board manages the G Fund investments. The Board has contracts with Barclays Global Investors to manage the F, C, S, and I Fund investments.

The G Fund is invested in short-term nonmarketable U.S. Treasury securities that are specially issued to the TSP. The G Fund interest rate equals the average of market rates of return on U.S. Treasury marketable securities outstanding with four or more years to maturity. TSP administrative expenses reduced the 2002 G Fund return by 0.06%, or \$.60 for every \$1,000 of G Fund account balance.

The F Fund is invested in the Barclays U.S. Debt Index Fund, a commingled fund that tracks the Lehman Brothers U.S. Aggregate (LBA) bond index. This index consists primarily of high-quality fixed-income securities representing the U.S. Government, Federal agency, mortgage-backed, corporate, and foreign government sectors of the U.S. bond market. TSP administrative expenses and F Fund investment management fees reduced the 2002 F Fund return by 0.06%, or \$.60 for every \$1,000 of F Fund account balance.

The C Fund is invested in the Barclays Equity Index Fund, a commingled fund that tracks the Standard & Poor's (S&P) 500 stock index, which includes stocks of 500 large and medium-size companies that are traded in the U.S. stock markets. TSP

administrative expenses and C Fund investment management fees reduced the 2002 C Fund return by 0.07%, or \$.70 for every \$1,000 of C Fund account balance.

The S Fund, established in May 2001, is invested in the Barclays Extended Market Index Fund, which tracks the Wilshire 4500 stock index. It consists of the stocks that are actively traded in the U.S. stock markets except those in the S&P 500 index. TSP administrative expenses and S Fund investment management fees reduced the 2002 S Fund return by 0.07%, or \$.70 for every \$1,000 of S Fund account balance.

The I Fund, established in May 2001, is invested in the Barclays EAFE Index Fund, a commingled fund that tracks the EAFE (Europe, Australasia, Far East) stock index. The EAFE index, comprising 21 countries, consists of the stocks of companies that are large relative to the size of the stock markets of their countries and industries. TSP administrative expenses and I Fund investment management fees reduced the 2002 I Fund return by 0.05%, or \$.50 for every \$1,000 of I Fund account balance.

For more information about the funds, see the *Summary of the Thrift Savings Plan for Federal Employees* or the *Summary of the Thrift Savings Plan for the Uniformed Services*. Monthly rates of return for the funds are available on the TSP Web site, www.tsp.gov.

Rates of Return for the G, F, C, S, and I Funds and Related Indexes*

Year	G Fund %	F Fund %	LBA Bond Index %	C Fund %	S&P Index %	S Fund %	Wilshire 4500 Index %	I Fund %	EAFE Index %
1993	6.1	9.5	9.8	10.1	10.1	-	14.6	-	32.7
1994	7.2	-3.0	-2.9	1.3	1.3	-	-2.7	-	7.8
1995	7.0	18.3	18.5	37.4	37.6	-	33.5	-	11.3
1996	6.8	3.7	3.6	22.8	23.0	-	17.2	-	6.1
1997	6.8	9.6	9.7	33.2	33.4	-	25.7	-	1.5
1998	5.7	8.7	8.7	28.4	28.6	-	8.6	-	20.1
1999	6.0	-0.8	-0.8	21.0	21.0	-	35.5	-	26.7
2000	6.4	11.7	11.6	-9.1	-9.1	-	-15.8	-	-14.2
2001	5.4	8.6	8.4	-11.9	-11.9	-2.2**	-9.3	-15.4**	-21.4
2002	5.0	10.3	10.3	-22.0	-22.1	-18.1	-17.8	-16.0	-15.9
Compound Annual Rates of Return 1993-2002									
	6.2	7.5	7.5	9.3	9.3	-	7.3	-	4.0
Monthly Returns for 2003									
Jan.	0.3	0.1	0.1	-2.7	-2.6	-2.4	-2.2	-4.2	-4.2
Feb.	0.3	1.4	1.4	-1.5	-1.5	-2.6	-2.5	-2.3	-2.3
Mar.	0.3	-0.0	-0.1	1.0	1.0	1.6	1.5	-1.9	-2.0

* The returns for the TSP funds represent net earnings after deduction of accrued administrative expenses and, in the cases of the F, C, S, and I Funds, after deduction of trading costs and accrued investment management fees. The returns for the four indexes shown do not include any deduction for administrative expenses, trading costs, or investment management fees.

** The S and I Funds were implemented in May 2001; therefore, there are no returns for these funds for earlier periods. Returns shown for 2001 for the S and I Funds are for May through December.



Thrift Savings Plan HIGHLIGHTS

October 2003

Open Season

October 15 – December 31

New Contribution Limits —

This open season, FERS participants can elect to contribute up to **14%** of basic pay, up to the IRS annual limit of \$13,000 in 2004. CSRS participants and members of the uniformed services can contribute up to **9%** of basic pay.

If you are age 50 or over and you are already contributing the maximum amount in regular contributions, you can make additional **catch-up contributions** of up to \$2,000 in 2003 and up to \$3,000 in 2004. You must make a new request each calendar year.

Lawsuit Settled — The TSP accepted a settlement offer from AMS, the initial (terminated) contractor for the new TSP record keeping system. The settlement netted \$5 million for participants. The \$36 million in administrative expenses that had already been expended was finally allocated to participants' accounts in July, resulting in a cost of approximately 30¢ per \$1,000 of account balance. More details are available in the Congressional testimony on the TSP Web site.

TSP Fund Balances

as of 8/31/2003

G Fund	\$ 53.0 billion
F Fund	\$ 12.0 billion
C Fund	\$ 49.0 billion
S Fund	\$ 3.0 billion
I Fund	\$ 1.0 billion
Total	\$118.0 billion
Participants	3.2 million

TSP Web site: www.tsp.gov**New Executive Director**

Gary A. Amelio was appointed as Executive Director of the Federal Retirement Thrift Investment Board effective June 1, 2003. The Executive Director of the Board serves as the Chief Executive Officer and managing fiduciary of the TSP.

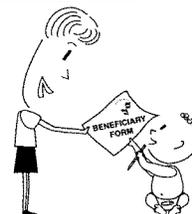
Mr. Amelio comes to the Board with substantial experience in pension plan administration and investments. Most recently, he served as Senior Vice President and Managing Director of the Retirement and Investment Services Department of PNC Bank, N.A., in Pittsburgh, Pennsylvania. Prior to his 14 years at PNC, Mr. Amelio spent seven years at Mellon Bank, N.A. Before that, he was employed in the tax department at Coopers and Lybrand. He is experienced in both the management and legal aspects of employee benefit plans. Mr. Amelio earned a J.D. from the University of Pittsburgh School of Law in 1981 and a B.A. from the University of Pittsburgh College of Arts and Sciences in 1978.

Now that the new system is up and running, Mr. Amelio intends to take a look at opportunities for enhancing the products and services available to participants while keeping administrative costs at a minimum. He is pleased to assume the management of one of the largest retirement plans in the world. ☺

Got beneficiaries?

If you think you designated a beneficiary for your TSP account, you should check the top of your statement to make sure the TSP Service Office has your form on file.

Has your life situation changed because of a marriage, a divorce, the birth or adoption of a child or grandchild, or the loss of a spouse or relative? Does the TSP have the correct address for each of your beneficiaries? If it has been a while since you sent in your Designation of Beneficiary form, you might want to update it.



If you need to update your beneficiary information, you must complete a new form. Please be sure to use the latest version (dated 8/2002). You will find it in the Forms & Publications section of the TSP Web site. It is also available from the TSP Service Office or your agency or service.

Please remember that a will does not affect the payout of your TSP account. Your account will be paid only according to your instructions on your Designation of Beneficiary form. If you do not have a valid form on file, the TSP will pay your account to your survivors in the order of precedence set by law. ☺

Federal Retirement Thrift Investment Board

Participants Ask ...**Q Why am I receiving my participant statement in October?**

A The enclosed statement covers the 4-month period from June 1 through September 30, 2003. It is your first statement since the TSP changed to daily processing.

From now on, statements will be issued quarterly, for the calendar year quarters ending March 31, June 30, September 30, and December 31.

Be sure to compare your opening balance on this statement with the closing balance on your last statement (for the period ending May 31, 2003). That statement showed the balance in your account on the last day of the old record keeping system.

Q Why does this statement look so different from previous statements?

A On the new statement, you will notice three main differences:

- There's a new format.
- Your financial information is expressed in both dollar amounts and shares.
- If you have a TSP loan, information about your loan is included in this statement, rather than on a separate loan statement.

A new leaflet, "Understanding Your TSP Participant Statement," is enclosed with this mailing. We hope you will find it helpful.

Your Withdrawal Options

Have you thought about how you want to take your money out of the TSP when you leave the Government? Here is a brief look at the withdrawal options available to you:

Partial Withdrawal —

- You can receive part of your account in a single payment, leaving the rest in the TSP until later. (You can use this option only once.)

Note: If you have previously made an age-based in-service withdrawal, you cannot make a partial withdrawal.

Full Withdrawal —

- You can receive your entire account in a single payment.
- You can receive your entire account in monthly payments.
- You can have the TSP purchase a life annuity for you with your entire account balance.

Mixed Withdrawal —

- You can withdraw your entire account using any combination of the above three full withdrawal options.

After you leave Federal service, you can either take your money out immediately or leave it in the TSP until a later date. Your withdrawal can be paid to you by check or sent directly to your checking or savings account by electronic funds transfer. In many cases, you also have the option of transferring your money to a traditional IRA or eligible employer plan.

Before making any withdrawal decisions, you should read the booklet *Withdrawing Your TSP Account After Leaving Federal Service* and make sure you understand the various options and their tax consequences. Please remember that you cannot change your request once it is processed. ¶

Pay it off!

If you have a TSP loan, it is important to repay it as soon as you can. And now, making TSP loan payments is easier than ever. As always, regular loan payments are deducted from your pay. But now you can also make extra payments to pay off your loan faster (or to make up for missed loan payments) by sending the TSP a personal check or money order. Here's how:

- Make your check payable to the Thrift Savings Plan.
- Write your Social Security number and the loan number on your check.
- Enclose a Loan Payment Coupon with your payment. (The coupon can be printed from the TSP Web site or photocopied from the *TSP Loan Program* booklet.) If you do not submit a completed coupon with the check, your payment may be delayed.
- Send your payment to the TSP Service Office, P.O. Box 61820, New Orleans, LA 70161-1820.

Are you paying off one loan so that you can apply for another?

If so, please think twice. If you borrow from your account now, you may end up with substantially less at retirement. The TSP was never intended to function as a bank. You should think of your TSP account as a long-term investment. ¶



It's nice to share!

When the TSP changed to daily valuation, it also changed the way it reports your account balance. Your balance is now provided to you in both dollars and shares. When you own shares, you own a piece of a company or fund. As a TSP participant, you now own shares in the funds in which you are invested.

The use of shares makes daily valuation possible. The price of a share is updated at the end of each business day. The change in the share price for each of the five TSP investment funds is determined by dividing that day's change in the value of the fund (after expenses) by the total number of shares in that fund.

Once the new daily share price is calculated, it is used for all account balance computations and transactions (such as contributions, interfund transfers, loans, and withdrawals) for that day.

For example, let's say you make a contribution of \$150 to the C Fund on a day when the C Fund share price is \$15.00 per share. As a result, your account would increase by 10 shares.

The TSP converted all fund balances into shares using an initial share price of \$10.00. The \$10.00 share price was selected because it was a round number that could easily be used to convert dollar balances into shares. This established a baseline, or starting point, as of May 31, 2003 (the last business day in the previous system). From that date forward, the share prices in each fund have changed at different rates, depending upon the returns of that investment fund.

You did not lose any money when your account was converted to shares. Your account balance in each investment fund was simply divided by \$10.00 to determine the number of shares you own.

Let's say, for example, that as of May 31, you had \$13,289.76 in the C Fund. That was converted to 1,328,976 shares. At \$10.00 per share, you still had \$13,289.76.

You can verify that the conversion was done correctly by comparing the ending balance on your previous participant statement (as of May 31, 2003) with the beginning balance on the enclosed statement (as of June 1, 2003).

The change to share-based accounting does not affect your investment returns. Under the previous dollar-based system, if you held \$10,000 in an investment fund at the beginning of a month and the net return for the month was 10%, at the end of the month you would have been credited with \$1,000.00 of earnings. Your month-end balance in that fund would be \$11,000.00 (assuming no contributions or loan payments were made during the month).

Under the new system, if at the beginning of the month you hold 1,000 shares of an investment fund which are worth \$10.00 per share (total value of \$10,000.00), and the share price increases by 10% (that is, to \$11.00 per share), you will still hold 1,000 shares, but those shares would be worth \$11,000.00 at the end of the month.

As you can see, either method of calculating your balance gives you the same result. 🐢



... wins the race. Sometimes faster isn't better. When it comes to your TSP account, patience and consistency are better.

Some TSP participants have been anxiously awaiting the new system because it offers them the chance to move their money from fund to fund as often as every day. They think they can improve their returns by constantly moving their money to adjust to trends in the market.

But just because you can do interfund transfers on a daily basis doesn't mean it's a good idea. Study after study has shown that people who try to be "market timers" rarely come out ahead at the retirement finish line.

There are times, however, when making an interfund transfer can be the right thing to do. It is a good idea to "rebalance" your account periodically. Amounts in one or more of your TSP funds may have become too large or too small because of gains or losses in the market. You should rebalance your account to make sure the proportion that is invested in each fund reflects your investment strategy.

Another way to gradually rebalance your account is to change the way your payroll contributions are invested. You can direct the new money you put into your account by changing your contribution allocation.

When it comes to your TSP account, set a steady pace, make decisions you can live with, be patient, and you'll be a winner!

Thrift Savings Plan Investment Information

TSP participants may invest in any or all of five TSP funds — the G, F, C, S, and I Funds. The Federal Retirement Thrift Investment Board manages the G Fund investments. The Board has contracts with Barclays Global Investors to manage the F, C, S, and I Fund investments.

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The F Fund is invested in the Barclays U.S. Debt Index Fund, which tracks the Lehman Brothers U.S. Aggregate (LBA) bond index. The LBA index consists primarily of high-quality fixed-income securities representing the U.S. Government, Federal agency, mortgage-backed, corporate, and foreign government sectors of the U.S. bond market. The 2002 administrative expense ratio (including investment management fees) was 0.06%, or \$.60 for every \$1,000 of F Fund account balance.

The C Fund is invested in the Barclays Equity Index Fund, which tracks the Standard & Poor's (S&P) 500 stock index. The S&P 500 index includes stocks of 500 large and medium-size companies that are traded in the U.S. stock markets. The

2002 administrative expense ratio (including investment management fees) was 0.07%, or \$.70 for every \$1,000 of C Fund account balance.

The S Fund, established in May 2001, is invested in the Barclays Extended Market Index Fund, which tracks the Wilshire 4500 stock index. The Wilshire 4500 index consists of the stocks that are actively traded in the U.S. stock markets except those in the S&P 500 index. The 2002 administrative expense ratio (including investment management fees) was 0.07%, or \$.70 for every \$1,000 of S Fund account balance.

The I Fund, established in May 2001, is invested in the Barclays EAFE Index Fund, which tracks the EAFE (Europe, Australasia, Far East) stock index. The EAFE index, comprising 21 countries, consists of the stocks of companies that are large relative to the size of the stock markets of their countries and industries. The 2002 administrative expense ratio (including investment management fees) was 0.07%, or \$.70 for every \$1,000 of I Fund account balance.

For more information about the funds, see the *Summary of the Thrift Savings Plan for Federal Employees* or the *Summary of the Thrift Savings Plan for the Uniformed Services*. Monthly rates of return for the funds are available on the TSP Web site, www.tsp.gov.

Rates of Return for the G, F, C, S, and I Funds and Related Indexes*

Year	G Fund %	F Fund %	LBA Bond Index %	C Fund %	S&P Index %	S Fund %	Wilshire 4500 Index %	I Fund %	EAFE Index %
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1994	7.2	-3.0	-2.9	1.3	1.3	-	-2.7	-	7.8
1995	7.0	18.3	18.5	37.4	37.6	-	33.5	-	11.3
1996	6.8	3.7	3.6	22.8	23.0	-	17.2	-	6.1
1997	6.8	9.6	9.7	33.2	33.4	-	25.7	-	1.5
1998	5.7	8.7	8.7	28.4	28.6	-	8.6	-	20.1
1999	6.0	-0.8	-0.8	21.0	21.0	-	35.5	-	26.7
2000	6.4	11.7	11.6	-9.1	-9.1	-	-15.8	-	-14.2
2001	5.4	8.6	8.4	-11.9	-11.9	-2.2**	-9.3	-15.4**	-21.4
2002	5.0	10.3	10.3	-22.0	-22.1	-18.1	-17.8	-16.0	-15.9
Compound Annual Rates of Return 1993 - 2002									
	6.2	7.5	7.5	9.3	9.3	-	7.3	-	4.0
Monthly Returns for 2003									
Jan.	0.3	0.1	0.1	-2.7	-2.6	-2.4	-2.2	-4.2	-4.2
Feb.	0.3	1.4	1.4	-1.5	-1.5	-2.6	-2.5	-2.3	-2.3
Mar.	0.3	-0.0	-0.1	1.0	1.0	1.6	1.5	-1.9	-2.0
Apr.	0.3	0.8	0.8	8.3	8.2	8.3	8.3	9.8	9.8
May	0.3	1.9	1.9	5.3	5.3	9.4	9.5	6.1	6.1
June	0.2	-0.3	-0.2	1.2	1.2	2.2	2.4	2.3	2.4
July	0.3	-3.4	-3.4	1.8	1.8	4.6	4.7	2.3	2.4
Aug.	0.4	0.7	0.7	1.9	2.0	4.1	4.2	2.4	2.4

* The returns for the TSP funds represent net earnings after deduction of accrued administrative expenses and, in the cases of the F, C, S, and I Funds, after deduction of trading costs and accrued investment management fees. The returns for the four indexes shown do not include any deduction for administrative expenses, trading costs, or investment management fees.

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Thrift Savings Plan HIGHLIGHTS

Statement Updates

*****1234

We put security in your Social Security number. Your SSN has a new look on your participant statement to protect your privacy.

Make a statement!

You can print a copy of your quarterly participant statement from the TSP Web site.

No Web access? You can use the ThriftLine (504-255-8777) to request that the most recent statement be mailed to you.

To enter the Account Access section on either the Web site or the ThriftLine, you will need your SSN and TSP PIN.

Need a PIN? If you have lost or forgotten your TSP PIN, you can request a new one on the Web site or the ThriftLine. Please allow 10 days to receive your PIN in the mail.

EFT = Easy, Fast, Trustworthy

EFT (electronic funds transfer) or Direct Deposit is the fastest and safest method for receiving money from your TSP account. However, if you request EFT for your loan or withdrawal payment, please check with your financial institution first to **verify the routing number and your account number** so that your money arrives promptly and to the correct account.

TSP Web site: www.tsp.gov

Checkup Time

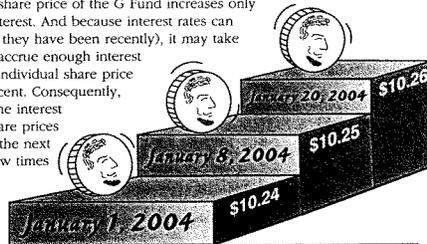
Open season, April 15 through June 30, is the perfect time to give your TSP account an annual checkup and make any adjustments needed to secure or preserve your financial health. Here's a quick checklist:

- ✓ **Pay yourself first.** Are you contributing enough to reach your retirement goals? FERS employees can now contribute 14% of basic pay up to the IRS limit of \$13,000; CSRS employees and members of the uniformed services can contribute 9% of basic pay up to the IRS limit. *To get an idea of how your TSP account can grow using different contribution rates, check out the calculator, [Projecting Your Account Balance](#), on the TSP Web site.*
- ✓ **Don't lose matching money.** Highly paid FERS employees should recalculate their contributions so they don't reach the elective deferral limit too soon and miss out on agency matching contributions. *The [Elective Deferral Calculator](#) on the TSP Web site can help you determine the maximum amount you can contribute.*
- ✓ **Renew your catch-up contributions.** If you are 50 or older this year and you are already contributing the maximum for which you are eligible, you can make up to \$3,000 in catch-up contributions. If you made catch-up contributions in 2003, your election ended in December. *Did you make a new election for 2004? Check with your agency or service to determine whether you should make your election electronically or by using a paper form.*

G Fund Earnings Step Up

Why don't you see daily changes in the G Fund share price, as you do in the other funds?

The share price for each investment fund changes each business day. But unlike the F, C, S, and I Fund share prices which fluctuate — sometimes by significant amounts — the share price of the G Fund increases only from accrued interest. And because interest rates can be very low (as they have been recently), it may take several days to accrue enough interest to increase the individual share price by at least one cent. Consequently, depending on the interest rate, G Fund share prices may step up to the next penny only a few times each month.



Federal Retirement Thrift Investment Board

Investing Wisely

The amount of money you will have in your TSP account for retirement depends on more than just the amount of your contributions. You also need to consider how your investment choices will affect your potential earnings.

Decide how much money you need to have in your TSP account when you withdraw it. This may take some thought but it's a critical first step. Then use the calculators found on the TSP Web site to estimate the effect of your contribution level and different rates of return.

Decide how much risk you are willing to take. Investors who assume greater risk are generally rewarded with higher returns over time. However, this may not occur in shorter time periods, as shown by the recent "bear" market for stocks. But be realistic about risk. Taking too much risk (such as putting all of your money in one stock fund) in an attempt to earn unrealistically high returns may be gambling with your retirement.

Consider your time horizon (the amount of time before you need the money). Generally, the longer your horizon, the more risk you can take. If you are near retirement, however, you may want to move your money into less-risky funds to preserve your account balance.

Use asset allocation to shape your investment strategy. By far, the biggest factor in determining your return is your "asset allocation" or "diversification" (spreading your assets among different types of investments that have different characteristics). In the TSP, you can do this by

allocating your account between stocks (the C, S, and I Funds) and fixed income investments (the G and F Funds). The more you have in stocks, the riskier the allocation. But remember, over time, stocks tend to produce higher returns than fixed-income investments.

Stick with your strategy and rebalance as needed. For your strategy to work, you must stick with it. First, don't be swayed by short-term market swings. Think long term! Second, you should periodically review and rebalance your account to maintain your target allocation. Rebalancing will mean selling your better performing funds and buying funds with a lower return (that is, selling high, buying low). Over the long term, maintaining your asset allocation should increase your return while maintaining the level of risk you have chosen. You can rebalance by changing your contribution allocation or by periodically making an interfund transfer.

Don't try to chase returns. This is a common trap for investors. If you make your investment decisions based on recent returns, you may end up buying high and selling low. This is likely to reduce your returns over time.

New Loan Rules

Beginning July 1, the TSP will deduct a \$50 fee from the proceeds of each new loan. Participants will be allowed to have only one general purpose loan and one residential loan. Once a loan is paid in full, participants will not be eligible for another loan of the same type for 60 days. For more information, visit the TSP Web site.

Rates of Return

Year	G Fund %	F Fund %	LBA Bond Index %	C Fund %	S&P Index %	S Fund %	Wilshire 4500 Index %	I Fund %	FAFE Index %
1994	7.2	-3.0	-2.9	1.3	1.3	-	-2.7	-	7.8
1995	7.0	18.3	18.5	37.4	37.6	-	33.5	-	11.3
1996	6.8	3.7	3.6	22.8	23.0	-	17.2	-	6.1
1997	6.8	9.6	9.7	33.2	33.4	-	25.7	-	1.5
1998	5.7	8.7	8.7	28.4	28.6	-	8.6	-	20.1
1999	6.0	-0.8	-0.8	21.0	21.0	-	35.5	-	26.7
2000	6.4	11.7	11.6	-9.1	-9.1	-	-15.8	-	-14.2
2001	5.4	8.6	8.4	-11.9	-11.9	-2.2*	-9.3	-15.4*	-21.4
2002	5.0	10.3	10.3	-22.0	-22.1	-18.1	-17.8	-16.0	-15.9
2003	4.1	4.1	4.1	28.5	28.7	42.9	43.8	37.9	38.6
Compound Annual Rates of Return 1994 - 2003									
	6.0	6.9	6.9	11.0	11.1	-	9.8	-	4.4
Monthly Returns for 2004									
Jan.	0.3	0.8	0.8	1.8	1.8	3.5	3.6	1.3	1.4
Feb.	0.4	1.1	1.1	1.3	1.4	1.8	1.8	2.2	2.3

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Questions for the Record
Senator Daniel K. Akaka
Oversight of the Thrift Savings Plan: Ensuring the Integrity of Federal Employee Retirement Savings
Senate Committee on Governmental Affairs
Subcommittee on Financial Management, the Budget, and International Security
March 10, 2004

Question for Alan Lebowitz, Department of Labor

1. Accountability is a critical part of ensuring the security of federal employees' retirement savings. An April 2003 General Accounting Office (GAO) report (GAO-03-400) recommended that Congress strengthen Department of Labor (DOL) oversight of the Thrift Savings Plan (TSP) by requiring the Secretary of Labor to report to Congress on issues of concern regarding the actions of the TSP Executive Director and the Federal Retirement Thrift Investment Board. DOL did not respond to the request to comment on the report.

Why did DOL not respond to the report, and does the Department agree with GAO's recommendations? If not, why?

Answer: The Department was asked to review the draft report and to provide written or verbal comments to GAO. Typically, we do not provide a formal written response unless there are recommendations made for specific actions by the Secretary of Labor or significant policy issues are raised by GAO. In this instance, as the recommendation was a matter for Congress to consider, EBSA staff discussed technical comments directly with the GAO audit team. The Department would be happy to work with Congress to better communicate our audit findings and support public confidence in the TSP program.

Questions for the Record
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Question for James M. Sauber, Chairman, Employee Thrift Advisory Council

1. Financial literacy is critical for federal workers to make sound decisions on their retirement savings. According to the attached February 19, 2004 Government Executive article entitled, "TSP Board Concerned About Participants' Conservative Investing Styles," Thrift Savings Plan (TSP) officials and Federal Retirement Thrift Investment Board (FRTIB) members believe that federal employees may not be receiving the best return on their TSP retirement savings due to these investment choices.

What would the Employee Thrift Advisory Council (ETAC) recommend to ensure that federal workers are informed to make the most of their retirement savings?

As I mentioned during the Q&A portion of the hearing, the quality and quantity of information and resources for retirement planning varies from agency to agency in the federal government. In the Postal Service, there is excellent support provided for workers with questions about the basic rules of participation in the TSP but very little information about how to make investment decisions. Agencies, like employee organizations, are naturally hesitant to offer investment advice. Perhaps the Thrift Investment Board could be encouraged to prepare a publication on investment strategy that could be used by agency retirement counselors. Although ETAC does not have a specific recommendation at this point, we plan to address the issue of participant education in our next meeting. Specifically, we believe this issue must be addressed in the context of any introduction of a lifecycle or a lifestyle fund option to the plan.

2. Referring to Mr. Amelio's testimony, do you agree with the nature of the three reforms he would like to implement to encourage participants to borrow from their TSP accounts as a last resort? Do you know how these changes would affect low wage workers?

The reforms were fully discussed at the March 24 meeting of the Employee Thrift Advisory Council. There was general support for the reforms. One of the ETAC organizations has expressed concern that the new limit (one instead of two) on the number of general purpose loans, but even that proposal has widespread support. The concern about the proposals impact on low-income workers is a legitimate one. On the one hand, these workers can least afford to forego the earnings lost when they borrow from their own TSP accounts. On the other hand, if the reforms discourage TSP participation among low-income workers (by limiting emergency access to savings), they may be counterproductive. My sense is that low-wage workers will benefit in the long run by reducing their utilization of the loan program. I will ask my fellow members of ETAC to join me in urging the Thrift Investment Board to monitor the impact of the changes on low-income workers and to review the changes if they discourage TSP participation.

3. Mr. Amelio has testified that individuals who take out a loan will be charged \$50 per loan application rather than dispersing the cost among all plan participants. During the hearing, you testified that not all members of the ETAC favor this proposal. Would you please detail the concerns raised by ETAC member organizations and discuss the measures taken by the FRTIB to ensure that the ETAC was fully involved in developing this proposal? Were there any concerns raised by the ETAC that were not addressed by the FRTIB, and if so, please describe them?

The FRTIB first raised the issue of the proposed \$50 fee at the September 23, 2003 meeting of the ETAC. As I recall, there was some reservations raised about how federal employees might react to having to pay a fee to borrow their own money, but no outright opposition to the fee. A second discussion ensued during the March 24 meeting and none of the organizations present expressed opposition. Based on these two discussions, I think it is accurate to say that the fee is broadly accepted as a fair and reasonable way to allocate the administrative cost of the loan program to those who use it.

ETAC organizations were also given advance copies of the new loan program regulations as published in the April 7 Federal Register to give them ample time to submit comments.

I believe the FRTIB has given ETAC organizations sufficient opportunities to participate in the policy-making process, and I do not know of any concerns not addressed by the FRTIB.

Questions for the Record
Senator Daniel K. Akaka
Oversight of the Thrift Savings Plan: Ensuring the Integrity of Federal Employee Retirement Savings
Senate Committee on Governmental Affairs
Subcommittee on Financial Management, the Budget, and International Security
March 10, 2004

Questions for the record

Questions for Blake R. Grossman, Barclays Global Investors

1. Although not a mutual fund, every step must be taken to ensure that the 3.2 million federal employees participating in the Thrift Savings Plan (TSP) do not experience the abuses that have afflicted millions in mutual funds. What internal safeguards does Barclays Global Investors have in place to identify and prevent these abuses in the TSP?

Answer:

We do not permit late trading in our collective trust funds, and we require that all orders for buying and selling units of these funds be received by the time at which the Net Asset Value is calculated. If intermediaries, such as third party retirement plan administrators and record-keepers, receive the orders, applicable law and contractual restrictions prohibit late trading.

Our investment philosophy is centered on providing index and risk-controlled active strategies that are highly efficient vehicles for long-term traders. It would be clearly inimical to this philosophy to facilitate any trading activity that might compromise the interest of our long-term investors.

We monitor activity in our international daily collective funds in an effort to detect and prevent market timing activity that might have a material adverse impact on fund investors. Because BGI generally does not have access to participant level activity in these funds, we must work through the intermediary or plan sponsor to take action to address any suspected market timing activity. Steps to prevent future market timing activity include working with the plan sponsor or record-keeper to impose trading restrictions or minimum holding periods on underlying participants. When necessary, BGI has resigned Defined Contribution accounts to prevent or reduce suspected market-timing activities in our funds, or taken actions to close mutual fund accounts opened through intermediaries.

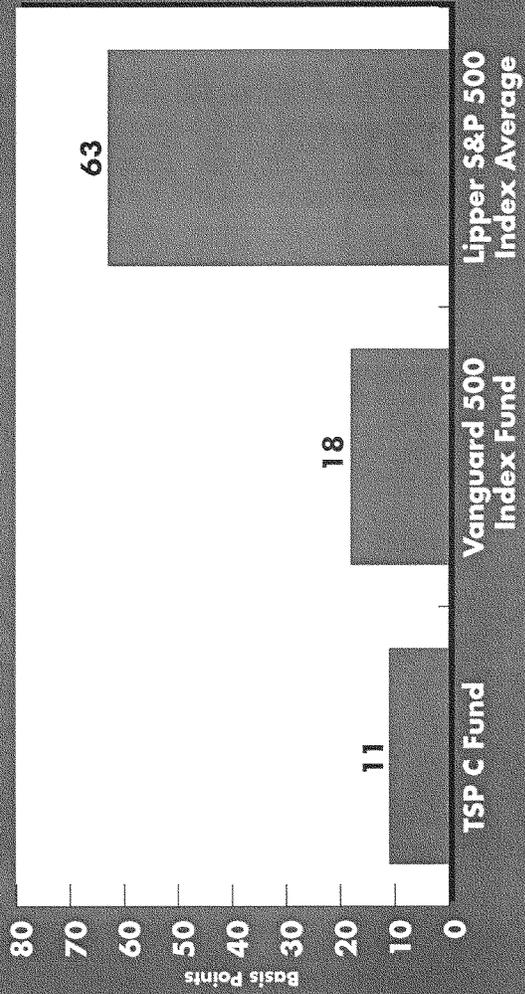
2. Senator Fitzgerald and I have introduced S.1822, the Mutual Fund Transparency Act of 2003, to restore public trust in mutual funds by increasing disclosures of fund fees and expenses and broker compensation. Could you please explain how Barclays discloses fees and administrative expenses associated with the TSP?

Answer:

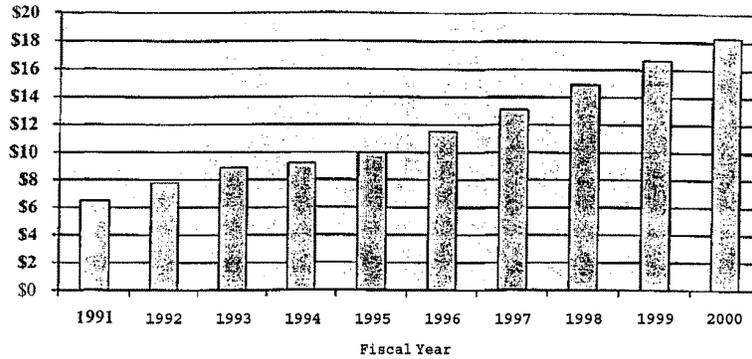
BGI provides only investment management services to the TSP. The Federal Retirement Thrift Investment Board provides the disclosure of fees and administrative expenses to TSP participants. This disclosure includes on an aggregated basis with other fund expenses, the BGI management fee as well as any other expenses associated with investment management activities. Expenses related to investment management activities are also reported in the audited financial statements of the funds in which the TSP is invested.

Expense Ratio Comparison

As of 12/31/03



Annual Cost Per Participant (NFC Cost Only)



According to a survey of 401K plan sponsors conducted by Charles D. Spencer & Associates, Inc. in 1996, total average annual administrative costs per participant were \$76 when including asset management fees, and \$41 when excluding asset management fees. This survey included 75 providers with plan sizes ranging from less than 500 employees to more than 10,000. As noted on the previous page, TSP's FY 2000 administrative expenses, before forfeitures, were \$24.38 per participant. KPMG's "Retirement Benefits in the 1990s: 1998 Survey Data," indicated that 401K plans of firms with 5,000 or more employees incurred administrative costs averaging 1.24 percent of plan assets in 1998. This survey included 317 employers within this size category. The "401k Provider Directory Averages Book, 6th Edition," published by HR Investment Consultants, stated that plans with 5,000 participants and \$200 million in assets incurred average administrative costs of 1.02 percent of plan assets in 2000. Total net TSP administrative expenses for the G, F, and C Funds were 5, 7, and 6 one-hundredths of one percent of each fund's average balance for FY 2000, respectively.