Calendar No. 522

113TH CONGRESS *2d Session*	SENATE	REPORT 113–244

SMART SAVINGS ACT

R E P O R T

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2117

TO AMEND TITLE 5, UNITED STATES CODE, TO CHANGE THE DEFAULT INVESTMENT FUND UNDER THE THRIFT SAVINGS PLAN, AND FOR OTHER PURPOSES

AUGUST 26, 2014.—Ordered to be printed

Filed, under authority of the order of the Senate of August 5 (legislative day, August 1), 2014

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Mr. CARPER, from the Committee on Homeland Security and Governmental Affairs, submitted the following

REPORT

[To accompany S. 2117]

The Committee on Homeland Security and Governmental Affairs, to which was referred the bill (S. 2117) to amend title 5, United States Code, to change the default investment fund under the Thrift Savings Plan, and for other purposes, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

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I. PURPOSE AND SUMMARY

The Smart Savings Act seeks to enhance the retirement security of federal employees. It does so by changing the default investment for new contributions to the Thrift Savings Plan (TSP)—the government-sponsored retirement savings and investment plan for federal employees—from a low-growth fund to a fund that should generally yield significantly larger account balances over time. Employees would retain the same ability to control their investment choices that they have now, and those employees wishing to continue investing exclusively in the fund with historically lower yields over time, or to invest in any other combination of the funds provided by the TSP, would remain able to do so.

II. Background and Need for Legislation

Congress created the Thrift Savings Plan (TSP) in 1986 to give federal employees the same kinds of savings and tax benefits that many private employers offer their employees under section 401(k) plans.[1] In contrast to a defined benefit plan, which provides a set pension after retirement, the TSP is a defined contribution plan, through which an employee and the employer contribute set amounts that are saved and invested in the employee's account until the employee retires. The amount available to the employee upon retirement then depends on the individual investment choices the employee has made over time, as well as the performance of those investments.

Under current statute, new federal employees are automatically enrolled in the TSP, and 3% of each employee's basic pay each pay period is automatically deducted from the employee's pay and deposited into the employee's TSP account, unless the employee affirmatively elects otherwise. In addition, the employing agency automatically contributes an amount equal to 1% of the employee's basic pay, and also makes matching contributions in an amount calculated on the basis of how much the employee contributes to the account.

The TSP offers a number of options for investing assets, from among which each employee may choose. Five of the options are individual funds, each invested in a particular class of securities:[2]

- The Government Securities Investment Fund (G Fund), invested in short-term U.S. Treasury securities.
- The Fixed Income Index Investment Fund (F Fund), invested in domestic government, corporate, and mortgage-backed bonds.[3]
- The Common Stock Index Investment Fund (C Fund), invested in the stocks of large and medium-sized U.S. companies.[4]
- The Small Capitalization Stock Index Fund (S Fund), invested in the stocks of small to medium-sized U.S. companies.[5]
- The International Stock Index Investment Fund (I Fund), invested in international stocks of 21 developed countries.[6]

The G Fund is the least volatile of these funds and has no risk of loss of principal, but the earnings are relatively low. The earnings of the other funds are generally higher than those of the G Fund, but the other funds are also more volatile and are subject

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[1] See generally, Thrift Savings Plan, "Purpose and History," available at *https://www.tsp.gov/planparticipation/about/purposeAndHistory.shtml;* "Summary of the Thrift Savings Plan: Your Plan, Your Future" (May 2014), available at *https://www.tsp.gov/PDF/formspubs/tspbk08.pdf* ("TSP Summary"); 5 U.S.C. chapter 84, subchapter III.

[2] These descriptions of the fund are based on information in TSP Summary, note 1 above.

[3] The F Fund is invested with the objective of matching the performance of Barklays Capital U.S. Aggregate Bond Fund. *See id.*

[4] The C Fund is invested with the objective of matching the performance of the Standard & Poor's 500 (S&P 500) Stock Index. *See id.*

[5] The S Fund is invested in stocks that are not included in the C Fund, with the objective of matching the performance of the Dow Jones U.S. Completion TSM (Total Stock Market) Index. *See id.*

[6] The I Fund is invested with the objective of matching the performance of the Morgan Stanley Capital International EAFE (Europe, Australasia, Far East) Stock Index. *See id.*

to the market risks and other kinds of risks distinctive of the class of instruments that each of the other funds is invested in.[7]

In addition to these individual funds, the TSP offers a series of Lifecycle Funds (L Funds), which are invested in professionally designed mixes of the five individual funds.[8] Each fund's name includes a future year, indicating that the fund is invested in a portfolio considered appropriate for employees who plan to retire and begin withdrawing the fund within five years before or after that year. Also, the asset allocation shifts over time, so that it becomes increasingly less volatile as the target year approaches. During 2014, the TSP offers five L-Funds, with target retirement dates ranging from 2015 to 2045.[9]

The earnings of each L Fund is a composite of the earnings of the underlying funds. Moreover, as the TSP program explains, each L Fund is exposed to all of the types of risks to which each of the individual underlying funds is exposed, but the total risk is reduced through diversification.[10]

Employees who participate in the TSP can choose to invest their current account balances and their future contributions entirely in any one of the funds or in a mix of their own choosing. However, for employees who have not elected where to direct their TSP investments, the current statute establishes that the employees' investments by default go to the G Fund.[11] This situation arises because a TSP account is automatically established for new federal employees to receive the contributions made to the employee's account by the employing agency and, unless the employee elects not to contribute, to receive the contributions from the employee and additional matching contributions from the agency. If the new employee does not choose a different investment choice, the contributions are invested by default in the G Fund, and this default investment choice continues to apply to all future earnings and contributions unless and until the employee elects otherwise.[12]

Putting TSP investments by default into the G Fund avoids certain financial risks, because that fund is invested in Treasury securities, which—unlike stocks and bonds—fluctuate little in value and have no risk of loss of principal. However, investing 100% of an employee's account in the G Fund increases other significant financial risks for the employee, including the risk that growth of the fund will lag behind inflation, and the risk that the employee's financial needs during retirement will exceed the employee's assets.

For these reasons, the Federal Retirement Thrift Investment Board (FRTIB), which administers the TSP program, and the Employee Thrift Advisory Council (ETAC), whose members are representatives of unions and other employee and annuitant organizations, evaluated whether the current default rules should be

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[7] *See id* at page 13.

[8] *See id.*

[9] Thrift Savings Plan, "Lifecycle Funds, Key Features," available at *https://www.tsp.gov/investmentfunds/lfundsheet/fundPerformance_L.shtml.*

[10] *See* TSP Summary, note 1 above.

[11] 5 U.S.C. § 8438(c)(2).

[12] *See* Federal Retirement Thrift Investment Board, Memorandum for Board Members, From: Greg Long, Executive Director, Subject: "L Fund Default Investment Option" (December 16, 2013), available at *http://www.frtib.gov/pdf/minutes/MM-2013Dec-Att3.pdf* ("FRTIB Executive Director memorandum"); Federal Retirement Thrift Investment Board, Memorandum for the Executive Director, From: Renee Wilder, Director, Office of Enterprise Planning, Subject: "Default Investment Fund Option" (April 9, 2013), available at *http://www.frtib.gov/pdf/minutes/MM-2013Apr-Att5.pdf* ("FRTIB Office of Enterprise Planning memorandum").

changed.[13] Based on that evaluation, both groups determined that the default investment option should be changed from the G Fund to an L Fund appropriate for the employee's age, provided that the employee should retain the ability to invest in the G Fund or in any other TSP fund or combination of funds if the employee so chooses.[14] To accomplish this change, the FRTIB decided to seek legislation like what was subsequently introduced as the Smart Savings Act.[15]

The reasons for changing the default option to be an age-appropriate L Fund, as the FRTIB urges Congress to do, are compelling. The L Funds offer professionally designed portfolios of investments with earnings that are generally higher than the earnings of the G Fund. As the Executive Director of the FRTIB has explained—

> The L Funds, offer professionally managed allocations across asset classes and are designed to maximize expected performance for the amount of risk taken. The design of the L Funds automatically addresses changing asset allocation needs as participants near their draw-down dates. While investing in an L fund exposes a participant to the risk inherent in the capital markets, the L Funds appropriately address those risks in their design. Further, those participants who conclude they do not want to assume market risk will always have the ability to change their allocations or move their account balances to the G Fund.[16]

Actual investment results have been consistent with making the L Fund the default option. Between August 2005, when the L Funds were established, through September 2013, which was a period that included the market downturn of 2008–2009, the cumulative returns for the G Fund were 29.75%. By comparison, the cumulative returns for the L 2040 Fund, which was designed for younger employees, were 65.78%.[17] Between August 2010 and September 2013, the cumulative returns for the G Fund were 6.33%, compared to 47.39% for the L 2040 Fund.[18]

Of course, the L Funds, being more volatile than the G Fund, performs less well than the G Fund at certain times and under certain circumstances. As a recent unusually severe example, in 2008, at the depths of the market downturn, while the G Fund had a positive return of about 4% annually, the L Funds all dropped in value: the least volatile L Fund, designed for employees near or beyond retirement age, dropped about 4.5% in value, while the most volatile L Fund, designed for employees for whom retirement was still about 30 years away, dropped about 32% in value.[19]

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[13] *See* Federal Retirement Thrift Investment Board, Minutes of the Joint Meeting of the Board Members and the Employee Thrift Advisory Council, April 22, 2013, available at *http://www.frtib.gov/pdf/minutes/2013Apr.pdf;* Federal Retirement Thrift Investment Board, Minutes of the Meeting of the Board Members, December 16, 2013, available at *http://www.frtib.gov/pdf/minutes/2013Dec.pdf.*

[14] *See id.*

[15] Specifically, the FRTIB adopted a motion that provided: "The Executive Director shall pursue legislation to make an age-appropriate L Fund the default option for Thrift Savings Plan Contributions by FERS participants." Id. The Federal Employees Retirement System, or FERS, is the retirement system applicable to great majority of new federal employees.

[16] *See* FRTIB Executive Director memorandum, note 12 above.

[17] *See id.*

[18] *See id.*

[19] *See* Thrift Savings Plan, "Investment Funds, Fund Performance, Annual Returns" *https://www.tsp.gov/investmentfunds/annual/annualReturns.shtml.*

However, the TSP is intended for employees investing for the long term, for whom a temporary loss in value is generally outweighed by the opportunity for greater long-term growth of the account. Especially for younger employees, their long investment horizon typically enables them to comfortably weather market cycles.[20] And the example from 2008, described above, illustrates how the L Funds designed for employees at or near retirement age, who will need to withdraw their TSP assets relatively soon, are much less susceptible to a large downward swing in value than the L Funds for younger employees. As the Director of the FRTIB's strategic planning office concluded, "for long-term investors, which includes the vast majority of newly-hired Federal employees and certainly younger participants, the L Fund is a more appropriate default option."[21]

To further test these assumptions, the FRTIB's investment consultant conducted a simulation of potential returns during a wide variety of hypothetical economic scenarios, comparing the strategy of investing a TSP account in the L Fund with a target retirement date of 2030, versus the strategy of investing 100% in the G Fund. The TSP Executive Director described the results of the simulation this way:

> When modeling a 'typical' TSP participant, currently aged 44 and retiring at age 61, the analysis projected that a portfolio 100% invested in the G Fund yielded a less favorable distribution of outcomes (i.e., account balance, replacement ratio [which is the ratio of gross income after retirement divided by gross income before retirement]) than the outcomes of a portfolio invested in the L Fund.[22]

This simulation further illustrates that an age-appropriate L Fund is a more prudent investment option than a strategy of investing 100% in the G Fund for long-term investors.

Actual investment patterns indicate that the assets of too many younger federal employees may not be prudently invested. Comparing age cohorts, the percentages of assets allocated to the G Fund are higher for older participants, consistent with their needing less-volatile and income-producing assets as they approach or exceed retirement age. But the exception to this pattern is that participants younger than 30—who should generally be investing for long-term growth, not short-term stability—have a disproportionately large percentage of their TSP assets in the G Fund: 48%.[23] Because many younger participants tend to have difficulty envisioning their need for retirement planning and saving, it is likely that an important reason why so much of their retirement assets remain in the default-option G Fund is inertia.[24]

In changing the default to an age-appropriate L Fund, this bill would bring the federal government into line with a substantial and growing trend among private-sector companies. A survey of nearly 550 employers over a variety of sizes and industries—and including 30% of Fortune 500 companies—found a substantial ma-

[20] *See* FRTIB Office of Enterprise Planning memorandum, note 12 above.
[21] *Id.*
[22] FRTIB Executive Director memorandum, note 12 above.
[23] *See id.*
[24] *See id.*

jority of these plans use target-date retirement funds for their default options:

> Currently, 78% of plans default participants' funds into a target-date fund, up from 69% in 2009 and 50% in 2007. . . . [S]table value or money market [funds are used as the default] by 6% of employers.[25]

Other surveys of private-sector plans show similar trends.[26]

The federal government, too, ought to help its employees invest appropriately. By changing the default to the long-term investment option of an age-appropriate L Fund, the Smart Savings Act would help new federal employees invest most appropriately for a secure financial future.[27]

III. Legislative History

S. 2117 was introduced by Senator Warren and Senator Portman on March 12, 2014, and was referred to the Committee on Homeland Security and Governmental Affairs. Senators Begich, Enzi, and Tester have been added as cosponsors. On June 25, 2014, the Committee considered S. 2117 and ordered the bill favorably reported without amendment, by voice vote. Members present for the vote were: Carper, Levin, McCaskill, Tester, Heitkamp, Coburn, McCain, Johnson, and Portman.

IV. Section-by-Section Analysis

Section 1. Short title

This section states that the short title of the bill is the "Smart Savings Act."

Section 2. Thrift Savings Plan default investment fund

This section would amend 5 U.S.C. chapter 84 to change the default investment fund for civilian TSP participants from the G Fund to an age-appropriate target-date asset allocation portfolio of funds. Under this section, if an employee has not elected which fund or funds the assets in the employee's TSP account should be invested in, the Executive Director of the Federal Retirement Thrift Investment Board would select the L Fund with a target date that is appropriate considering the age of the employee. In addition, this section provides that, before an employee's assets are invested in an L Fund by default, the employee shall be sent information to acknowledge that the investment is made at the employee's risk.

This section would also require the Executive Director to issue guidance implementing the legislation no later than nine months

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[25] See AonHewitt, "2011 Trends and Experience in Defined Contribution Plans: Paving the Road to Retirement," available at *http://www.aon.com/attachments/thought-leadership/2011_Trends_Experience_Executive_Summary_v5.pdf*; see also FRTIB Office of Enterprise Planning memorandum, note 12 above.

[26] *See id.*

[27] A FRTIB representative has advised Committee staff that, because L Funds are somewhat more volatile than the G Fund, after enactment of the Smart Saving Act the FRTIB would send risk-acknowledgement information to each new employee whose TSP assets are automatically placed in an L Fund, to help ensure that each employee is aware of the investment, understands the risks, and has information on how the employee can elect to change the investment if the employee so chooses.

after the date of enactment, and the bill would go into effect on the date on which the guidance is issued.

V. Evaluation of Regulatory Impact

Pursuant to the requirement of paragraph 11(b)(1) of rule XXVI of the Standing Rules of the Senate the Committee has considered the regulatory impact of this bill. The enactment of this legislation will not have significant regulatory impact.

VI. Congressional Budget Office Cost Estimate

U.S. Congress,
Congressional Budget Office,
Washington, DC, July 3, 2014.

Hon. Tom Carper,
Chairman, Committee on Homeland Security and Governmental Affairs, U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for S. 2117, the Smart Savings Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Santiago Vallinas and Dan Ready.

Sincerely,

Douglas W. Elmendorf.

Enclosure.

S. 2117—Smart Savings Act

S. 2117 would change the default investment fund in the Thrift Savings Plan (TSP) for government employees. Currently, contributions of employees who are enrolled in the TSP, but have not specified where to invest their funds, are automatically invested in the Government Securities Investment Fund. This bill would shift the default fund to a Lifecycle fund with an age-appropriate asset allocation.

CBO estimates that enacting S. 2117 would not affect direct spending. The Joint Committee on Taxation (JCT) estimates there could be a small revenue effect because enacting the bill might change the number of federal employees who choose to contribute to the TSP, thus modifying their total tax liability. Therefore, pay-as-you-go procedures apply. However, JCT estimates that any revenue effects would be negligible.

S. 2117 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would impose no costs on state, local, or tribal governments.

On May 7, 2014, CBO transmitted a cost estimate for H.R. 4193, the Smart Savings Act, as ordered reported by the House Committee on Oversight and Government Reform on March 12, 2014. The two bills are substantively identical and the cost estimates are the same.

The CBO staff contacts for this estimate are Santiago Vallinas and Dan Ready. This estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

VII. CHANGES IN EXISTING STATUTE MADE BY THE BILL, AS REPORTED

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by S. 2117, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

UNITED STATES CODE

TITLE 5—GOVERNMENT ORGANIZATION AND EMPLOYEES

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PART III—EMPLOYEES

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Subpart G—Insurance and Annuities

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CHAPTER 84—FEDERAL EMPLOYEES' RETIREMENT SYSTEM

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Subchapter III—Thrift Savings Plan

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§ 8438. Investment of Thrift Savings Fund

(a) * * *

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(c)(1) * * *

[(2) If an election has not been made with respect to any sums in the Thrift Savings Fund available for investment, the Executive Director shall invest such sums in the Government Securities Investment Fund.]

(2)(A) Except as provided in subparagraph (B), if an election has not been made with respect to any sums available for investment in the Thrift Savings Fund, the Executive Director shall invest such sums in an age-appropriate target date asset allocation portfolio of the funds described in subsection (b), as determined by the Executive Director.

(B) If an election has not been made by a member (as defined in section 211 of title 37) contributing to the Thrift Savings Fund under section 8440e with respect to any sums available for investment in such member's Thrift Savings Fund account, the Executive Director shall invest such sums in the Government Securities Investment Fund.

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§ 8439. Accounting and information

(a) * * *

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(d)*(1)* Each employee, Member, former employee, or former Member who elects to invest in any investment fund or option under this chapter, other than the Government Securities Investment Fund, shall sign an acknowledgement prescribed by the Executive Director which states that the employee, Member, former employee, or former Member understands that an investment in any such fund or option is made at the employee's, Member's, former employee's, or former Member's risk, that the employee, Member, former employee, or former Member is not protected by the Government against any loss on such investment, and that a return on such investment is not guaranteed by the Government.

(2) Before the date on which an individual covered under section 8438(c)(2)(A) begins contributing to the Thrift Savings Fund, the individual shall sign a risk acknowledgment described under paragraph (1).

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Subchapter VII—Federal Retirement Thrift Investment Management System

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§ 8472. Federal Retirement Thrift Investment Board

(a) * * *

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(g)(1) * * *

(2) Except in the case of investments [required by section 8438 of this title to be invested in securities of the Government] *under section 8438(c)(2)(B),* the Board may not direct the Executive Director to invest or to cause to be invested any sums in the Thrift Savings Fund in a specific asset or to dispose of or cause to be disposed of any specific asset of such Fund.

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