

# Civil Service Pension Reform: The Experience of the Thrift Savings Plan

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# Outline of the Presentation

- ◆ The old Federal Civil Servant System and the 1983 Reform
- ◆ The new Civil Servant System and the Role of TSP
- ◆ TSP's Legal Framework and Governance Structures
- ◆ The Design of TSP's Pension Plan
  - The accumulation phase
  - The payout/benefit phase
- ◆ TSP's Performance
- ◆ Conclusions and Possible Lessons

# Part I. The Old Civil Servant Pension Scheme

# Key Features of the Old Scheme

- ◆ Traditional salary based Defined Benefit system
- ◆ Accrual rates:
  - 1 ½ % first 5 years, 1 ¾% years 5 to 10, 2% years above 10
- ◆ Maximum replacement rate of 80%
- ◆ Reference Wage – Highest Three Years of Earnings
- ◆ Exempt from Public Social Security System
- ◆ Employee Contribution - 7% with no tax deduction
- ◆ Eligibility for full retirement at age 55 with 30 years service, age 60 with 20 years, 62 with 5 years
- ◆ Price indexation of benefits after retirement

# Reasons for the 1983 Federal Pension Reform

- ◆ Part of broader Social Security reforms in 1983
  - Needed to include federal workers to enhance solvency
- ◆ Cost of old system was perceived as too high in the context of record fiscal deficits in the early 1980's
- ◆ System was viewed as limiting civil servants' mobility and impediment to downsizing of staffing levels
- ◆ Public pensions were seen as more generous than average pensions in the private sector
- ◆ Emergence of defined contribution (DC) plans as an alternative model

# Part II. The New Civil Servant Pension Scheme

# Contributions to the New Scheme

- ◆ Employee contributions
  - Originally 0.8% of pay for defined benefit component;
  - Raised to 3.1% (2013) and 4.4% (2014 and after)
  - 4.2% of applicable wage base to Social Security
  - Contributions to the new defined contribution plan (TSP)
- ◆ Employer contributions
  - 11 - 13% of employee pay for defined benefit
  - 6.2% of applicable wages to Social Security
  - 1 – 5% automatic/matching contributions to the TSP

# Civil Servant Benefits under the New Scheme

- ◆ Participation mandatory for all workers beginning service on or after Jan 1, 1984
- ◆ Three part retirement benefit:
  - Benefit from defined benefit plan at 1%/year accrual rate; increases to 1.1%/year at 30 years of service
  - Benefit from Social Security (mandatory participation)
    - Average replacement rate of 40%, lower for higher income workers
  - Benefit from the TSP (voluntary participation)
- ◆ Survivor and disability benefits remained in defined benefit plan
- ◆ “Old” workers remained in old system (CSRS); had option to switch to new system (FERS)



# Retirement Conditions under the New Scheme

- ◆ Five year vesting period
- ◆ Retirement conditions in new Defined Benefit Plan:
  - Age 55 with 30 years of service; age gradually increased to 57 for employees born in 1970 and after
  - Or age 60 with 20 years of service or 62 with 5 years
  - Same conditions for men and women
- ◆ Retirement conditions in Social Security:
  - Normal retirement at age 65 increasing to 67
  - Same conditions for men and women
- ◆ Average retirement age is 61

# Comparison between the New and Old Schemes

- ◆ Much lower accrual rate in new DB plan (about half)
- ◆ Raised minimum retirement age from 55 to 57
- ◆ No indexing of benefits for retirees until age 62
  - Indexing rate less generous than old system
- ◆ Average replacement rates after full career:
  - 40% under new DB plan
  - 40% under Social Security for average income workers
  - Total: 80% for average income workers, equal to old DB plan
  - However, higher income workers get less than 80% under new system due to Social Security formula
  - TSP makes up the difference for higher income workers

# The Role of the Thrift Savings Plan (TSP) in the New Scheme

- ◆ Provides complementary income, especially for higher income workers
- ◆ Provides tax-favored defined contribution individual accounts
- ◆ Designed to operate on a defined contribution (DC) basis, like US private sector “401(k) plans”

# TSP Legal Framework and Governance Structure

- ◆ Law establishing TSP provided basis for independence from political influence
- ◆ Independent Board of Directors that governs separate administrative body staffed by civil servants
- ◆ Full asset segregation
  - Amounts belong to participants – held “in trust” in individual accounts
  - Participants have legal ownership under U.S. law and Constitution

# TSP Legal Framework and Governance Structure

- ◆ Fiduciary responsibilities – Enforceable in the courts
  - Must act prudently and solely in the interest of the participants and beneficiaries
  - Executive Director and 5 Board members are accountable for all actions
- ◆ Independence of the Board
  - Five Board members appointed by the President & confirmed by Senate
  - 4-year fixed, staggered terms
  - Cannot be easily removed (Do not serve “at the pleasure of” the President or Congress)
  - Board members appoint the Executive Director

# TSP Legal Framework and Governance Structure

- ◆ Budgetary independence
  - Independent budget authority (not subject to White House control)
  - Administrative charges to TSP account balances for all expenses
  - No Congressional appropriations
- ◆ Investment structure
  - Index (passive) investment funds
  - No voting shares in portfolio
  - External asset management

# TSP Regulatory Oversight

- ◆ Private pensions supervisory agency (Department of Labor) oversees TSP
  - Performs annual series of audits and issues findings and recommendations
  - Reports to the Board
- ◆ Congressional oversight
  - Hearings
  - Government Accountability Office audits

# TSP Administration

- ◆ Lean structure
- ◆ Approximately 240 TSP employees
  - Policy
  - Legal
  - Accounting
  - Oversee operations and IT system
- ◆ Other key functions outsourced through contracts
  - Investment management
  - Record keeping
  - Call centers
  - Participant support (forms processing, notices, etc.)



# TSP Administration

- ◆ Payroll function
  - Essential to control data, prevent mistakes
  - Contribution records must balance
- ◆ Accounting controls
  - Individual account plan, need to balance every day
- ◆ Audit
  - Annual internal audit required by law under US GAAP Auditors report directly to Board
- ◆ Computer system
  - Robust computer system essential to proper functioning
  - Run system every night
  - Ever increasing need for IT capacity

# TSP Communications

- ◆ Website is now primary communications vehicle
  - Transactions available on-line: investment decisions & some loans;  
Over 90% of investment transactions online
  - Account balances and statements
- ◆ Voice response system (ThriftLine)
  - Automated account information
  - Some automated transactions
  - Opt out to call centers
- ◆ TSP Publications & Forms
  - Available for download on the website
- ◆ Agency responsibilities to communicate enrollment and retirement information

Part III. TSP:  
Accumulation Phase

# TSP Contribution Rules

- ◆ Since 2010, automatic enrollment at 3% contribution rate; in 2015, placed in age-appropriate L Fund
- ◆ Immediate agency automatic contribution equal to 1% of salary
- ◆ Government matches first 5% of employee contributions
  - 100% match on first 3%
  - 50% match on next 2%
- ◆ All employees can voluntarily contribute up to annual limit of \$18,000
  - Over age 50, can contribute an additional \$6,000 annually
- ◆ Employees can “roll-in” qualified money from other plans

# TSP Investment Structure

- ◆ Participants choose how to invest their accounts
- ◆ Law requires use of index funds for equity
  - Index funds are designed to follow entire markets
  - Ensures investment management is “passive”
  - Index funds are low cost
- ◆ Board decided to use indexing for fixed income
- ◆ Prohibition on active public agency involvement in corporate governance
  - Law prohibits direct voting of shares (proxies)
- ◆ Funds and accounts valued each business day

# Current TSP Investment Options

- ◆ **G Fund** – Government Securities
  - Specially issued government securities
- ◆ **F Fund** – Corporate and government bond index fund
  - Tracks the Barclays U.S. Aggregate Bond index
- ◆ **C Fund** – Large capitalization U.S. stocks.
  - Tracks the S&P 500 index
- ◆ **S Fund** – Small to medium capitalization U.S. stocks
  - Tracks the Dow Jones U.S. Completion TSM (Total Stock Market) index
- ◆ **I Fund** – International stocks
  - Tracks the MSCI EAFE index
- ◆ **L Funds** – Lifecycle funds
  - Introduced in 2005

# The TSP Lifecycle (L) Funds

- ◆ “Lifecycle” or target date asset allocation funds
- ◆ Uses 5 TSP core funds
- ◆ Participants decide when they will need their money
- ◆ Farther out time horizons: more aggressive investments, with more equity
- ◆ As horizon date approaches: more conservative investments, with more fixed income
- ◆ Five funds selected
  - Income Fund (for those already withdrawing their accounts)
  - 2020 Fund
  - 2030 Fund
  - 2040 Fund
  - 2050 Fund

# Selection of External Asset Managers

- ◆ Board selects appropriate indices
- ◆ Board chooses selection criteria
  - Based on staff recommendations (with expert advice)
  - “Minimum criteria” used to limit competition to firms that have necessary size, experience
- ◆ Board chooses weight to give to technical factors vs. cost. As criteria become more objective, cost weighting can be greater.



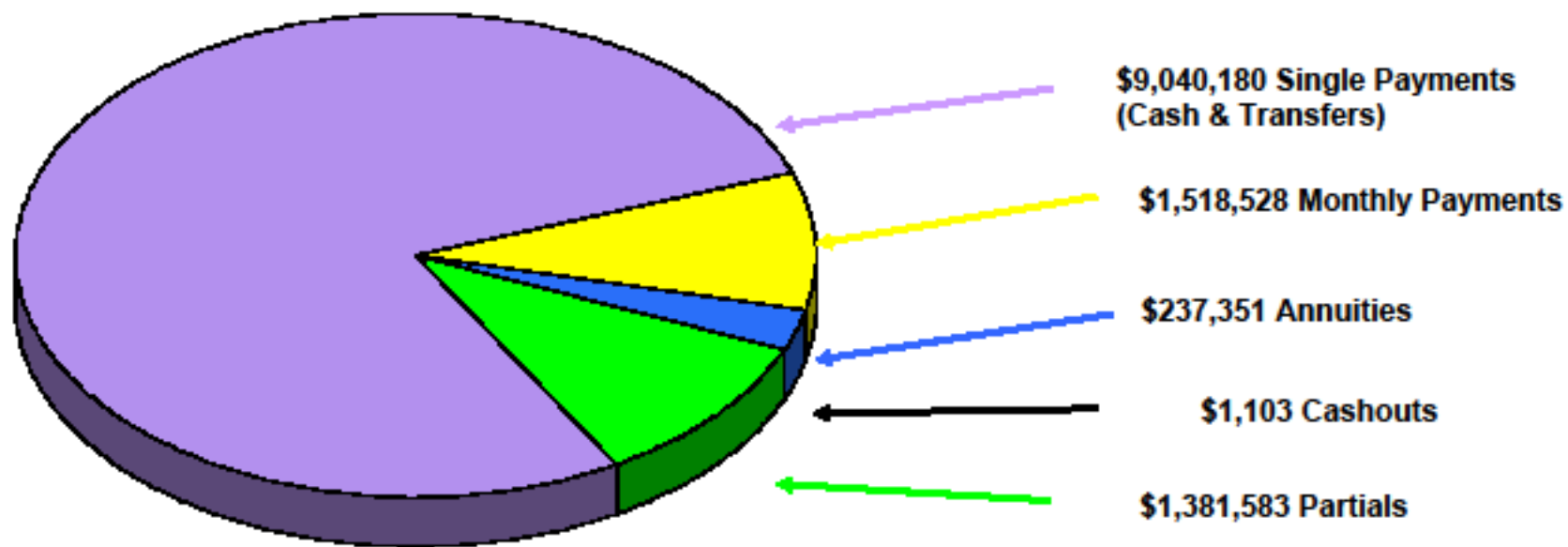
Part IV. TSP:  
Payout/Benefit Phase

# Menu of Retirement Products

- ◆ Three options for participants to select (can choose more than one):
  - Lump-sum payment without restrictions
  - Monthly payments from TSP account
  - Life annuity
- ◆ Can transfer certain payments to IRAs or other plans
- ◆ Can leave money in account until age 70 ½
- ◆ Board voted to pursue legislation to liberalize withdrawal options

# Separated Participant Withdrawals 2015

(Civilian and Uniformed Services)



**Total Amount Paid in 2015 \$ 12,178,745**

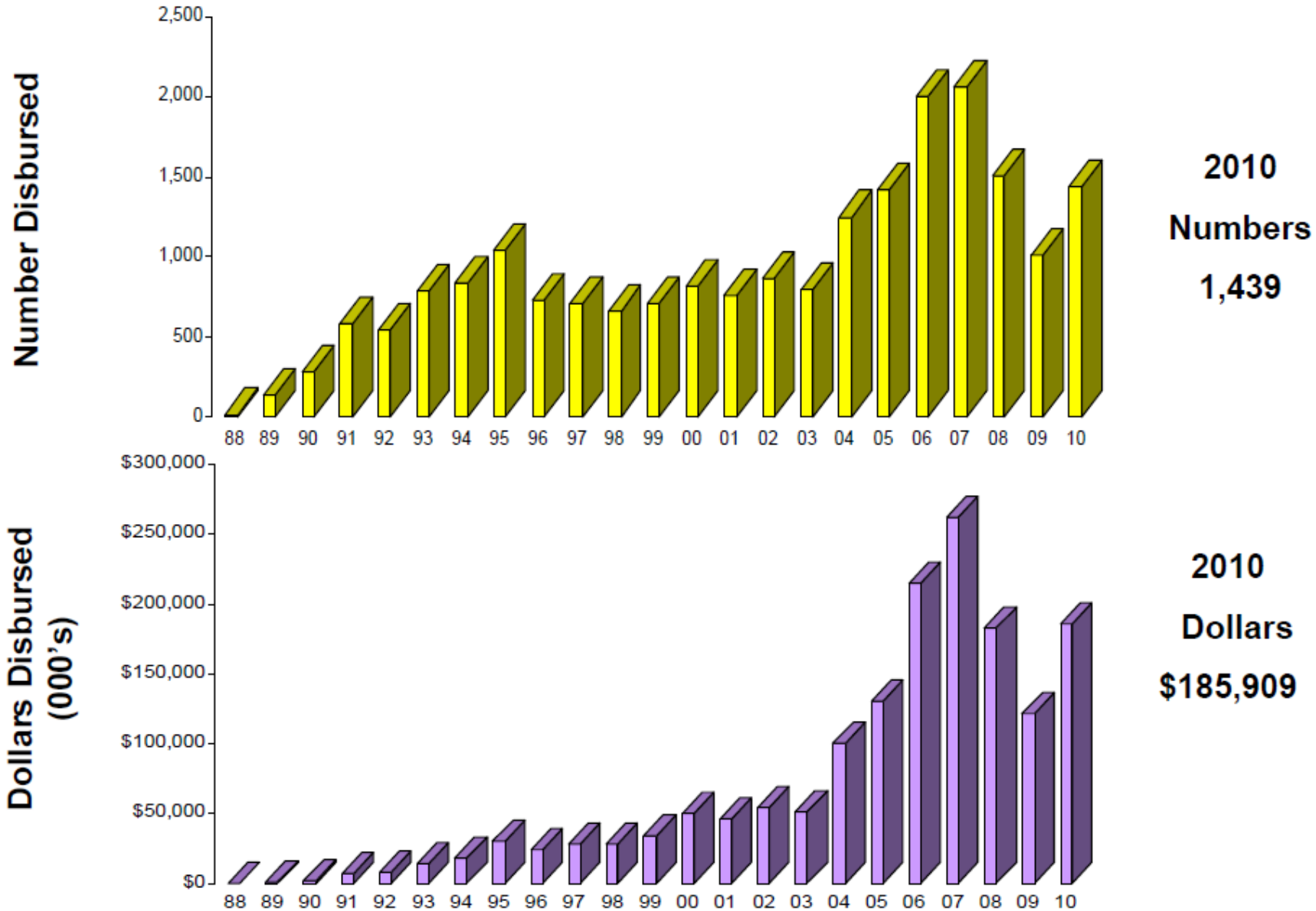
Dollars (000's)

# TSP Life Annuities

- ◆ Only an option
  - Not required unless spouse insists
- ◆ 18 different annuity types
  - Single, joint and survivor, etc
- ◆ TSP selects vendor and monitors performance
  - No TSP liability once annuity is purchased
- ◆ Annuity provider competitively procured
  - Insurance companies compete on price
- ◆ Not a popular option in low interest environment

# Annuity Purchase History

(Civilian and Uniformed Services)

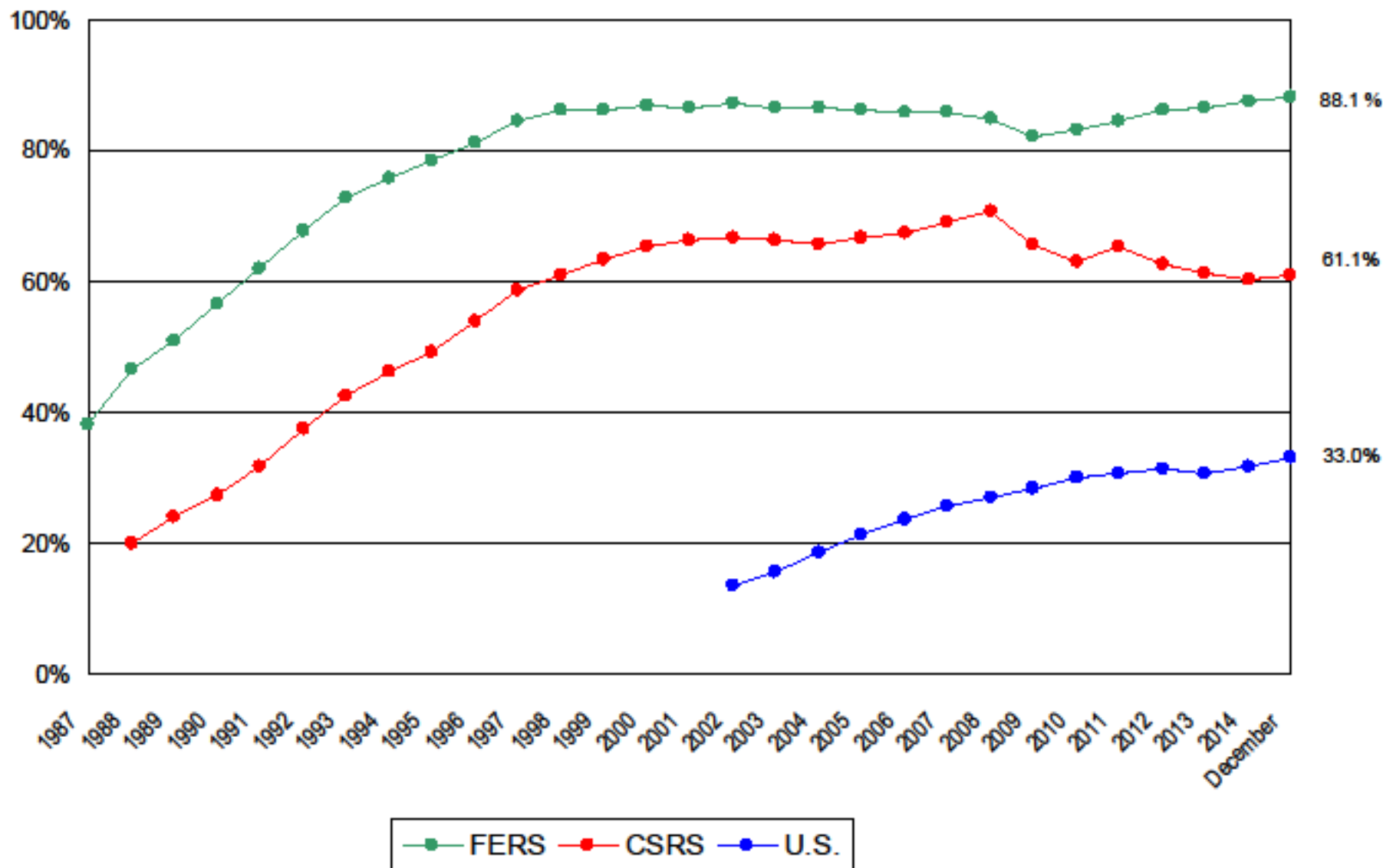


# Death and Disability Benefits

- ◆ Death and disability benefits under main DB plan
- ◆ Additional optional insurance for death or disability available, fully paid by employee
- ◆ Upon death, designated beneficiaries receive TSP account balance
- ◆ If no designated beneficiary, use order of precedence under law
- ◆ Spouse establishes own TSP account with same investment and withdrawal options as active members
- ◆ All other beneficiaries receive direct payment with option to transfer to inherited IRA, if applicable

# Part V. TSP Performance

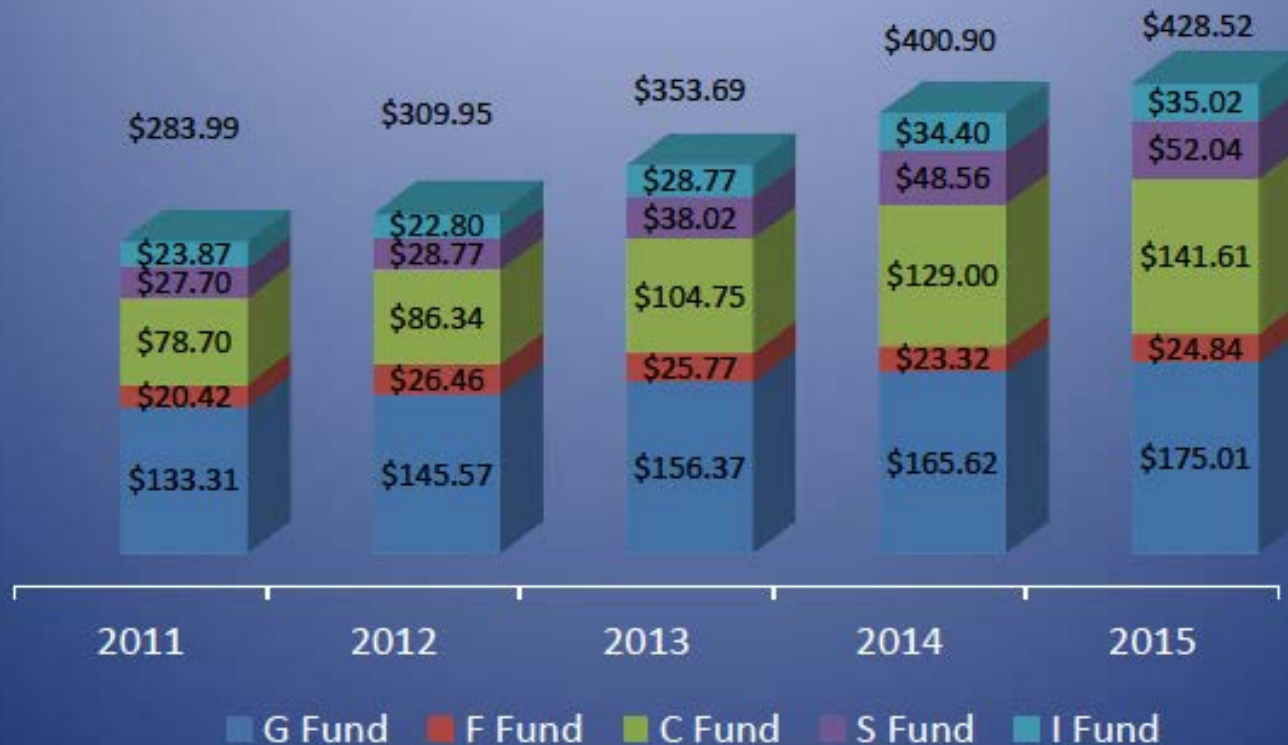
## Thrift Savings Plan Participation Rates



Annual data as of September of the respective year.



# Average Assets (in \$billions)



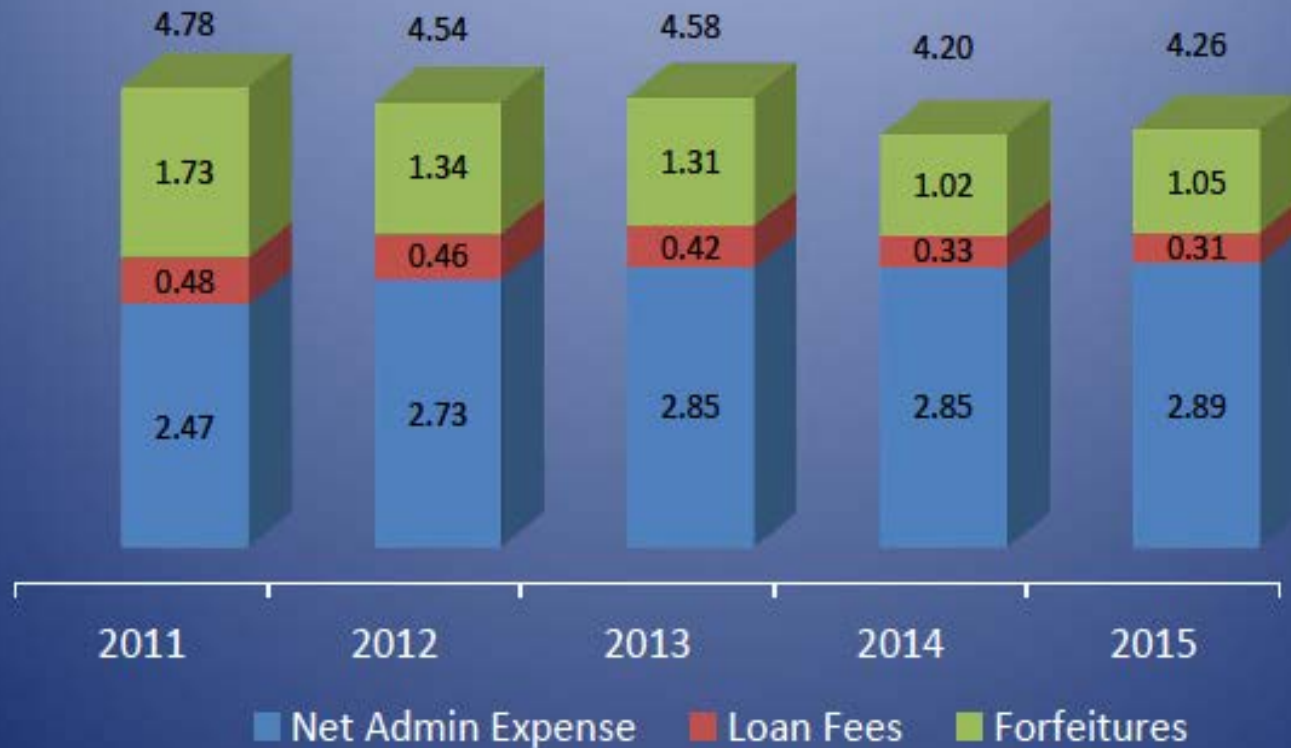
# TSP Fund Performance ending December 31, 2015

	<b>G Fund</b>	<b>F Fund</b>	<b>C Fund</b>	<b>S Fund</b>	<b>I Fund</b>
<b>1 Year</b>	2.04%	0.91%	1.46%	-2.92%	-0.51%
<b>3 Year*</b>	2.08%	1.93%	15.21%	13.13%	4.80%
<b>5 Year*</b>	2.03%	3.57%	12.63%	10.65%	3.79%
<b>10 Year*</b>	2.94%	4.74%	7.36%	8.03%	3.20%

\*Annualized

	<b>L Income</b>	<b>L 2020</b>	<b>L2030</b>	<b>L2040</b>	<b>L2050</b>
<b>1 Year</b>	1.85%	1.35%	1.04%	0.73%	0.45%
<b>3 Year*</b>	4.18%	7.30%	8.68%	9.65%	10.48%
<b>5 Year*</b>	3.90%	6.50%	7.58%	8.33%	N/A
<b>10 Year*</b>	4.13%	5.41%	5.90%	6.19%	N/A

# Net and Gross Administrative Expense Ratios (in basis points)



# Reasons for the Low TSP Costs

- ◆ 2015 expense ratio was 2.9 basis points (.029% or 29 cents per \$1,000 of account balance)
  - Pays for administration of the plan
- ◆ Why costs are low:
  - Use of low-cost index funds
  - Simple plan structure (only 5 investment funds)
  - Huge economies of scale
  - Use of investment manager instead of mutual funds
    - Investment manager maintains only one TSP account; not 4.9 million accounts
    - Individual accounts are maintained in TSP record keeping system
  - Competitive procurement of all functions

# Part VI. Lessons Learned

## 30 years of TSP

# Key Lessons

- ◆ Independent structure has proven resilient
- ◆ Independence is essential for a civil servant fund
- ◆ Passive investing has provided attractive returns (except during crisis) at low cost with less political risk
- ◆ As participants reach retirement age, we have seen that withdrawal options need to be liberalized



Questions?

THRIFT  
SAVINGS  
PLAN