

The Federal Thrift Savings Plan: A Model for the Private Sector?

The federal Thrift Savings Plan, or “TSP,” (a 401(k)-like plan for federal workers) often is portrayed as an example for all participant-directed retirement plans. Fees charged to TSP participants are considerably lower than the average fees charged to participants in private-sector 401(k) plans.¹ This cost differential reflects the unique economics of the TSP, which bear little resemblance to those of its private-sector counterparts.

As testimony by the GAO makes clear, the TSP is a unique arrangement that cannot fairly be compared with or duplicated by 401(k) plans.² The TSP’s low reported costs for investment management and plan administration reflect the facts that the plan is unusually large, only covers employees of a single employer, and enjoys broad relief from the regulations and compliance costs that apply to private-sector plans.³ In addition, other federal agencies perform some portion of TSP’s administrative work, and these costs are subsidized by U.S. taxpayers. The extent of these hidden costs are unknown and are not reflected in the TSP fee structure.

Immense Size

With \$207 billion in assets and 3.7 million participants at year-end 2006,⁴ the TSP is easily the largest single defined contribution plan in the United States. The largest private-sector defined contribution plan sponsor is IBM, which has total defined contribution plan assets of \$28.8 billion,⁵ about one-seventh the size of the TSP. The TSP is able to achieve tremendous economies of scale because it offers a limited range of investments,⁶ aggregated and executed centrally, to millions of participants of the same employer (i.e., the federal government), all of whose contributions are made through similar or identical computerized payroll systems.⁷ In contrast, the private-sector 401(k) system consists of some 452,000 plans serving 62 million participant accounts.⁸ About 90 percent of 401(k) plans have fewer than 100 participants, and about two-thirds of 401(k) plans have less than \$1 million in plan assets.⁹ Participants in plans with small amounts of assets tend to pay higher fees than plans with greater assets because of the relatively fixed costs that all plans must incur.

Federal Thrift Savings Plan Investment Fund Assets

(year-end 2006)

	Billions of Dollars	Percent of Total
U.S. Government Securities Investment Fund (“G Fund”) ¹	\$72.8	36%
Barclays U.S. Debt Index Fund (“F Fund”) ²	\$11.1	6%
Barclays Equity Index Fund (“C Fund”) ²	\$76.5	38%
Barclays Extended Market Index Fund (“S Fund”) ²	\$17.4	9%
Barclays EAFE Index Fund (“I Fund”) ^{2,3}	\$22.8	11%
Total Investment Funds ⁴	\$200.6	100%
MEMO:		
Lifecycle Funds ⁵	\$16.9	8%
Other Funds	\$183.7	92%

¹ This “fund” is invested in nonmarketable U.S. Treasury securities which are specially issued to the TSP.

² The Barclays “funds” are collective trusts, not mutual funds.

³ EAFE stands for Europe, Australasia, and Far East; it is an international equity investment.

⁴ Total net assets available for benefits totaled \$206.6 billion at year-end 2006 and include receivables, participant loans, and fixed and other assets, in addition to the investment fund assets.

⁵ The lifecycle funds invest in the investment funds listed above in the table. There are no additional fees.

Source: Deloitte and Touche, LLP, Independent Auditors’ Report, Financial Statements of the Thrift Savings Fund—2006 and 2005

Larger accounts have the bargaining power to negotiate lower asset management fees, because management costs do not necessarily rise proportionately as account balances rise. The manager of the TSP’s four index funds receives revenue from the TSP by charging a fee for managing the assets and/or by retaining a portion of the revenue from securities lending activity in the portfolios. It is not clear exactly how much revenue the fund manager earns directly or indirectly from its relationship with the TSP, as the investment management agreement and associated fee structure are subject to a confidentiality agreement and not available to the public.¹⁰

Unknown Costs

The full costs of TSP administration are not reflected in the TSP expense ratio. The expense ratio does account for most recordkeeping duties, which are performed by the TSP and outside vendors. The TSP’s expenses, however, are reduced by forfeitures of non-vested agency contributions and participant loan processing fees, together amounting to approximately 1 basis point.¹¹ In addition, some administrative functions associated with providing services to participants—including some participant education functions, distribution of enrollment materials, and processing of deferral election changes—are handled by the employing federal agencies with respect to their own employees. The agencies also serve as primary TSP contact points for employees. The cost of this decentralized administration, which is built into each agency’s operating budget, is unknown. These costs are not charged to TSP participants, but are borne by the employing agencies.

Also, the U.S. Treasury undertakes certain functions for the TSP without charge, including accounting for the government securities fund, cutting checks, and executing electronic fund transfers, all of which would add substantial costs in private-sector plans.

Other Features Affecting Costs

Limited Investment Options and Services. Offering a limited number of investment options lowers the TSP's administrative costs. In the private sector, many employees value having a wider range of choices available in their retirement savings plans. In addition, the TSP does not provide some services that 401(k) plans typically provide. For example, TSP statements are provided electronically unless a participant specifically requests a hard copy, which saves millions of dollars per year. In contrast, electronic delivery rules for plans covered by ERISA are complex and require that many participant communications be provided in hard copy form unless the employee specifically consents to electronic delivery.

Lower Compliance Costs. Congress authorized the TSP in the Federal Employees' Retirement System Act of 1986 (FERSA). While the TSP must adhere to certain compliance regulations under FERSA, these regulations are less onerous than those covering private-sector plans. Private-sector plans are subject to extensive requirements under ERISA and the Internal Revenue Code, including nondiscrimination and top-heavy testing, numerous participant disclosure obligations, procedures for correcting operational and other errors, and filing an annual report with the Department of Labor. Without these additional compliance costs, the TSP is able to operate on a lower budget.

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For all of these reasons, it is impossible for private-sector participant-directed plans to achieve TSP-like results. The TSP enjoys efficiencies of size and workforce composition, limitations in investment choices and participant services, defrayal of some plan costs by U.S. taxpayers, fewer regulatory requirements, and lower compliance costs—all of these factors in combination make the TSP unique in the world of employer-sponsored retirement plans.

Endnotes

¹ The average asset-weighted expense ratio borne by 401(k) plan participants for investing in mutual funds was 0.71 percent in 2006. See Holden and Hadley, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006," *ICI Fundamentals*, September 2007 (available at www.ici.org/pdf/fm-v16n4.pdf). In contrast, the expense ratios for the core TSP funds in 2006 were approximately 0.03 percent (or 3 basis points). See www.tsp.gov/rates/tspexpensratio2006.pdf, which reports fees from 1988 through 2006. The 2006 amount is the lowest in the entire time series of data. The expense ratio was 0.05 percent in 2005. There is no additional fee for investing in the lifecycle funds beyond the fees charged for each of the underlying funds (proportional to the lifecycle fund's investment in that fund). The allocation percentages of the core funds within the lifecycle funds are determined by the Federal Retirement Thrift Investment Board based on advice received from outside advisers.

² Oral testimony of Barbara D. Bovbjerg, Director, Education, Workforce and Income Security Issues, Government Accountability Office, before the Committee on Education and Labor, House of Representatives, March 6, 2007 (available at frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&dodid=f:33655.pdf).

³ Research from the Congressional Research Service and Congressional Budget Office also makes these points. (For example, see www.cbo.gov/ftpdocs/52xx/doc5277/Report.pdf.)

⁴ See *Financial Statements of the Thrift Savings Fund—2006 and 2005*, audited by Deloitte and Touche, LLP, March 26, 2007 (available at www.tsp.gov/forms/financial-stmt.pdf).

⁵ See "The P&I 1000: The Top 1,000 Pension Funds/Sponsors," *Pensions & Investments*, Jan. 22, 2007. IBM data are as of Sept. 30, 2006. The next largest private-sector defined contribution plan sponsor is Boeing, with \$27.3 billion in defined contribution plan assets as of Sept. 30, 2006.

⁶ As shown in the figure, the TSP investment options include four index funds (three stock funds and one bond fund), one fund invested in (nonmarketable) U.S. Treasury securities, and a series of lifecycle funds comprised of the other five core funds. The index funds are collective trusts rather than mutual funds and thus are not offered to the general public. The Treasury securities fund is managed internally by the Federal Retirement Thrift Investment Board.

⁷ According to TSP staff, the largest five or six federal payroll offices account for approximately 90 percent of TSP participants.

⁸ See Cerulli Associates, *Cerulli Quantitative Update: Retirement Market 2006*, 2006.

⁹ Tabulation of Form 5500 data; for summary statistics for plan-year 2005, see U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin, Abstract of 2005 Form 5500 Annual Reports*, February 2008 (available at www.dol.gov/ebsa/PDF/2005pensionplanbulletin.PDF).

¹⁰ Another benefit to the investment manager is the opportunity to cross trade securities with other client accounts.

¹¹ The *Financial Statements of the Thrift Savings Fund—2006 and 2005* reports that forfeitures amounted to \$16 million in 2006.



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